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# GEORGIAN ECONOMIC TRENDS

## Quarterly Review

**October**

**2007**

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# GEORGIAN ECONOMIC TRENDS

Georgian Economic Trends (GET) is a quarterly publication of the Georgian-European Policy and Legal Advice Centre (GEPLAC), which aims at providing all interested readers with a review of developments in the Georgian economy and analysis of economic reform and policy pursued by the government. GET is issued in both Georgian and English languages and is available on the internet.

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| Veronika Schneider | Labour Market and Households Budgets |

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# OPINION.
# CURRENCY BOARD AGAINST THE BACKGROUND OF DUTCH DISEASE

A discussion is becoming increasingly popular in recent times on whether or not the so-called Currency Board should replace the country's central bank; that is, the National Bank of Georgia (NBG). An American expert, Steve Hanke, has even visited Georgia for this purpose and had meetings with top echelon government representatives. He tried to convince the Georgian Government of the advantage of the Currency Board over the central bank institution. Given the topicality of the issue, I would like to comment briefly upon what the Currency Board means and how it can benefit present-day Georgia.

## Currency Board Paradigm

The essence of the Currency Board is to anchor a national currency at a fixed rate to a stable foreign currency or a currency basket and carry out the conversion with that specific currency or one of the basket currencies without any restrictions in an automatic regime. This will require the country to have large amounts of foreign currency in order not to impede currency conversion operations at a fixed rate. Normally, foreign currency reserves of the state should be more than 100 percent of emitted money. This, however, can be achieved in the case of a stable source of large foreign currency inflows. From an ethical standpoint, the institute of the Currency Board is welcomed because it restricts discretionary rights of the state in this specific area.

The Currency Board mechanism rules out the issuance of any debt to the government by a central bank let alone the deficit in the central budget. It requires that the government put an end to the state budget deficit and to have at least an insignificant budget surplus in order to set up special funds (for example, a stabilisation fund). It is also noteworthy that under such circumstances, commercial banks heighten their credit policy which, given the equality of other conditions, is expressed inter alia in their refusal to participate in quasi-fiscal deficit projects when the government calls for crediting economically unattractive projects (for example, to issue credits to Georgia's agricultural production and food processing industry in the setting of the trade embargo imposed by Russia upon respective products).

Normally, the introduction of the Currency Board mechanism is expedient when there is a very high inflation rate in the country; that is, in the case of hyperinflation because the simultaneous existence of a stable exchange rate and budget surplus (or, at least, the budget without deficit) is an effective instrument to achieve macroeconomic stability. This has been proven in practice and it was precisely through applying this instrument that an annual inflation in Brazil, for example, which reached 2700 percent in the early 1990s was curbed. The same mechanism was used in Estonia, which reduced its inflation rate of 1069 percent to 29 percent in 1992-95, whilst in Lithuania, the 309.2 percent inflation went down to 72 percent in 1994 as compared to the previous year. It is noteworthy that hyperinflation in Georgia occurred only in 1993-94 with a monthly inflation rate comprising 50-70 percent. Nevertheless, the financial stabilisation programme of that time did not envisage the introduction of the Currency Board (although this idea also existed at that time) because the country did not have a stable source of foreign currency reserve and the government lacked the ability to pursue a relatively effective fiscal policy.

It should also be emphasised that the Currency Board does not necessarily guarantee the protection of the countries with open economies (Georgia represents this type of economy now) from a financial crisis in any other country because such a situation creates a fertile ground for speculative operations. An obvious example of the above said is the devaluation of Mexican peso in 1994 when even the Currency Board failed to protect Argentina from the flight of foreign capital.

As an institute, the Currency Board is appropriate for the period of transition to macroeconomic stability. Besides, it is impossible to use it simultaneously across the world because therein the economically developed countries would be forced to move to the gold standard and, thus, necessitating other countries to do the same at the end of the day.

## Recurrences of Dutch Disease

After the Rose Revolution, Georgia contracted the so-called Dutch Disease;* that is, large foreign currency flows (mainly USD) started coming into the country. This created the long-term tendency of strengthening the national currency, the lari, which, first and foremost, had an adverse effect upon the current account balance. Amongst the causes of this disease, those worth noting are the establish-

* *Aslamazishvili, N., "Dutch Desease" in Georgian Economy: Current Reality and Potential Threats," Georgian Economic Trends, Quarterly Review, October 2006; Papava, V., "The Baku-Tbilisi-Ceyhan Pipeline: Implications for Georgia" in* The Baku-Tbilisi-Ceyhan Pipeline: Oil Window to the West. *Eds. S. Frederick Starr and Svante E. Cornell. Uppsala, Uppsala University, 2005, pp. 90-96, online http://www.silkroadstudies.org/BTC_5.pdf*

ment of the fiscal order in the country (especially at the customs) where importers pay the state taxes in lari out of previously hidden and accumulated revenues in US dollars and a large-scale privatisation implemented with the participation of foreign capital and foreign direct investments. In order to carry out these transactions inside the country, foreign investors have to convert US dollars into the national currency. Georgian labour migrants' remittances (usually in USD which is converted into lari to cover current costs) is another factor which facilitates the appreciation of the lari.

It is well known that the Currency Board is a rather inflexible mechanism against a real appreciation of a national currency of any particular state. It was also one of the reasons that this mechanism was not applied in the past in Georgia since it was expected that the financial stabilisation would be followed by a real appreciation of the lari, which, in fact, happened on a certain scale but that was not a result of the Dutch Disease.

In order to impede the process of appreciation of the lari caused by the Dutch Disease, the NBG permanently purchases US dollars flowing into the country. On the one hand, this transaction increases NBG reserves and somehow "smoothes down" the appreciation of the lari but, on the other hand, pushes up the inflation by putting an additional supply of lari into circulation. In such a situation, it is very important to have a state budget surplus which should become an effective mechanism for curbing inflation. In reality, however, a deficit in the state budget still exists whilst the increase in separate costs contributes to the inflation.

**What Wonders Does the Currency Board Promise?**

Large inflows of foreign currency, accompanied by the Dutch Disease, create, at a glance, a prerequisite for introducing the Currency Board regime as the large inflows of foreign currency lead to the increase in foreign currency reserves of the state. The deficit in the state budget, however, makes it not only impossible to introduce the Currency Board but also contributes to the aggravation of the Dutch Disease. If the Currency Board is nonetheless introduced, it will be necessary, given the fixed exchange rate, to emit increasingly more currency which will further accelerate the inflation.

In the event the abovementioned causes of the Dutch Disease become weaker or completely disappear, the foreign currency reserves, considering Georgia's scarce export potential and trade embargo imposed by Russia, will instantly deplete and become a cause of a deep financial crisis.

It should also be taken into account that the government is, first and foremost, a political body whereas the central bank is a professional one. That is why the central bank leadership has far more guarantees of protection whilst the government may be replaced at any aggravation of a political situation. Putting the primary responsibility of maintaining a moderate inflation rate only upon a political body such as the government (which is a principal requirement of the Currency Board), then, is associated with political threats.

Vladimer Papava<br>Editorial Board Member

**3 July**

Progress made in implementing the **European Neighbourhood Policy Action Plan** was presented at a high-level conference in Batumi. Georgian cabinet members, EU officials and think-tank representatives participated in the conference which was held with the support of the Georgian European Economic Policy and Legal Advice Centre (GEPLAC) and the Friedrich Ebert Foundation. Georgia and the EU signed an Action Plan within the European Neighbourhood Policy (ENP) last October. The Action Plan is a political document laying out the strategic objectives for the co-operation between Georgia and the EU and covers a timeframe of five years. Its implementation will "encourage and support Georgia's objective of further integration into European economic and social structures," the Action Plan reads.

**3 July**

With 110 votes to one on its third and final reading, Parliament approved a proposal paving the way for the establishment of **Free Industrial Zones in Georgia**. The law allows for a zone, covering at least ten hectares, to be established upon the initiative of the government, a legal entity or a private individual. Companies operating in the zone would be exempt from profit and property tax and the VAT. Goods exported from the zone or sent to other parts of Georgia would also be exempt from customs dues. The law does not specify where the zones will be set up. Officials, however, have said that the ports of Poti and Batumi and Tbilisi airport are the most likely sites.

**6 July**

**The purchase of six hydro power plants and two electricity distribution companies** by the Czech company Energo-Pro has been finalised. The company paid USD 132 million for the acquisition. The purchase of the two distribution grids–United Energy Distribution Company (UDC) and the Energy Company of Ajara–makes Energo-Pro the leading electricity distributor in Georgia with control of over 60 percent of the market. The six hydro power plants will give the company a total power generation capacity of more than 350 megawatt hours. Energo-Pro has committed to invest USD 85 million in the rehabilitation of the hydro power plants and USD 15 million in the distribution networks. The company has also pledged to spend USD 100 million on the construction of a new hydro power plant with a capacity of 100 megawatt hours. Negotiations will begin in a few months in order to select a site for this new hydro power plant.

**11 July**

Russian state agencies, a regional governor, a tycoon and a former prime minister are among those who have purchased **assets in Georgia's breakaway region of Abkhazia**, according to a document issued by the Georgian Ministry for Refugees and Accommodation. The document lists 31 assets–mainly holiday villas, sanatoria and hotels–which have been sold recently by the Abkhaz secessionist authorities. The Russian defence ministry, according to the document, owns three holiday villas in Gagra, Sokhumi and Gudauta and leases two sanatoria, both in Gagra. Russian aluminium magnate, Oleg Deripaska, is alleged to be the owner of Kholodnaia Rechka, Stalin's former holiday home. Alexander Tkachev, Governor of Russia's southern district of Krasnodar on the Abkhaz border, is alleged to have bought "Beria's Dacha." Lavrenty Beria was the chief of Stalin's secret police. Sergei Kirienko, chief of Russia's Federal Atomic Energy Agency (Rosatom) and the former Russian prime minister in the late 1990s, owns two wine factories in Abkhazia, according to the Georgian Ministry for Refugees and Accommodation. The Russian Ministries of Internal Affairs and Agriculture are also listed in the document as owners of some assets in Abkhazia. The Ministry for Refugees and Accommodation also reported that one holiday villa in Gagra is owned by a Turkish firm. Authorities in Tbilisi have warned Russia against investing in the breakaway province. The National Bank of Georgia said recently it planned to ask foreign banks to freeze the accounts of Russian firms and individuals that had bought assets in Abkhazia.

**14 July**

Georgia's Black Sea port of Poti and 400 hectares of adjacent land are to be leased so as to create a **Free Industrial Zone**. The Georgian Ministry of Economic Development said that the leasing period would comprise 49 years. On 3 July the Georgian Parliament approved a proposal giving the green light to free industrial zones. The winner of the bid, according to the Ministry of Economic Development, will have to establish the infrastructure necessary for the operation of a free economic zone. The port in Poti trans-shipped 7 million tones of cargo last year which is 9.1 percent more than in 2005. It is expected that the trans-shipment will increase by 12 percent this year. The port has the capacity to handle a total of 25 tonnes of cargo per year. In February, executives from a United Arab Emirates (UAE) company, Dubai World, visited Poti on a fact-finding mission to investigate the port's potential. Rakeen, a development company from the UAE's Ras Al Khaimah emirate, is also eyeing up the port. The company has already announced plans to invest USD 1.5 billion in real estate projects in Georgia. At this stage, it is considered the front runner in the bidding process.

**18 July**

Fitch, a global credit rating agency, stated that it had assigned **a "BB-" rating to Georgia with "a stable outlook."** The rating reflected a declining public debt burden, rapid GDP growth, an impressive record of structural reform, an increase in foreign direct investment inflows and strong international financial support and was an upgrade from previous ratings. In December 2005, Standard and Poor's, another credit rating agency, assigned "B+" long-term and "B-" short-term sovereign credit ratings to Georgia with "a positive outlook." A year later, in November 2006, however, Standard and Poor's negatively revised its outlook on Georgia to "stable" owing to an increased geopolitical risk mainly involving the tensions in its relationship with Russia.

The latest positive assessment was due to an impressive growth in the economy and foreign direct investment and a significant decrease in the foreign debt. Georgia has completely repaid its debts to Austria and China with its debt to Turkmenistan, which was USD 393 million, now standing at USD 22 million. There was, however, a word of caution. Georgia's moderate income level, large current account deficit and narrow economic base continued to constrain its rating, according to Fitch.

**25 July**

**At least 100 new processing enterprises will be set up in Georgia** in order to boost the country's agriculture sector by the end of next year. The plan involved selling off over 40 000 hectares of agricultural land at 20 percent of its market price with the land being sold separately in 400-hectare plots. Would-be investors will have to set up a new processing plant within the year. The terms of the sales are envisaged to be simple with bids concerning the creation of more employment and greater output being successful. The Government expected that at least one million new jobs would be created as a result of the project. 108 small- and medium-sized agricultural processing enterprises have been set up in the country in the last two years.

**30 July**

**The management rights to Batumi airport** have been given to the Turkish company, Tepe-Akfen-Vie (TAV), for the next 20 years for the symbolic amount of one dollar. The company has invested about USD 15 million in the construction of a new terminal at the airport which was opened in May. The company will have to repay the airport's debt of GEL 1.4 million (over USD 800 000). It will, however, receive all the profits from the operations at the airport. TAV also has the management rights of Tbilisi airport for 15 years.

**31 July**

Georgia's Central Bank has issued a **banking license to HSBC** thereby giving the formal go-ahead for the bank to start operations in Georgia. The president of the National Bank of Georgia (NBG) presented the license to Steven Bennett, the General Director of HSBC-Georgia, which is due to open its doors in Tbilisi in November 2007. According to the National Bank, "The world's leading financial institution entering the Georgian market signals the increasing interest of foreign investors in Georgia."

**2 August**

**Budgetary revenues in the first seven months** of 2007 exceeded the forecasted GEL 2.9 billion (about USD 1.7 billion) by over GEL 163 million (about USD 97.6 million), the Finance Ministry said. Revenues in January-July, exceeding GEL 3.1 billion (roughly USD 1.85 billion), were up 42.2 percent against the same period in 2006. In June, the Parliament approved a proposal to increase state spending by up to GEL 600 million in 2007, bringing the total forecasted expenditure to about GEL 4.6 billion (approximately USD 2.7 billion). The lion's share of the increased funding–GEL 442 million (USD 263 million) out of GEL 600 million–went to the Defence Ministry thereby bringing the 2007 defence budget to GEL 955.3 million (USD 568.6 million).

**29 August**

Beginning in September, the rural population of Georgia will receive **pensions according to the length of service and merits**. A corresponding resolution was adopted at a meeting of the Government. According to the Minister of Health Care, persons with a length of service exceeding 25 years will receive GEL48 instead of the current GEL38. Those with a length of service below 25 years will receive an additional GEL4 and GEL7. The population of Tbilisi has been receiving pensions according to the length of service and merits since last September.

**6 September**

President Saakashvili said that the **reshuffled cabinet's new programme** was result-oriented and aimed at "strengthening Georgia." Mr Saakashvili said that the programme would consolidate gains in the judicial, defence and law enforcement spheres, guarantee energy security and ensure equal opportunities, jobs and healthcare for everyone. He added said that the government had a very concrete plan to **set up at least one hundred new agricultural processing enterprises** by the end of next year.

He further reported that the creation of "an appropriate healthcare network" was also a governmental priority. Earlier this year, the government laid out a plan, entitled **"100 New Hospitals,"** which envisages the attraction of private investment for the construction of new hospitals and outpatient clinics throughout Georgia with a total of 7800 beds by 2009. Saakashvili said that the **further development of the country's infrastructure** would help to stimulate an already growing tourism sector. "Our **plan is to develop tourism** and build new roads to at least 200 large villages," he said.

The president also announced "the **next stage of education reform**" which would involve the training of people in niche specialties. He said that more vocational education and training centres were needed to train "pharmaceutical specialists, construction workers, service experts, mining engineers, etc." Amongst other plans, he announced the rehabilitation and **computerisation of 400 schools throughout Georgia**. "The first stage will see one computer for every 20 pupils," Saakashvili said. "But our ambition is to have one for every student."

Saakashvili said that the cabinet's **ambition is to have 13-15 percent economic growth**" and stated that the plan was to attract **foreign direct investment to the tune of USD 2 billion** and "to put Georgia in the list of the top 20 business-friendly countries."

The **protection of property rights,** which has increasingly come under the spotlight, is, the president said, "a cornerstone of our country's development." Saakashvili, however, added that property right should not prevail when the wider society's interest is concerned such as, for example, when it involves what he called an "illegally privatised plot of land in a public park."

**11 September**

Vladimir Papava, a lawmaker from the ruling National Movement party who is the Deputy Chairman of the Parliamentary Committee for Budgetary and Financial Issues, said that the planned increase in state expenditure by GEL 430 million would intensify current **inflationary pressure.** "Today inflation is already high in the country and it would not be wise to add to the state spending by incorporating funds generated from privatisation," Papava said. Officials from the Georgian National Bank echoed Papava's concerns. Finance Minister, Nika Gulauri, however, said that "this will cause no problems if the Finance Ministry and the National Bank act jointly." The Prime Minister, Zurab Noghaideli, said recently that the level of inflation would be maintained below 8 percent this year.

**13 September**

Georgian telecommunications provider, Caucasus Online, and the US-based Tyco Telecommunications, an industry pioneer in undersea communications technology, have signed a contract to construct a 1100-kilometer **undersea fibre optic system** which will connect Georgia's Black Sea port of Poti with the Bulgarian city of Varna. The system will serve Georgian markets by providing direct access to Western Europe via a state-of-the-art undersea fibre optic link. The system will have an ultimate capacity to transmit 6410 GB wavelengths on each fibre pair for a total bandwidth of nearly 1.3 terabits. "The undersea solution we are deploying with Tyco Telecommunications will serve markets in Georgia and the Caspian region with a system that meets our stringent criteria for capacity, scalability and robustness using advanced and proven technologies," said the Chief Executive of Caucasus Online who added that USD 75 million would be invested in the project. Tyco Telecommunications expects to deliver the system in the fall of 2008.

**14 September**

The Parliament discussed the proposed **increase in state expenditure** by GEL 431 million. According to the draft amendments presented by the Finance Minister, the total expenditure of GEL 5.1 billion will mean a GEL 400 million shortfall. The lion's share of extra funds, comprising GEL 316 million (about USD 190 million) and initially set at GEL 320 million, will be allocated to the Ministry of Defence. As a result, the total defence spending for 2007 will exceed GEL 1.271 billion (approximately USD 765 million). Another major beneficiary of the increased state expenditure will be the Ministry of the Interior which will receive an additional GEL 51 million (about USD 30.7 million) of which GEL 11.5 million (about USD 6.9 million) will be allocated to the Border Police and GEL 125000 (USD 75 300) to the Counter-Intelligence Department.

The draft budgetary amendments also outline the additional funding of other ministries as follows: Ministry of Justice – GEL 11.8 million on the repair and construction of prisons, Ministry of Agriculture – GEL 5.5 million on grape harvesting, Ministry of Culture and Sport – GEL 4.7 million, the Central Election Commission – GEL 3 million, the South Ossetian provisional administration – GEL 767000 and various regional projects – GEL 40 million.

**26 September**

Georgia has moved out of the group of countries considered to have "a rampant corruption problem," the Berlin-based corruption watchdog Transparency International (TI) said. TI's annual **Corruption Perceptions Index 2007**, which measures the degree to which corruption is perceived to exist in a given country, ranked Georgia 79th from 180 countries listed in the report. Georgia received 3.4 out of a total score of ten points. TI said it was "a significant improvement" over the score in 2006 (2.8) when Georgia was 99th from the 163 countries listed. "Nevertheless, a score of 3.4 still indicates that corruption is a significant problem in the public sector," the report said.

**26 September**

**Georgia is ranked 18th on the ease-of-doing-business index** according to Doing Business 2008, a World Bank report, up from the 37th position last year. Doing Business 2008 ranks a total of 178 economies with the top 25, in order, as follows: Singapore, New Zealand, the United States, Hong Kong (China), Denmark, the United Kingdom, Canada, Ireland, Australia, Iceland, Norway, Japan, Finland, Sweden, Thailand, Switzerland, Estonia, Georgia, Belgium, Germany, the Netherlands, Latvia, Saudi Arabia, Malaysia and Austria. Georgia was the top reformer last year and is currently in fifth position after Egypt, Croatia, Ghana and the FYR Macedonia.

**27 September**

Beginning from next year, Georgia's **sole supplier of natural gas may be Azerbaijan**, the Georgian Prime Minister said during his visit to Baku. At this stage, however, he declined to comment about the price of the gas. The head of the State Oil Company of Azerbaijan said that the gas price will not change significantly and added that the final agreement upon this issue will be reached next year. Reportedly, the price of gas from Azerbaijan may be USD 180 instead of USD 120 per 1000 cubic meters.

# SUMMARY MACROECONOMIC INDICATORS

| | | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 6 month |
|---|---|---|---|---|---|---|---|---|
| GDP and real sector | | | | | | | | |
| Nominal GDP | mln GEL | 6674.0 | 7456.0 | 8564.1 | 9824.3 | 11621.0 | 13783.9 | 7506.9 |
| Real GDP | mln GEL, 1996 | 4839.9 | 5104.8 | 5669.3 | 6001.4 | 6577.5 | 7192.6 | 3710.8 |
| Nominal GDP per capita | GEL | 1516.3* | 1705.6* | 1972.1* | 2276.7* | 2689.1* | 3131.8* | 1708.1 |
| | USD | 731.8* | 777.3* | 919.0* | 1187.6* | 1483.5* | 1762.9* | 1006.9 |
| Real GDP per capita | GEL, 1996 | 1099.6* | 1167.8* | 1305.5* | 1390.8* | 1522.0* | 1634.2* | 844.4 |
| GDP by sectors | | | | | | | | |
| Industry | % of nominal GDP | 16.6 | 17.6 | 17.7 | 16.1 | 15.7 | 14.9 | 13.3 |
| Agriculture | % of nominal GDP | 21.0 | 19.2 | 19.3 | 16.4 | 14.8 | 11.3 | 10.2 |
| Construction | % of nominal GDP | 3.9 | 5.1 | 6.4 | 8.1 | 8.1 | 6.9 | 6.1 |
| Real GDP growth | % over prev. year | 4.8 | 5.5 | 11.1 | 5.9 | 9.6 | 9.4 | 12.5 |
| Real growth by sectors | | | | | | | | |
| Industry | % over prev. year | -2.5 | 8.4 | 7.7 | 4.1 | 11.5 | 15.9 | 13.0 |
| Agriculture | % over prev. year | 8.2 | -1.4 | 10.3 | -7.9 | 12.0 | -9.6 | -0.1 |
| Construction | % over prev. year | 10.3 | 43.1 | 46.6 | 35.9 | 14.1 | 9.8 | 9.5 |
| Price indexes | | | | | | | | |
| GDP deflator | 1996=100 | 137.5 | 145.8 | 150.6 | 162.8 | 175.6 | 190.5 | 201.0 |
| Consumer prices (year average) | 2000=100 | 104.7 | 110.5 | 115.8 | 122.4 | 132.5 | 144.7 | 154.7 |
| Producer's prices (year average) | 2000=100 | 103.6 | 110.8 | 113.9 | 119.2 | 128.0 | 142.0 | 151.0 |
| Investments | | | | | | | | |
| GFCF[1] | % of nominal GDP | 27.2 | 24.5 | 26.7 | 27.5 | 28.1 | 25.6 | 26.8 |
| Net FDI[2] inflow | mln USD | 109.9 | 156.1* | 330.9* | 482.8* | 542.3* | 1075.6* | 642.7 |
| Labour market and Wages | | | | | | | | |
| Population | mln | 4.60 | 4.57 | 4.54 | 4.52 | 4.52 | 4.40 | - |
| Labour force | mln | 2.11 | 2.10 | 2.05 | 2.04 | 2.02 | 1.97 | 2.02 |
| Unemployment rate | % | 11.1 | 12.6 | 11.5 | 12.6 | 13.8 | 13.6 | 14.9 |
| Average nominal wage | GEL | 82.6 | 99.1 | 101.5 | 116.4 | 149.3 | 190.2 | 225.2 |
| | %, over prev. year | 13.9 | 20.0 | 2.4 | 14.7 | 28.3 | 27.4 | 25.0 |
| Living standards** | | | | | | | | |
| Level of poverty | | 51.1 | 52.1 | 54.5 | 24.6 | 24.1 | 23.3 | - |
| Depth of poverty | | 19.3 | 19.8 | 21.1 | 8.1 | 7.6 | 7.2 | - |
| Severity of poverty | | 9.9 | 10.3 | 11.2 | 4.0 | 3.6 | 3.3 | - |
| National accounts | | | | | | | | |
| Household consumption | % of nominal GDP | 78.6 | 77.0 | 71.6 | 72.8 | 66.4 | 78.4 | 76.2 |
| Government consumption | % of nominal GDP | 9.6 | 9.8 | 9.8 | 14.0 | 17.3 | 15.4 | 19.4 |
| Gross capital formation | % of nominal GDP | 28.3 | 25.5 | 27.7 | 28.3 | 28.6 | 26.7 | 27.6 |
| Net exports | % of nominal GDP | -14.4 | -13.2 | -14.6 | -16.6 | -17.8 | -24.2 | -24.0 |
| Government finance | | | | | | | | |
| Revenue | mln GEL | 740.3 | 816.1 | 956.0 | 1773.0 | 2607.5 | 3773.2 | 2072.2 |
| Expenditure | mln GEL | 906.4 | 1040.7 | 1118.5 | 1923.6 | 2616.5 | 3821.4 | 2048.7 |
| Deficit(-) or Surplus (+) | mln GEL | -166.1 | -224.6 | -162.5 | -150.6 | -9.0 | -48.2 | +23.5 |
| Financing of deficit | | | | | | | | |
| Domestic | % of deficit | 13.5 | 40.0 | 31.9 | 11.0 | 398.0 | -256.0 | - |
| Foreign | % of deficit | 86.5 | 60.0 | 68.1 | 89.0 | -298.0 | 356.0 | - |
| Total Debt | mln GEL | 4449.5 | 4843.3 | 4608.0 | 4306.6 | 4076.1 | 3855.4 | 4352.2 |
| Domestic | % of debt | 33.5 | 31.4 | 34.0 | 36.6 | 37.7 | 39.2 | 34.7 |
| Foreign | % of debt | 66.5 | 68.6 | 66.0 | 63.4 | 62.3 | 60.8 | 65.3 |
| Monetary indicators | | | | | | | | |
| M2 (year end) | mln GEL | 403.8 | 462.3 | 527.4 | 846.1 | 1069.9 | 1389.2 | 1655.8 |
| Velocity of money (M2) | | 17.89 | 17.78 | 16.23 | 11.78 | 10.83 | 9.90 | 11.35 |
| Deposit rate**** | % per annum | 11.1 | 11.4 | 10.6 | 9.5 | 8.7 | 8.1 | 8.8 |
| Lending rate***** | % per annum | 24.0 | 23.1 | 21.6 | 20.2 | 17.9 | 18.0 | 17.2 |
| Treasury bill rate | % per annum | 29.93 | 43.42 | 44.26 | 19.66 | 12.57 | - | - |

| | | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 6 month |
|---|---|---|---|---|---|---|---|---|
| Balance of payments | | | | | | | | |
| Current account | mln USD | -211.4 | -207.2** | -375.6** | -344.3** | -700.7** | -1154.1** | -806.7 |
| Capital account | mln USD | -5.2 | 18.4 | 19.9 | 40.8 | 58.6 | 170.9 | 52.1 |
| Financial account | mln USD | 187.8** | 181.9** | 369.5** | 302.9** | 623.2** | 924.8** | 702.1 |
| Net errors and omissions | mln USD | 44.8 | 6.9** | -13.8** | 1.5** | 18.8** | 58.4** | 52.6 |
| Overall balance | mln USD | 0.0** | 0.0** | 0.0** | 0.0** | -0.1** | 0.0** | 0.1 |
| External economic position | | | | | | | | |
| Gross international reserves | mln USD | 161.9 | 202.2 | 196.2 | 386.6 | 478.6 | 930.8 | 1220.7 |
| | Import coverage (month) | 1.9* | 2.2* | 1.6* | 2.3 | 2.1* | 3.0* | 3.5 |
| Exchange rate (year average) | USD/GEL | 2.0723 | 2.1945 | 2.1459 | 1.9168 | 1.8126 | 1.7766 | 1.6980 |
| Real effective exchange rate | %, 1995=100 | 108.2 | 102.7 | 94.9 | 107.0 | 110.3 | 109.4 | 111.1 |
| Terms of trade (year end) | 1995=100 | 97.8 | 96.0 | 77.0 | 72.0 | 75.0 | - | - |
| NPV[3] of external debt | % of nominal GDP | 36.8 | 36.6 | 39.6 | 28.3 | 22.9 | 19.8 | - |
| Foreign debt service | % of total exports | 6.3 | 5.0 | 4.6 | 6.5 | 5.1 | 6.0 | - |

*Source: Department for Statistics, Ministry of Economic Development; Ministry of Finance; National Bank of Georgia (NBG) and IMF*

*Note: * Verified data*

*** Revised data*

**** The level of poverty as well as depth and severity of poverty in 2003-2005 are based on the official minimum subsistence, whilst the same indicators for 2004-2006 refer to the 60 percent of median consumption*

***** The numbers of deposit rate reflect weighted average rates on time deposits denominated in domestic and foreign currency*

****** The numbers of credit rate reflect weighted average rates on short term (up to one year) and long term (over the one year) credits denominated in domestic and foreign currency*

*Acronyms used:*

*1.GFCF – Gross Fixed Capital Formation*

*2.FDI – Foreign Direct Investments*

*3.NPV – Net Present Value*

## Georgian Economy Compared with the EU25

| | Georgia | | | | | | | EU-25 |
|---|---|---|---|---|---|---|---|---|
| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2006 |
| Real GDP growth, % over prev. year | 1.8 | 4.8 | 5.5 | 11.1 | 5.9 | 9.6 | 9.4 | 2.9* |
| GNI per capita (PPP, Euro) | - | - | - | 2308.0 | 2331.0 | 2627.8 | 2933.2 | 21353.1[1] |
| GDP per capita (nominal USD) | 689.8* | 731.8* | 777.3* | 919.0* | 1187.6* | 1483.5* | 1762.9* | 30899.1 |
| Inflation (year average) | 4.0 | 4.7 | 5.6 | 4.8 | 5.7 | 8.2 | 9.2 | 2.2 |
| end of year | 4.6 | 3.4 | 5.4 | 7.0 | 7.5 | 6.2 | 8.8 | - |
| Lending rate (year average)[2] | 25.3 | 24.0 | 23.1 | 21.6 | 20.2 | 17.9 | 18.0 | 5.1[3] |
| Fiscal balance, % to GDP | -3.2 | -2.5 | -1.9 | -3.2 | -2.3 | -0.1 | -0.3 | -1.6* |
| Public debt, % to GDP | 69.4 | 66.7 | 65.0 | 53.8 | 43.8 | 35.1 | 28.0 | 61.9* |
| of which: | | | | | | | | |
| domestic | 24.8 | 22.3 | 20.4 | 18.3 | 16.0 | 13.2 | 11.0 | - |
| foreign | 44.6 | 44.4 | 44.6 | 35.5 | 27.8 | 21.9 | 17.0 | - |
| Current account, % to GDP | -5.3 | -6.6 | -6.1* | -9.4 | -6.7 | -10.9* | -14.9* | -0.6[4] |
| Net FDI inflow, mln USD | 131.7 | 109.9 | 156.1* | 330.9* | 482.8* | 542.3* | 1075.0* | -98122.0[5] |
| Memorandum items: | | | | | | | | |
| Nominal GDP | | | | | | | | |
| mln GEL | 6043.1 | 6674.0 | 7456.0 | 8564.1 | 9824.3 | 11621.0 | 13783.9 | - |
| mln USD | 3059.2* | 3220.8* | 3398.1* | 3990.8 | 5124.7* | 6411.0* | 7758.9* | 14418169.0* |
| mln Euro | 3310.7 | 3594.0 | 3591.2 | 3523.7 | 4119.0 | 5139.2 | 6183.1 | 11461184.7* |
| Exchange rates (nominal, year average) | | | | | | | | |
| USD/GEL | 1.9759 | 2.0723 | 2.1945 | 2.1459 | 1.9168 | 1.8126 | 1.7766 | - |
| Euro/USD | 0.9238 | 0.8961 | 0.9461 | 1.1326 | 1.2443 | 1.2444 | 1.2580 | 1.2580 |

*Source: Department for Statistics, Ministry of Economic development; NBG; World Bank; IMF; European Central Bank and Eurostat*

*Note: * Verified data*

*[1] EU23 (excludes Cyprus and Malta)*

*[2] The number for Georgia reflect weighted average rates on short term (up to one year) and long term (over the one year) credits denominated in domestic and foreign currency, the number for the EU refers to the euro zone (EU12) only and reflects the rate on new loans in Euro with duration of up to one year*

*[3] December 2006*

*[4] 2005*

*[5] Provisional value*

# Part I. Overview of the Georgian Economy

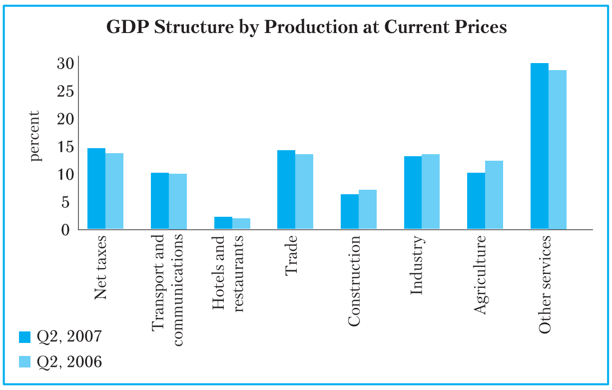
## 1. GROSS DOMESTIC PRODUCT AND REAL SECTOR

**Table 1: Nominal and Real Gross Domestic Product**

| | Nominal GDP (mln GEL) | Share of compensation of emloyees (%) | Share of operating surplus and mixed income (%) | Share of net taxes on production and imports (%) | GDP deflator (1996=100) | Real GDP (in 1996 prices, mln GEL) | Change in real GDP compared to last year's corresponding period (%) | Real GDP per capita (in 1996 prices, GEL) |
|---|---|---|---|---|---|---|---|---|
| 2000 | 6043.1 | 27.6 | 64.9 | 7.5 | 130.5 | 4618.0 | 1.8 | 1041.2** |
| 2001 | 6674.0 | 25.2 | 66.9 | 7.9 | 137.5 | 4839.9 | 4.8 | 1099.6** |
| 2002 | 7456.0 | 22.3 | 69.6 | 8.2 | 145.8 | 5104.8 | 5.5 | 1167.8** |
| 2003 | 8564.1 | 20.3 | 72.1 | 7.6 | 150.6 | 5669.3 | 11.1 | 1305.5** |
| 2004 | 9824.3 | 20.7 | 73.4** | 9.9 | 162.8 | 6001.4 | 5.9 | 1390.8** |
| 2005 | 11621.0 | 16.9 | 70.8** | 12.2 | 175.6 | 6577.5 | 9.6 | 1522.0** |
| Q 1 | 2508.7 | 15.8 | 72.6** | 10.8 | 176.2 | 1416.1 | 8.6 | 327.7 |
| Q 2 | 2824.0 | 16.7 | 70.5** | 12.0 | 171.6 | 1636.4 | 10.1 | 378.0 |
| Q 3 | 3032.9 | 16.7 | 70.7** | 12.7 | 173.1 | 1742.7 | 12.6 | 403.3** |
| Q 4 | 3255.4 | 18.0 | 69.6** | 13.1 | 181.7 | 1782.3 | 7.2 | 412.4** |
| 2006 | 13783.9 | 16.5 | 69.9** | 13.5** | 190.5 | 7192.6 | 9.4 | 1634.2** |
| Q 1 | 2834.5 | 17.1 | 70.5** | 12.4** | 183.7 | 1534.7 | 8.4 | 348.7 |
| Q 2 | 3354.4 | 17.7 | 68.3** | 14.0** | 189.1 | 1764.7 | 7.8 | 401.0** |
| Q 3 | 3625.0 | 15.7 | 70.1 | 14.1 | 189.0 | 1907.6 | 9.5 | 433.4** |
| Q 4 | 3970.0 | 16.2 | 70.5 | 13.3 | 200.2 | 1985.5 | 11.4 | 451.1** |
| 2007 | | | | | | | | |
| Q 1 | 3409.1 | 17.6** | 67.7** | 14.7 | 198.3 | 1709.2 | 11.4 | 388.9 |
| Q 2* | 4097.4 | 18.2 | 66.8 | 15.1 | 203.7 | 2001.6 | 13.4 | 455.5 |

*Source:Department for Statistics, Ministry of Economic Development and GEPLAC calculations*
*Note: *Preliminary assessment*
***Verified data*

In Q2, 2007, a high annual growth of the GDP was sustained due to a significant increase in budget expenditure, investment inflows and external demand. A notable quarterly increase in economic activity, despite a slight decrease in households' demand, was also caused by a seasonal factor in addition to the abovementioned reasons.




*Source: Department for Statistics, Ministry of Economic Development*

No changes were observed in the reviewed period in the GDP structure by production where the shares of net taxes and trade kept rising and the share of agriculture kept falling in annual terms. The share of health care and construction decreased, whereas that of financial intermediation increased. The share of public administration showed a notable annual and quarterly increase. In quarterly terms, the share of transport significantly decreased and the share of health care notably increased.

Similarly to the first quarter, almost half of the GDP was created in four sectors. The trade accounted for the highest share with industry, public administration and agriculture trailing by 13.1, 11.7 and 10.1 percent, respectively.

Labour productivity (real added value per employee) remained high in the spheres of financial intermediation (GEL 5709), transport and communications (GEL 3169), industry (GEL 2474), hotels and restaurants (GEL 2273), construction (GEL 1879), trade (GEL 1632) and real estate transactions (GEL 1170). This indicator in the whole of the economy comprised GEL 1033, showing an annual 19.6 percent and a quarterly 18.5 percent growth.

Despite a high annual and quarterly growth, labour productivity was again low in the agriculture sector which accounts for almost half of employment in the economy. An annual increase of this indicator in such spheres as transport, agriculture, public administration and health care was partially conditioned by the cut in the number of employees.

Along with the increase in employees in the construction sector, the labour productivity indicator of this sphere decreased notably as compared to Q2, 2006 and the previous quarter. This indicator, however, grew in the sphere of hotels and restaurants. A notable quarterly decrease of labour productivity was also observed in the sphere of financial intermediation because of the doubling of employees.

**Table 2: Contribution of Selected Sectors of the Economy to GDP Real Change, Q2, 2007***

| | Change to last year's corresponding period (%) | Contribution to GDP real change (percentage points) |
|---|---|---|
| Agriculture | 6.0 | 0.7 |
| Mining | 9.5 | 0.1 |
| Manufacturing | 17.0 | 1.5 |
| Electricity generation | 7.1 | 0.2 |
| Household production | 15.4 | 0.4 |
| Construction | 7.0 | 0.5 |
| Trade | 17.8 | 2.4 |
| Hotels and restaurants | 19.5 | 0.4 |
| Transport | 16.8 | 1.3 |
| Communications | 13.8 | 0.5 |
| Financial intermediation | 33.1 | 0.8 |
| Real estate | 14.8 | 0.5 |
| Rent | 6.5 | 0.2 |
| Public administration | 6.7 | 0.6 |
| Education | 20.5 | 0.7 |
| Health care | 11.9 | 0.5 |
| Other social services | 8.0 | 0.3 |
| Hired employment in household | 4.2 | 0.0 |
| FISIM | 1.5 | 0.0 |
| GDP at basic prices | 13.3 | 11.6 |
| Taxes | 14.5 | 1.9 |
| Subsidies | 3.6 | -0.1 |
| GDP at market prices | 13.4 | 13.4 |

*Source: Department for Statistics, Ministry of Economic Development and GEPLAC calculations*
*Note: *Preliminary assessment*

In Q2, 2007, the areas of communications, real estate transactions, industry, transport, trade, hotels and restaurants were marked with high growth rates, well exceeding the overall economic growth rate. The growth of financial intermediation was 2.5 times higher than the mentioned indicator. In contrast to the first quarter, the real GDP change was largely influenced by the dynamics in trade, industry and hotel and restaurant sectors.

Quite high annual and quarterly growth rates of the financial intermediation were mainly conditioned by the increase in revenues from loans issued by the banking sector to physical and legal persons and also by the attraction of foreign investments.

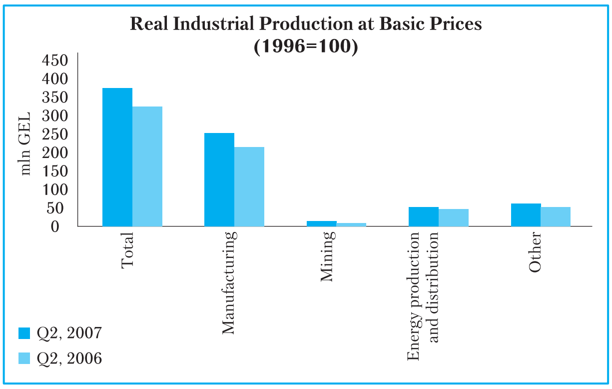
## Table 3: Indicators of Industry

| | Value added in industry at current basic prices (mln GEL) | Index of industry (1996=100) | Real value added in industry at basic prices (% changes over the same period of the previous year) | Share of value added in industry at current basic prices (%) | | | |
|---|---|---|---|---|---|---|---|
| | | | | Mining | Manufacturing | Energy production and distribution | Other |
| 2000 | 1044.2 | 108.2 | 3.2 | 3.9 | 49.5 | 25.2 | 21.4 |
| 2001 | 1111.0 | 105.0 | -2.5 | 3.4 | 46.4 | 23.1 | 27.1 |
| 2002 | 1315.8 | 114.0 | 8.4 | 3.8 | 47.5 | 23.7 | 25.0 |
| 2003 | 1515.3 | 122.9 | 7.7 | 5.0 | 49.2 | 21.4 | 24.4 |
| 2004 | 1581.9 | 127.1 | 4.1 | 4.9 | 50.8 | 19.2 | 25.1 |
| 2005 | 1823.0 | 140.9 | 11.5 | 5.0 | 54.8 | 17.9 | 22.3 |
| Q1 | 361.3 | 108.2 | 3.9 | 5.4 | 49.8 | 24.7 | 20.1 |
| Q2 | 432.6 | 134.8 | 13.2 | 4.9 | 59.4 | 17.8 | 17.9 |
| Q3 | 480.3 | 142.3 | 12.4 | 5.0 | 55.8 | 14.2 | 25.0 |
| Q4 | 548.8 | 178.2 | 12.5 | 4.9 | 53.5 | 16.7 | 24.9 |
| 2006 | 2053.6 | 163.8 | 15.9 | 7.0 | 57.7 | 18.3 | 17.0 |
| Q1 | 392.1 | 117.6 | 8.7 | 5.9 | 57.7 | 22.1 | 14.3 |
| Q2 | 442.2 | 166.4 | 23.4 | 7.8 | 57.1 | 19.2 | 15.9 |
| Q3 | 562.4 | 170.8 | 20.0 | 7.6 | 59.8 | 13.7 | 18.9 |
| Q4 | 656.9 | 200.5 | 12.5 | 6.5 | 56.3 | 19.3 | 17.9 |
| 2007 | | | | | | | |
| Q1 | 459.2 | 129.5 | 10.1 | 6.8 | 55.3 | 21.6 | 16.3 |
| Q2* | 537.3 | 191.5 | 15.1 | 6.9 | 61.9 | 17.2 | 14.0 |

*Source: Department for Statistics, Ministry of Economic Development and GEPLAC calculations*
*Note: *Preliminary assessment*

An annual growth rate of industry was much higher than the corresponding indicator in the previous quarter mainly due to a high annual increase in manufacturing. A sharp quarterly increase in industry, however, was ensured by an impressive growth of the mining sector.

The annual and quarterly growth of manufacturing was, on the one hand, ensured by the rise in external demand (namely, for ferroalloy, cement, processed and semi-processed gold, natural wines and mineral waters) and, on the other hand, by the rise in the domestic demand for food products, textile, concrete, timber and construction materials.




*Source: Department for Statistics, Ministry of Economic Development*

A notable annual increase in mining output was mainly associated with the enhanced extraction of copper ore and concentrates and minerals for the chemical industry and fertilisers. An almost doubling of the output in quarterly terms was caused by the enhanced extraction of raw oil and oil products as well as rock, gravel and sand for construction works along with the increased demand for export products.

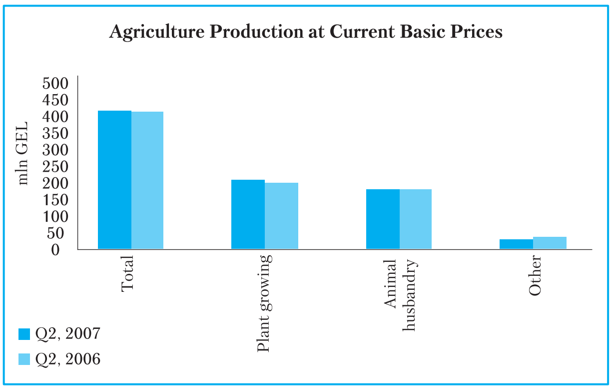
With the rise in the electricity generation and the service concerning water distribution, the sphere of energy generation and distribution showed a notable annual increase. In quarterly terms, however, given the seasonality factor, the real added value in this sphere decreased by 6.6 percent.

**Table 4: Indicators of Agriculture**

| | Value added in agriculture at current basic prices (mln GEL) | Index of agriculture (1996=100) | Real value added in agriculture at basic price (% changes over the same period of the previous year) | Share of value added in agriculture at current basic prices (%) | | |
|---|---|---|---|---|---|---|
| | | | | Plant growing | Animal husbandry | Other |
| 2000 | 1245.0 | 91.3 | -12.0 | 43.2 | 45.6 | 11.2 |
| 2001 | 1399.0 | 98.8 | 8.2 | 46.7 | 44.2 | 9.1 |
| 2002 | 1434.6 | 97.3 | -1.4 | 46.7 | 47.3 | 6.0 |
| 2003 | 1653.0 | 107.4 | 10.3 | 46.9 | 41.0 | 12.1 |
| 2004 | 1610.7 | 99.0 | -7.9 | 44.4 | 46.6 | 9.0 |
| 2005 | 1716.4 | 110.8 | 12.0 | 46.9 | 45.3 | 7.8 |
| Q1 | 467.1 | 100.9 | 19.0 | 31.4 | 56.5 | 12.1 |
| Q2 | 460.4 | 115.1 | 3.0 | 51.2 | 39.7 | 9.1 |
| Q3 | 381.1 | 118.2 | 18.2 | 64.3 | 32.2 | 3.5 |
| Q4 | 407.8 | 109.2 | 13.4 | 48.0 | 47.8 | 4.2 |
| 2006 | 1561.1 | 100.2 | -9.6 | 43.5 | 50.3 | 6.2 |
| Q1 | 361.6 | 92.0 | -8.8 | 33.8 | 56.6 | 9.6 |
| Q2 | 410.7 | 98.5 | -14.4 | 47.4 | 43.2 | 9.4 |
| Q3 | 377.8 | 96.5 | -18.3 | 52.9 | 43.3 | 3.8 |
| Q4 | 411.0 | 114.0 | 4.3 | 39.7 | 58.1 | 2.2 |
| 2007 | | | | | | |
| Q1 | 350.5 | 86.0 | -6.5 | 31.0 | 62.2 | 6.8 |
| Q2* | 411.7 | 104.4 | 6.0 | 50.2 | 43.0 | 6.8 |

*Source: Department for Statistics, Ministry of Economic Development and GEPLAC calculations*
*Note: *Preliminary assessment*

Agriculture showed a moderate annual and a sharp quarterly increase. The annual dynamics of this sector was largely conditioned by the increase in output of vegetables and cucurbit crops as well as meat and milk.




*Source: Department for Statistics, Ministry of Economic Development*

Favourable weather conditions contributed to significantly higher grain yields and the trebling of fruit and vegetables in quarterly terms. It should also be noted that the swine influenza epidemics caused a sharp decrease in animal husbandry. Nevertheless, a quarterly growth rate of the agriculture comprised 21.3 percent.

## Table 5: Indicators of Transport and Communications

| | Value added in transport and communications at current basic prices (mln GEL) | Index of transport and communications (1996=100) | Real value added in transport and communications at basic prices (% changes over the same period of the previous year) | Share of value added in transport and communications at current basic prices (%) | |
|---|---|---|---|---|---|
| | | | | Transport | Communications |
| 2000 | 858.8 | 238.5 | 12.8 | 82.4 | 17.6 |
| 2001 | 911.1 | 241.8 | 1.4 | 79.6 | 20.4 |
| 2002 | 1057.4 | 261.7 | 8.2 | 79.3 | 20.7 |
| 2003 | 1187.5 | 290.4 | 11.0 | 74.2 | 25.8 |
| 2004 | 1313.1 | 311.2 | 7.1 | 71.0 | 29.0 |
| 2005 | 1443.0 | 345.7 | 11.1 | 67.8 | 32.2 |
| Q1 | 293.3 | 280.1 | 4.4 | 66.0 | 34.0 |
| Q2 | 354.4 | 339.3 | 15.1 | 68.5 | 31.5 |
| Q3 | 395.2 | 381.8 | 10.1 | 67.5 | 32.5 |
| Q4 | 400.1 | 381.4 | 13.9 | 67.9 | 32.1 |
| 2006 | 1583.5 | 394.3 | 14.1 | 69.7 | 30.3 |
| Q1 | 370.8 | 342.2 | 22.2 | 71.2 | 28.8 |
| Q2 | 335.5 | 372.1 | 9.7 | 70.0 | 30.0 |
| Q3 | 450.4 | 439.7 | 15.2 | 70.7 | 29.3 |
| Q4 | 426.8 | 423.3 | 11.0 | 65.6 | 34.4 |
| 2007 | | | | | |
| Q1 | 446.6 | 409.3 | 19.6 | 75.1 | 24.9 |
| Q2* | 414.7 | 432.4 | 16.2 | 70.2 | 29.8 |

*Source: Department for Statistics, Ministry of Economic Development and GEPLAC calculations*
*Note: *Preliminary assessment*

Despite a significant drop in rail service, a sharply increased passenger and cargo transportation by road and air and notably enhanced cargo handling ensured a high annual growth of services rendered by transportation companies.

Although in Q2, 2007 rail cargo transportation sharply increased and the service of travel bureaus and tourist agencies grew notably, a large seasonal drop in pipeline gas transportation and the decrease in revenues from auxiliary transportation service resulted in a quarterly growth which was 2.1 times lower than the annual one.

A high annual and moderate quarterly growth in the communication sector can be explained by the foreign direct investments and, consequently, the further enhancement of the mobile telephone network.

## Table 6: Indicators of Construction

| | Value added in construction at current basic prices (mln GEL) | Index of construction (1996=100) | Real value added in construction at basic prices (% changes over the same period of the previous year) |
|---|---|---|---|
| 2000 | 224.7 | 167.3 | 4.0 |
| 2001 | 259.6 | 184.6 | 10.3 |
| 2002 | 379.5 | 264.2 | 43.1 |
| 2003 | 547.4 | 387.3 | 46.6 |
| 2004 | 793.2 | 526.3 | 35.9 |
| 2005 | 937.9 | 600.4 | 14.1 |
| Q1 | 204.3 | 530.6 | 26.6 |
| Q2 | 216.6 | 598.0 | 36.7 |
| Q3 | 279.6 | 706.2 | 19.3 |
| Q4 | 237.4 | 566.8 | - 13.7 |
| 2006 | 944.2 | 659.7 | 9.8 |
| Q1 | 165.0 | 586.7 | 10.6 |
| Q2 | 235.5 | 585.0 | 17.5 |
| Q3 | 282.4 | 792.7 | 12.2 |
| Q4 | 261.3 | 673.6 | 18.9 |
| 2007 | | | |
| Q1 | 205.1 | 657.7 | 12.1 |
| Q2* | 252.9 | 625.9 | 7.0 |

*Source: Department for Statistics, Ministry of Economic Development and GEPLAC calculations*
*Note: *Preliminary assessment*

Despite the state's financing of international and intra-national motorways, the private housing boom and the increase of direct foreign investments in the construction of a sea terminal and hotels, the growth of the construction sector slowed down in annual terms and further decreased in quarterly terms. This can be partially attributed to the growth of the informal segment in the construction sector and the completion of the construction of trunk pipelines and large energy projects as compared to 2006.

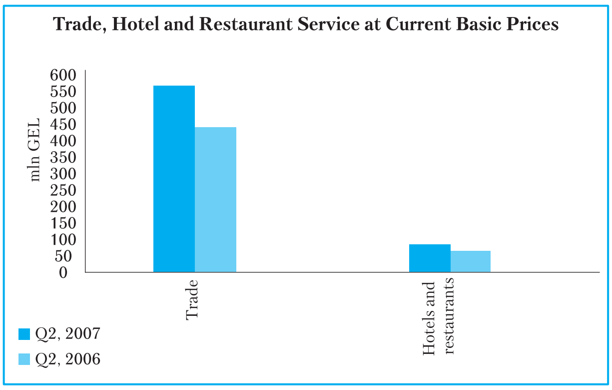
**Table 7: Indicators of Trade, Hotels and Restaurants**

| | Value added in trade at current basic prices (mln GEL) | Index of trade (1996=100) | Real value added in trade at basic prices (% changes over the same period of the previous year) | Value added in hotels and restaurants at current basic prices (mln GEL) | Index of hotels and restaurants (1996=100) | Real value added in hotels and restaurants at basic prices (% changes over the same period of the previous year) | Share of value added in hotels and restaurants at current basic prices (%) | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Hotels | Restaurants |
| 2000 | 762.3 | 119.4 | 10.8 | 141.1 | 165.1 | 8.2 | 19.7 | 80.3 |
| 2001 | 871.0 | 129.9 | 8.8 | 192.1 | 220.9 | 33.7 | 46.2 | 53.8 |
| 2002 | 956.2 | 135.0 | 3.9 | 218.6 | 237.5 | 7.6 | 35.2 | 64.8 |
| 2003 | 1137.6 | 151.3 | 12.1 | 244.9 | 271.2 | 14.2 | 30.9 | 69.1 |
| 2004 | 1247.2 | 163.6 | 8.2 | 266.2 | 279.8 | 3.2 | 24.5 | 75.5 |
| 2005 | 1388.8 | 179.0 | 9.4 | 330.3 | 327.7 | 17.1 | 29.1 | 70.9 |
| Q1 | 289.9 | 146.9 | 11.8 | 70.2 | 289.0 | 0.8 | 29.5 | 70.5 |
| Q2 | 334.9 | 185.7 | 13.0 | 86.4 | 346.1 | 36.0 | 31.3 | 68.7 |
| Q3 | 362.3 | 181.0 | 5.7 | 84.1 | 326.6 | 21.4 | 29.1 | 70.9 |
| Q4 | 401.7 | 202.3 | 7.8 | 89.6 | 349.2 | 13.0 | 25.7 | 73.3 |
| 2006 | 1875.3 | 214.3 | 19.8 | 302.9 | 366.6 | 11.9 | 41.0 | 59.0 |
| Q 1 | 359.3 | 170.4 | 16.0 | 70.1 | 313.0 | 8.2 | 28.5 | 52.5 |
| Q 2 | 449.9 | 218.2 | 17.5 | 64.3 | 379.9 | 9.8 | 31.9 | 68.1 |
| Q 3 | 483.7 | 231.4 | 43.5 | 73.1 | 357.7 | 9.5 | 35.3 | 64.7 |
| Q 4 | 582.4 | 237.4 | 17.4 | 95.4 | 415.9 | 19.1 | 64.2 | 35.8 |
| 2007 | | | | | | | | |
| Q 1 | 435.0 | 194.0 | 13.8 | 70.8 | 327.6 | 4.7 | 28.7 | 71.3 |
| Q 2* | 579.7 | 257.0 | 17.8 | 86.2 | 453.8 | 19.5 | 28.4 | 71.6 |

*Source: Department for Statistics, Ministry of Economic Development and GEPLAC calculations*
*Note: *Preliminary assessment*

In annual terms, the growth in retail trade was affected by a notable increase in the demand for ready-made food products, alcoholic and soft drinks, textile and tobacco products as well as by an impressive increase in the trade of household utensils and motorcars.

In quarterly terms, a significant growth of commodity turnover was caused by a sharp increase in wholesale trade (against a notable decrease in retail trade), in motorcar trade and in their technical service costs.



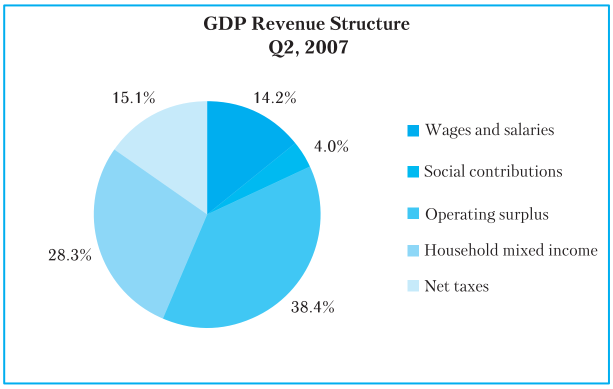

*Source: Department for Statistics, Ministry of Economic Development*

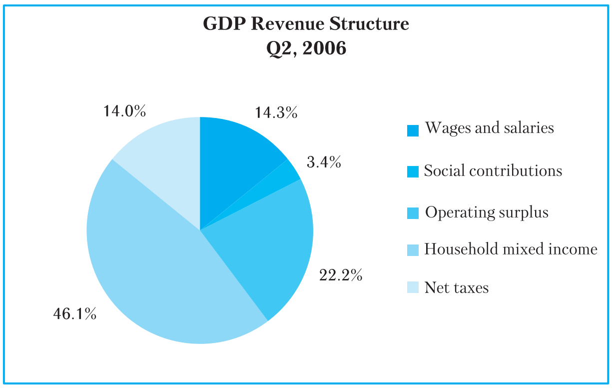
The hotel and restaurant sector showed the highest annual and quarterly growth. The annual growth was mainly achieved as a result of an impressive improvement in hotel service with a sharp quarterly increase also conditioned by a significant increase in restaurant service. The real added value created in restaurants exceeded the corresponding indicator for hotels by as many as 3.5 times.

In Q2, 2007, spending of households on consumption showed an insignificant annual increase and a slight quarterly decrease. The demand on the part of the state was marked with quite a high annual and a notable quarterly increase.

In the reviewed period, the fixed capital formation indicator grew sharply both in annual and quarterly terms by 41.3 and 39.3 percent, respectively. This was the result of direct foreign investment inflows in the national economy; namely, in the spheres of energy, manufacturing, construction, trade and transportation and communications as well as the result of investment projects implemented in the public sphere.

In the analysed period, exports showed a higher growth rate than imports in annual and quarterly terms but the export was still 1.6 times lower than the import. Moreover, despite a 5.1 percent annual decrease of the import share in the GDP, Georgia still remained an import-dependent country.




*Source: Department for Statistics, Ministry of Economic Development*

In the reviewed period, the Department for Statistics made some changes to the data in the GDP revenue formation report. According to the updated data, operating surplus showed quite an impressive annual (2.1 times) and a sharp quarterly growth which led to an impressive annual increase of its share by 16.2 percentage points. In quarterly terms, the share of operating surplus notably increased by 7.2 percentage points.

High annual and quarterly growth rates were observed in labour cost and taxes paid on production and import thus somewhat increasing their shares. It should also be noted that mixed income notably decreased as compared to a year and a quarter ago and resulted in a sharp drop of its share in the GDP structure.

Although the volume of amounts paid to the rest of the world mainly in the form of profit and other revenues increased by 2.2 times on the average as compared to the same period last year and the previous quarter, the Gross National Income (GNI) maintained high growth rates and comprised GEL 4134.4 million. The further growth of the GDP and transfers from abroad by the country's residents ensured the increase in Net Disposable Income (NDI) as compared to the corresponding period last year and the previous quarter. Moreover, the higher growth of the NDI, as compared to spending on final consumption, caused the increase in net savings by an annual GEL 296.4 million and quarterly GEL 474.1 million.

## 2. PUBLIC FINANCE

**Table 8: Total Consolidated Budget Revenues**

| | Total Revenues* (mln GEL) | Total Tax Revenues (mln GEL) | GDP % | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Total Revenues | Total Tax Revenues | VAT | Profit Tax | Excise Duty | Income Tax | Customs Duty | Social Tax |
| 2000 | 905.2 | 854.3 | 15.0 | 14.1 | 4.6 | 1.3 | 1.5 | 1.8 | 0.9 | 2.1 |
| 2001 | 1033.9 | 954.7 | 15.5 | 14.3 | 5.2 | 1.0 | 1.3 | 2.0 | 0.8 | 2.1 |
| 2002 | 1135.3 | 1054.7 | 15.2 | 14.1 | 5.4 | 1.1 | 1.2 | 1.9 | 0.8 | 1.7 |
| 2003 | 1272.7 | 1186.6 | 14.9 | 13.9 | 4.8 | 1.2 | 1.2 | 1.8 | 0.8 | 2.1 |
| 2004 | 2102.0 | 1827.6 | 21.4 | 18.6 | 6.4 | 1.6 | 1.6 | 2.7 | 1.0 | 3.0 |
| 2005 | 3152.7 | 2411.5 | 27.2 | 20.8 | 8.5 | 1.8 | 2.4 | 2.5 | 1.1 | 3.7 |
| Q1 | 618.2 | 471.1 | 25.6 | 19.5 | 8.1 | 1.8 | 2.2 | 2.8 | 1.0 | 3.1 |
| Q2 | 608.0 | 566.0 | 29.5 | 20.1 | 8.2 | 2.1 | 2.7 | 2.4 | 1.0 | 3.1 |
| Q3 | 745.9 | 655.2 | 25.7 | 25.7 | 8.4 | 2.1 | 2.7 | 2.4 | 1.2 | 3.9 |
| Q4 | 918.6 | 719.2 | 21.8 | 21.8 | 9.2 | 1.4 | 2.3 | 2.6 | 1.1 | 4.5 |
| 2006 | 4235.6 | 3149.4 | 30.7 | 22.9 | 9.7 | 2.5 | 2.4 | 2.8 | 1.0 | 3.7 |
| Q1 | 827.7 | 609.7 | 22.2 | 22.2 | 9.3 | 2.5 | 2.2 | 2.8 | 1.2 | 3.5 |
| Q2 | 997.4 | 780.7 | 30.1 | 23.5 | 9.6 | 2.9 | 2.6 | 2.6 | 1.6 | 3.5 |
| Q3 | 1200.6 | 853.6 | 32.9 | 23.4 | 9.9 | 2.9 | 2.7 | 2.6 | 1.0 | 3.5 |
| Q4 | 1209.9 | 905.4 | 30.5 | 22.8 | 10.0 | 1.8 | 2.3 | 3.3 | 0.3 | 4.1 |
| 2007 | | | | | | | | | | |
| Q1 | 1235.4 | 948.1 | 36.2 | 27.8 | 11.6 | 5.0 | 2.6 | 3.4 | 0.3 | 4.1 |
| Q2 | 1210.0 | 1044.7 | 29.5 | 25.5 | 11.6 | 3.0 | 2.6 | 3.0 | 0.3 | 4.0 |

*Source: Treasury Service, Ministry of Finance; Department for Statistics, Ministry of Economic Development and GEPLAC calculations*
*Note: *Excluding grants*

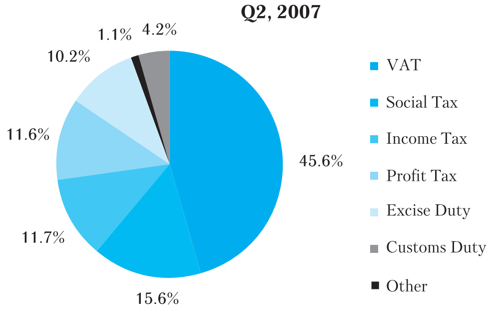
High annual growth rates in tax and non-tax revenues ensured the 21.2 percent increase in consolidated budget revenues and grants in the second quarter which was almost 2.5 times less than the corresponding indicator of the previous quarter. This can be attributed to the slowdown in annual growth rates of the abovementioned revenues and a sharp decrease in capital revenues and grants. A downward trend in total revenues and grants also continued in quarterly terms due to a notable drop in non-tax and capital revenues and a twofold decrease in grants.

An annual drop in capital revenues to the consolidated budget and a high annual growth of the GDP in nominal terms somewhat decreased the fiscal efficiency indicator in Q2, 2007. A sharp quarterly decrease in non-tax revenues, along with that in capital revenues, caused the 6.7 percentage point reduction of the abovementioned indicator.

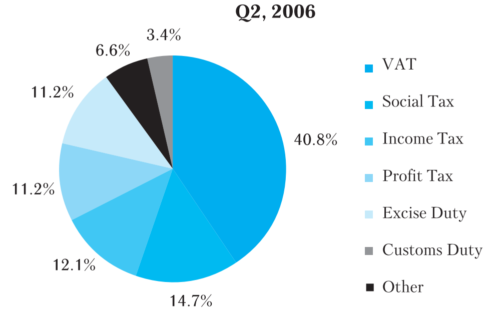
The annual development of tax revenues was again influenced by a significant increase in VAT, social, income and profit tax revenues. A quarterly growth rate, however, was 3.3 times lower that the annual one which resulted from a sharp drop in profit tax revenues and a modest growth in income tax revenues.

Certain changes were observed in the tax revenue structure with the share of VAT increasing significantly due to its upward annual and quarterly dynamics. Against the background of customs duty liberalisation, the share of customs revenues notably decreased as compared to a year ago. The slowdown in the growth rate of profit tax revenues caused a sharp quarterly decrease of this tax share as compared to previous quarters.

**Share of Selected Taxes in Consolidated Budget Tax Revenues Q2, 2007**




**Share of Selected Taxes in Consolidated Budget Revenues Q2, 2006**




*Source: Treasury Service, Ministry of Finance; Department for Statistics, Ministry of Economic Development and GEPLAC calculations*

VAT continued to be the main source of tax revenues in the reviewed period. An annual increase rate of this tax comprised 49.5 percent. Such VAT dynamics was largely determined by the increase in VAT revenues from the sales of imported and locally produced filtered cigarettes and tobacco products, oil and oil products and service and the price increase on natural gas. A quarterly growth rate was lower by as many as 2.4 times than the annual growth rate which was mainly associated with the decrease in revenues from locally produced filtered cigarettes and a seasonal drop in the demand for natural gas.

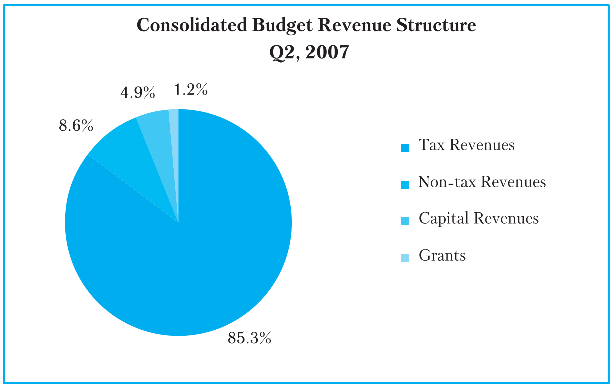
Q2, 2007, as compared to the same period last year, showed the 41.9 percentage increase in social tax revenues. These revenues were three times higher from the private sector than from the public sector. Social tax revenues showed a quarterly 16 percent increase which resulted from higher collections by GEL 3.1, 12.3 and 7.4 million, respectively, from public and private sectors and physical person entrepreneurs than in the previous quarter.

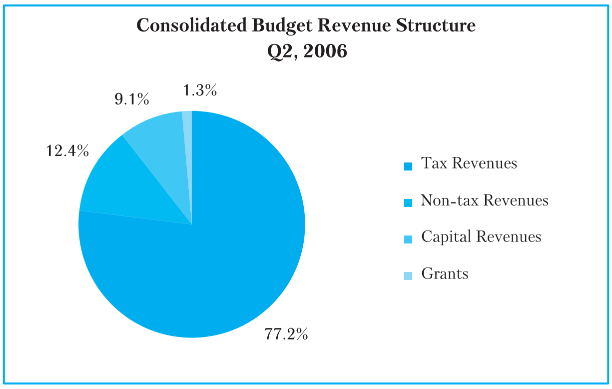
Income tax showed a high annual growth (40.4 percent) which was influenced by the increase in the wages of public sector employees and in the revenues of non-resident persons. A quarterly growth rate, however, was rather modest (6.3 percent) due to the ongoing reorganisation of budget entities. It should be noted that income tax revenues from the private sector were higher by GEL 8.4 million than in the previous quarter.

In Q2, 2007, as compared to the same period last year, profit tax revenues increased by 28.2 percent. This was caused by the increase in the profit of Georgian as well as foreign enterprises as well as the growth of their revenues in the form of dividends and interest. In quarterly terms, the profit tax revenues decreased significantly which downgraded this tax from the second to the fourth position. This can be explained by the collection of relatively moderate revenues against a high quarterly base indicator.

Following the increase in the demand for locally produced filtered cigarettes, imported motorcars, petroleum and diesel, the reviewed period showed an annual and quarterly increase in excise tax revenues.

The customs duty volume, in annual terms, notably decreased (78.4 percent) due to the custom tariff liberalisation. At the same time, the increase in the collection of this duty from motorcar imports ensured the 6.7 percent quarterly increase of the revenues.




*Source: Treasury Service, Ministry of Finance; Department for Statistics, Ministry of Economic Development and GEPLAC calculations*

Despite a sharp decrease in license, registration and consulate fees, an annual increase in non-tax revenues comprised 15.8 percent in the analysed period. This was mainly the result of a significant increase in gambling fees, penalties and fines, state duties as well as in revenues received in the form of state-issued loan repayments. The halving of non-tax revenues, as compared to the previous quarter, can be explained by a sharp decrease in license fees (by 2.3 times), casino and bookmaking permit fees (by 5 times) and gambling fees.

The reviewed period saw a significant annual reduction (by 52.6 percent) and a slight quarterly reduction) in capital revenues. This can be explained by a gradual decrease in the current year's privatisation proceeds as compared to 2006.

GEL 14.1 million was received in the form of grants in the second quarter which is higher by 8.5 percent than the corresponding indicator a year ago. In quarterly terms, however, the volume of grants halved. The majority of the grants was represented by capital grants from international organisations.

The consolidated budget expenditure in the reviewed period was marked with a high growth rate as compared to both a year and a quarter ago. Such annual development in expenditure was conditioned by a significant increase in budget allocations to the spheres of defense, public order and security and economic activity whilst the quarterly dynamics was conditioned by the increase in spending on defence, economic activity and housing and utilities.

## Table 9: Consolidated Budget Expenditures

| | Total Expenditure (mln GEL) | GDP % | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | Total Expenditure | General Public Service | Defence, Public Order and Security | Foreign Debt Service | Education | Health Care | Social Safety and Social Service |
| 2000 | 1126.5 | 18.6 | 2.2 | 1.7 | - | 2.2 | 0.6 | 3.4 |
| 2001 | 1237.9 | 18.5 | 3.1 | 2.0 | - | 2.1 | 0.8 | 2.9 |
| 2002 | 1409.5 | 18.9 | 3.5 | 2.0 | 0.9 | 2.2 | 0.9 | 3.0 |
| 2003 | 1522.1 | 17.8 | 3.1 | 1.9 | 0.9 | 2.1 | 0.4 | 4.0 |
| 2004 | 2412.2 | 24.6 | 3.6 | 4.4 | 0.5 | 2.9 | 1.0 | 4.7 |
| 2005 | 3280.8 | 28.3 | 3.1 | 5.9 | 0.3 | 2.5 | 1.8 | 5.4 |
| Q1 | 621.2 | 25.7 | 3.2 | 5.5 | 0.5 | 2.2 | 1.4 | 6.4 |
| Q2 | 773.4 | 27.4 | 2.5 | 5.4 | 0.3 | 2.1 | 1.7 | 6.0 |
| Q3 | 827.8 | 27.1 | 2.8 | 5.7 | 0.2 | 2.4 | 1.8 | 4.8 |
| Q4 | 1058.4 | 32.1 | 4.8 | 6.8 | 0.4 | 3.1 | 2.0 | 4.6 |
| 2006 | 4464.1 | 32.4 | 3.7 | 8.0 | 0.3 | 3.0 | 1.6 | 5.0 |
| Q1 | 766.7 | 27.9 | 3.3 | 6.4 | 0.3 | 2.5 | 1.3 | 5.2 |
| Q2 | 1074.5 | 32.4 | 3.8 | 8.1 | 0.2 | 2.9 | 1.8 | 4.7 |
| Q3 | 1178.1 | 32.3 | 3.5 | 7.9 | 0.7 | 3.1 | 1.8 | 4.9 |
| Q4 | 1444.8 | 36.4 | 4.3 | 9.3 | 0.3 | 3.4 | 1.6 | 5.4 |
| 2007 | | | | | | | | |
| Q1 | 1033.9 | 30.3 | 4.5 | 10.2 | 0.3 | 2.7 | 1.5 | 4.5 |
| Q2 | 1295.5 | 31.6 | 5.4 | 10.7 | 0.2 | 2.3 | 1.3 | 3.6 |

*Source: Treasury Service, Ministry of Finance; Department for Statistics, Ministry of Economic Development and GEPLAC calculations*

The abovementioned, in its turn, affected the expenditure structure of the consolidated budget showing a sharp increase in the shares of spending on defence and public order and security and a decrease in the shares of spending on general public services, social safety, education and housing and utilities as compared to the corresponding period last year. In quarterly terms, the shares of spending on defence and housing and utilities increased whereas that in general public services, social safety and public order and security notably decreased.

In the analysed period, capital expenditure again comprised 20.7 percent of the total budget expenditure with the spending on the purchase of goods and services being lower by 1.2 percentage points. The expenditure for labour reimbursement comprised 9.9 percent of all the expenditure.

The reviewed period saw high annual and quarterly growth in defence expenditure, much of which was used to finance the introduction of state-of-the-art communications systems in the Ministry of Defence, the construction of billets and the purchase of uniforms, the equipping of military sub-units with weapons and technical systems and the improvement of living conditions of military officers and their families. It is also to be noted that 39.5 percent of defence allocations was used as capital expenditure.

Expenditure on general public services showed quite a modest annual but a sharp quarterly growth. This expenditure was allocated mainly to finance executive and representative bodies, financial and fiscal activity, foreign relations and slo to service debt and redistribute financial flows amongst various governmental levels.

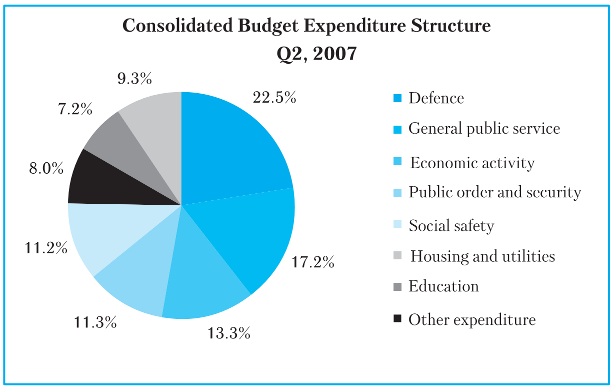
Spending on economic activity was marked with a high annual and quarterly growth. Much of this expenditure was directed towards financing energy and transportation spheres, namely, the repair and installation work at hydro power plants, the modernisation and rehabilitation of international and intra-national roads and the repair of bridges.

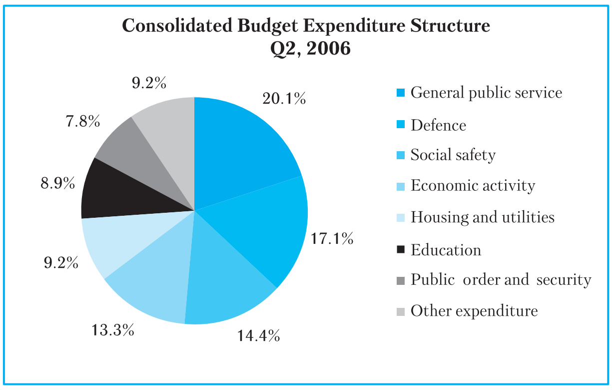
The spending on public order and security increased significantly in the second quarter. Their quarterly increase, however, looked modest against a high base indicator. A certain part of these allocations was spent on the refurbishment and reconstruction of court buildings, the purchase of service-purpose vehicles and training-retraining programmes for judges and the state guard service. Significant amounts were used to finance the installation of telephone and computer networks in the prosecutor's office and the rehabilitation and overhaul of penitentiary facilities.

The analysed period saw a decrease in social safety expenditure both in annual and quarterly terms which resulted in a downgraded share of the abovementioned spending from the third to the fifth position in the overall expenditure structure. This can be explained by rather high base indicators. Much of the social safety allocations was spent on pensions, liabilities accumulated on regressive pensions and allowances to poorer families and also on targeted state programmes of professional training, rehabilitation and the equipment of health care infrastructure.

Spending on housing and utilities increased only somewhat as compared to a year ago. In quarterly terms, however, it doubled due to a seasonal factor. The allocations were used for the development of utilities and the rehabilitation of the water supply system.

Education expenditure decreased by GEL 2.7 million in annual terms and insignificantly in quarterly terms. The allocations were used to finance the repair and rehabilitation of public schools, the development of the university infrastructure and the establishment of computer centres, programmes on financial assistance to teachers in conflict regions and the replenishment of the library fund.




*Source: Treasury Service, Ministry of Finance; Department for Statistics, Ministry of Economic Development and GEPLAC calculations*

In Q2, 2007, the state debt increased by GEL 296.2 million in annual terms and by GEL 336 million in quarterly terms mainly due to loans obtained from the World Bank and the EBRD. Moreover, at the end of the reviewed period, the foreign debt comprised GEL 2841.7 million whilst the domestic debt amounted to GEL 1510.5 million with 48.8 percent accounting for one-year maturity renewable bonds and the remaining part mainly for the so-called historical debts.

It should also be noted that the state budget allocated GEL 23.8 million for the debt service of which GEL 8.6 million was used to service the foreign debt and GEL 15.1 million to service the domestic debt.

**Table 10: Budget Balance**

| | Balance (mln GEL) | Balance (expenditure %) | Balance (GDP %) |
|---|---|---|---|
| 2000 | - 207.0 | 18.4 | 3.4 |
| 2001 | - 155.9 | 12.6 | 2.3 |
| 2002 | - 251.6 | 17.9 | 3.4 |
| 2003 | - 201.3 | 13.2 | 2.4 |
| 2004 | - 288.4 | 12.0 | 2.9 |
| 2005 | -24.0 | 0.7 | 0.2 |
| Q1 | + 7.5 | 1.2 | 0.3 |
| Q2 | +78.8 | 10.2 | 2.8 |
| Q3 | - 29.7 | 3.6 | 0.1 |
| Q4 | -80.6 | 7.6 | 2.4 |
| 2006 | -34.2 | 0.8 | 0.3 |
| Q1 | +70.6 | 9.2 | 2.6 |
| Q2 | -64.1 | 6.0 | 1.9 |
| Q3 | +91.6 | 7.8 | 2.5 |
| Q4 | -132.4 | 9.2 | 3.3 |
| 2007 | | | |
| Q1 | +230.9 | 22.3 | 6.8 |
| Q2 | -41.4 | 5.5 | 1.7 |

*Source: Treasury Service, Ministry of Finance; Department for Statistics, Ministry of Economic Development and GEPLAC calculations*

In Q2, 2007, as compared to the corresponding period last year, the consolidated budget deficit deteriorated by GEL 7.3 million. In quarterly terms, however, as the growth of expenditure was higher that that of revenues, the surplus of the previous quarter reverted into a deficit. 32.3 percent of the deficit was financed through external sources whilst the remaining portion through domestic sources.

# 3. MONEY AND BANKING

**Table 11: NBG Accounts (thousand GEL, end of period)**

| | NBG International Reserves | NBG Claims on General Government | Reserve Money (M1) | Currency in Circulation | Banks' Deposits | | Real Cash Balances Index (December 1995=100)* |
|---|---|---|---|---|---|---|---|
| | | | | | Required Reserves | Balances on Correspondent Accounts | |
| 2000 | 229033 | 760750 | 391737 | 329157 | 38943 | 23636 | 2100 |
| 2001 | 333594 | 749415 | 429857 | 365669 | 53300 | 10888 | 2256 |
| 2002 | 442529 | 766681 | 508969 | 417178 | 72228 | 19525 | 2242 |
| 2003 | 407090 | 795572 | 579912 | 472242 | 81405 | 25214 | 2590 |
| 2004 | 705616 | 841414 | 836536 | 676158 | 92334 | 68045 | 3442 |
| 2005 | 857973 | 832849 | 1001451 | 811400 | 129833 | 60218 | 3890 |
| Q1 | 704931 | 841691 | 809154 | 658218 | 97725 | 53211 | 3253 |
| Q2 | 802276 | 841972 | 879314 | 694576 | 109141 | 75597 | 3513 |
| Q3 | 807656 | 836230 | 933404 | 746508 | 122067 | 64829 | 3757 |
| Q4 | 857973 | 832849 | 1001451 | 811400 | 129833 | 60218 | 3891 |
| 2006 | 1594982 | 748849 | 1193231 | 929538 | 224559 | 39135 | 4097 |
| Q1 | 883278 | 832849 | 978908 | 775443 | 139334 | 64132 | 3664 |
| Q2 | 969643 | 832849 | 1044679 | 803260 | 158689 | 82729 | 3642 |
| Q3 | 1094184 | 832849 | 1096913 | 853577 | 202331 | 41005 | 3861 |
| Q4 | 1594982 | 784849** | 1193231 | 929538 | 224559 | 39135 | 4097 |
| 2007 | | | | | | | |
| Q1 | 1732251 | 784849** | 1157369 | 861 359 | 231147 | 64862 | 3709 |
| Q2 | 2038618 | 775300 | 1409355 | 927130 | 226134 | 210549 | 3924 |

*Source: NBG and GEPLAC calculations*
*Note: *The Real Cash Balances Index is derived from dividing the indicator for currency in circulation by CPI for the corresponding period (1995=100)*
***Revised data*

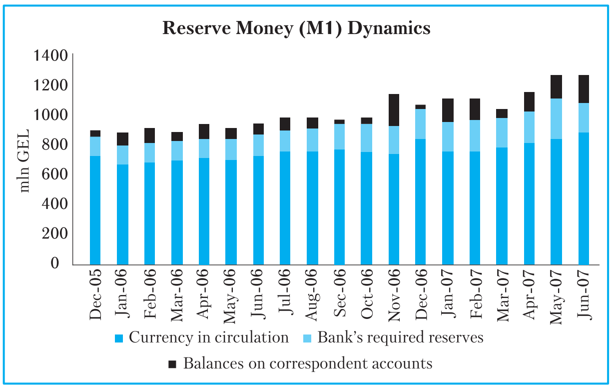
A high growth rate of the NBG's foreign currency reserves, especially in annual terms, continued into the reviewed period. The reserve dynamics was mainly determined by the NBG interventions at the Interbank Currency Exchange (TICEX) as the direct foreign investments kept flowing in. Foreign currency inflows were significantly linked with the privatisation process. As the result of the privatisation of the energy facilities alone, the country's international reserves increased by USD 145.6 million in the analysed period.

By the end of Q2, 2007, the pace of money supply notably slackened. Where in May the annual growth rate of reserve money comprised 28.7 percent by an average monthly indicator, it was 24.6 percent in June. The growth of the monetary base was mainly influenced by the NBG's foreign currency purchases at the TICEX which was caused by an excess supply. In April-June, the net NBG purchases made up USD 245.8 million, resulting in releasing GEL 403.4 million into circulation.

To sterilise large liquidity, the NBG, similarly to the previous period, actively used the deposit certificate auctions which resulted in their circulation making up GEL 371.6 million by the end of June. It is noteworthy that during the second quarter, the NBG covered GEL 1018 million and emitted GEL 1093 million worth of deposit certificates. Moreover, the NBG succeeded in placing GEL 10 million worth of state bonds in June. Accordingly, the net volume of liquidity withdrawn from circulation by means of the abovementioned instruments made up GEL 85 million in the second quarter.

In the analysed period, the volume of the governmental deposits comprised on average GEL 633 million thus exceeding the previous year's same indicator by 2.3 times. The balances on these accounts showed an annual GEL 319.5 million growth. The dynamics of governmental deposits was influenced by the proceeds from the privatisation of energy facilities. The growth was also largely affected by a high collection of tax revenues.

Against the background of the abovementioned monetary flows, the reserve money showed quite high annual and quarterly growth rates in the accounting period. The growth of the cash in circulation, however, was rather modest. Significant changes towards the increase were observed in such components of the reserve money as balances on commercial banks' correspondent accounts in the NBG and minimal reserves which was partially conditioned by a new rule for required reserves having entered into force on 1 June.




*Source: NBG*

Under the abovementioned rule, commercial banks are required to retain 13 percent of the average balance of the means attracted in the national currency on correspondent accounts. Moreover, they are given the right to reserve 13 percent of the means attracted in foreign currency in US dollars instead of reserving them in the national currency as previously required. Even though this approach reduces the risks of the banking system (foreign exchange, credit risks), the necessity to observe the open foreign exchange position limit makes it difficult for commercial banks to fulfil such a requirement.

In Q2, 2007, the growth of stock of money in circulation outpaced that of the consumer price index and, accordingly, caused the increase of the Real Cash Balances Index.

It is noteworthy that, in contrast to the previous quarters, the government debt to the NBG notably decreased.

**Table 12: Commercial Banks' Accounts (thousand GEL, end of period)**

| | Commercial Banks' Credits to Economy | Share of Credits to Non-Budgetary Sector (%) | Net Foreign Assets | Deposits | | Share of Households in Deposits (%) |
|---|---|---|---|---|---|---|
| | | | | in National Currency | in Foreign Currency | |
| 2000 | 430315 | 100.0 | -12610 | 67094 | 235868 | - |
| 2001 | 489783 | 99.51 | 3708 | 54989 | 328606 | 42.5 |
| 2002 | 629486 | 98.93 | 25040 | 71478 | 401301 | 53.5 |
| 2003 | 785923 | 98.42 | 42456 | 85863 | 532989 | 60.3 |
| 2004 | 964917 | 99.97 | 54595 | 230104 | 665836 | 50.5 |
| 2005 | 1730466 | 100.00 | -231480 | 333611 | 841285 | 54.7 |
| Q1 | 1070710 | 99.98 | 20984 | 203870 | 684471 | 57.2 |
| Q2 | 1229399 | 99.98 | -18482 | 253233 | 738697 | 58.2 |
| Q3 | 1431937 | 99.98 | -22138 | 296225 | 825201 | 54.0 |
| Q4 | 1730466 | 100.00 | -231480 | 333611 | 841285 | 54.7 |
| 2006 | 2681492 | 100.00 | -385051 | 561824 | 1272493 | 50.8 |
| Q1 | 1948496 | 99.99 | -269532 | 378414 | 915702 | 55.0 |
| Q2 | 2263516 | 99.35 | -308977 | 522700 | 1032399 | 48.2 |
| Q3 | 2536840 | 100.00 | -408385 | 500689 | 1117334 | 52.2 |
| Q4 | 2681492 | 100.00 | -385051 | 561824 | 1272493 | 50.8 |
| 2007 | | | | | | |
| Q1 | 3019857 | 100.00 | -627561 | 606075 | 1330634 | 50.8 |
| Q2 | 3534481 | 100.00 | -782822 | 798938 | 1626138 | 45.4 |

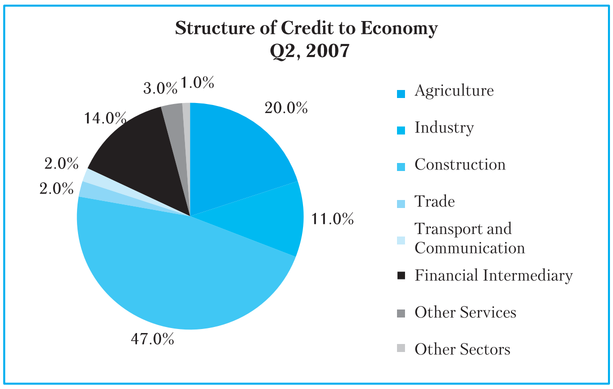
*Source: NBG and GEPLAC calculations*

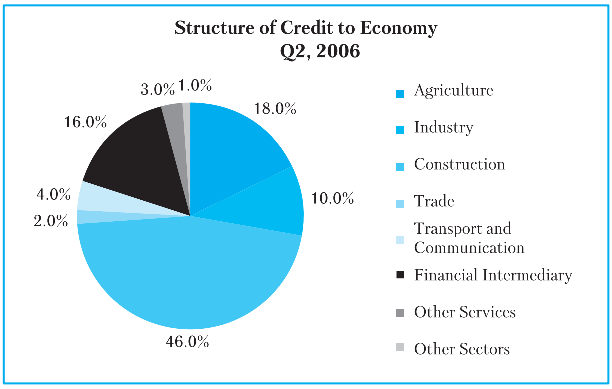
The analysed period again saw a high annual growth rate in deposits collected by the commercial banks which comprised 54.1 percent. Additionally, the growth rates of current and time deposits were almost equal at 53.6 and 54.7 percent, respectively. An annual growth of current accounts was mainly caused by an impressive dynamics in the deposits of legal persons, namely, energy, trade and service sector companies.

It should be emphasised that an annual growth rate of deposits in national currency, as compared to the previous quarter, lagged behind that of deposits in foreign currency which somewhat pushed up the dollarisation coefficient of deposits.

A high growth rate in commercial banks' credits to economy was maintained in Q2, 2007. Moreover, the share of long-term loans increased in the credit portfolio. The share of short-term credits, however, decreased by almost 2 percent as compared to the same period last year and comprised 31.1 percent. The increase in the share of long-term loans in the credit portfolio can be explained by the optimisation of credit resources by commercial banks, on the one hand, and by improvements in the risk management, on the other.

It is noteworthy that the share of consumer loans in the credit structure further increased having translated into a higher annual growth rate of loans to physical persons as compared to legal persons (respectively, 79.1 and 53.1 percent).




*Source: NBG and GEPLAC calculations*

The reviewed period showed a higher growth rate in foreign currency denominated loans issued by commercial banks. The increase in national currency denominated loans comprised 53 percent (GEL 912 million) as compared to the previous year's same period whilst that in foreign currency denominated loans comprised 70 percent (USD 1.6 billion).

The second quarter demonstrated some changes in the distribution of credits to the sectors of economy which further diversified the credit portfolio of commercial banks. The share of credits to the construction sector notably increased (annual 63 percent). An increase was also observed in the share of credits to the health and social service (153 percent), agriculture, forestry and fishery (112 percent), transport and communications (76 percent) and industry (67 percent) sectors. It is noteworthy that the share of loans to trade no longer increased at such a high pace as in earlier periods. The share of credits to the trade sector in the credit portfolio, therefore, notably decreased.

**Table 13: Money Aggregates (thousand GEL, end of period)**

| | Money Outside Banks (M0) | Reserve Money (M1) | Broad Money (M2) | Broad Money (M3) | Money Multiplier | | Money Velocity | |
|---|---|---|---|---|---|---|---|---|
| | | | | | M2 | M3 | M2 | M3 |
| 2000 | 315007 | 391737 | 382101 | 617969 | 0.98 | 1.58 | 19.53 | 11.67 |
| 2001 | 348850 | 429857 | 403839 | 732445 | 0.94 | 1.70 | 17.89 | 10.23 |
| 2002 | 390787 | 508931 | 462265 | 863566 | 0.91 | 1.70 | 17.78 | 9.54 |
| 2003 | 441536 | 579912 | 527398 | 1060388 | 0.91 | 1.83 | 16.23 | 8.07 |
| 2004 | 615993 | 836536 | 846097 | 1511933 | 1.01 | 1.81 | 11.78 | 6.59 |
| 2005 | 736284 | 1001451 | 1069895 | 1911181 | 1.07 | 1.91 | 10.83 | 6.07 |
| Q1 | 608555 | 809154 | 812425 | 1496897 | 1.00 | 1.85 | 14.27 | 7.74 |
| Q2 | 636495 | 879314 | 889728 | 1628425 | 1.01 | 1.85 | 13.03 | 7.12 |
| Q3 | 686116 | 933404 | 982341 | 1807542 | 1.05 | 1.94 | 11.80 | 6.41 |
| Q4 | 736284 | 1001451 | 1069895 | 1911181 | 1.07 | 1.91 | 10.83 | 6.07 |
| 2006 | 827357 | 1193231 | 1389182 | 2661674 | 1.16 | 2.23 | 9.90 | 5.12 |
| Q1 | 709102 | 978908 | 1087516 | 2003218 | 1.11 | 2.05 | 12.03 | 6.53 |
| Q2 | 729106 | 1044679 | 1251806 | 2284205 | 1.20 | 2.19 | 9.69 | 5.31 |
| Q3 | 773243 | 1096913 | 1273391 | 2421024 | 1.16 | 2.21 | 11.21 | 6.00 |
| Q4 | 827357 | 1193231 | 1389182 | 2661674 | 1.16 | 2.23 | 9.90 | 5.12 |
| 2007 | | | | | | | | |
| Q1 | 765376 | 1157369 | 1372487 | 2705882 | 1.19 | 2.34 | 12.30 | 6.00 |
| Q2 | 856423 | 1409355 | 1655771 | 3281910 | 1.17 | 2.33 | 11.35 | 5.70 |

*Source: NBG*

An the annual growth rate of broad money (M2) comprised 32.3 percent in the analysed period which was attributed mainly to the GEL 276.2 million increase in national currency denominated deposits. As the deposits in national as well as foreign currencies sharply increased in the banking sector, the broad money aggregate (M3) indicator grew at an extremely fast rate comprising an annual 43.6 percent.

The demand for money was again influenced by a growth of the economy's real sector, ongoing processes in the public sector, the inflation and exchange rate developments, foreign currency flows and seasonal factors.

**Table 14: Change in Prices**

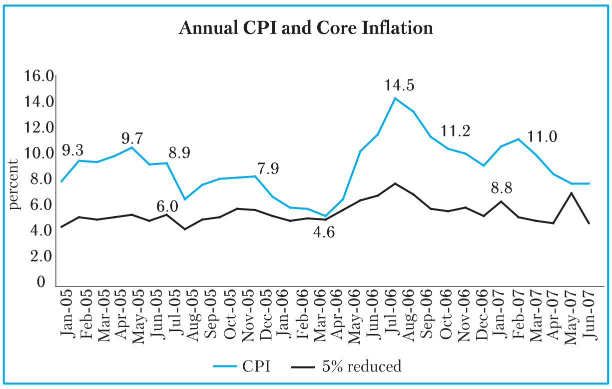
| | Consumer Price Index December 1995=100 (end of period) | Change in Consumer Price Index (%, as compared to the end of the previous period) | Change in Core Inflation (%, as compared to the end of the previous period)* | Producer Price Index December 2000=100 (end of period) |
|---|---|---|---|---|
| 2000 | 156.7 | 4.6 | 0.9 | 100.0 |
| 2001 | 162.1 | 3.4 | 1.3 | 108.9 |
| 2002 | 170.9 | 5.4 | 0.5 | 111.3 |
| 2003 | 182.7 | 7.0 | 2.3 | 118.7 |
| 2004 | 196.5 | 7.5 | 2.2 | 120.1 |
| 2005 | 208.6 | 6.2 | 3.0 | 130.1 |
| Q1 | 202.4 | 3.0 | 0.6 | 129.8 |
| Q2 | 197.7 | -2.3 | 0.0 | 128.3 |
| Q3 | 198.7 | 0.5 | 1.1 | 127.4 |
| Q4 | 208.6 | 5.0 | 1.2 | 129.2 |
| 2006 | 226.9 | 8.8 | 1.4 | 145.0 |
| Q1 | 211.6 | 1.5 | 0.6 | 133.9 |
| Q2 | 220.3 | 4.1 | 0.9 | 145.3 |
| Q3 | 221,0 | 0.4 | -1.1 | 146.1 |
| Q4 | 226.9 | 2.6 | -0.6 | 145.0 |
| 2007 | | | | |
| Q1 | 232.2 | 2.3 | -0.4 | 148.8 |
| Q2 | 236.2 | 1.7 | -0.8 | 155.8 |

*Source: Department for Statistics, Ministry of Economic Development and NBG*

*Note: *The core inflation indicator does not include exogenous factors and mainly reflects the impact of monetary policy upon the price developments. A stable core inflation reflects the fact that the pursued monetary policy did not induce sharp change in consumer prices*

In June 2007, consumer prices decreased by 0.2 percent in annual terms as compared to the previous month. Given that the annual decrease in consumer prices in the corresponding period of the last year was also 0.2 percent, the annual inflation did not increase in June. Although the mentioned indicator decreased as compared to the previous quarter, an average annual inflation indicator was still high at 10.1 percent.

The analysis of prices by the length of consumption showed that the prices decreased on short-, medium- and long-term goods but increased on service in the month of June. The inflation indicator remained the high on short-term consumption goods (7.3 percent). It was, however, much higher in the service sector (11.3 percent).




*Source: Department for Statistics, Ministry of Economic Development*

It should be noted that after a relatively insignificant increase in April and quite a significant increase (1.6 percent) in May, a monthly inflation rate showed a decrease in June. This was mainly determined by seasonal factors such as the drop in prices on certain agricultural produce. Such a price dynamics was also influenced by the NBG's sterilisation measures and the government's somewhat restricted spending policy the proof of which is a negative core inflation indicator (-0.8).

Overall, in the first half of the current year the consumer prices increased by 4.1 percent with 1.6 percent of it accounting for products with regulated prices. The most significant increase was observed in such consumer groups as electricity, natural gas and other fuel, which was largely conditioned by the rise in tariffs on natural gas, water and waste disposal.

The changes in consumer prices were partially caused by the increase in producers prices both in annual and quarterly terms due mainly to a notable rise in electricity and natural gas prices as well as in the prices for water collection, treatment and distribution.

**Table 15: Interest Rates**

| | Money Market Rate (GEL)* | Money Market Rate in Foreign Currency** | Commercial Banks' Interest Rates (annual weighted average) | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | on loans | | | | on deposits | | | |
| | | | GEL | | Foreign currency | | GEL | | Foreign currency | |
| | | | short-term | long-term | short-term | long-term | short-term | long-term | short-term | long-term |
| 2000 | - | - | 22 | 17 | 30 | 20 | 11 | 2 | 11 | 13 |
| 2001 | - | - | 24 | 17 | 27 | 21 | 8 | 3 | 11 | 12 |
| 2002 | 24 | 16 | 25 | 16 | 25 | 20 | 11 | 12 | 11 | 12 |
| 2003 | 12 | 13 | 25 | 19 | 23 | 19 | 10 | 12 | 10 | 11 |
| 2004 | 8 | 8 | 27 | 20 | 22 | 17 | 8 | 12 | 9 | 11 |
| 2005 | 8 | 7 | 22 | 21 | 20 | 16 | 9 | 12 | 8 | 10 |
| Q1 | 9 | 5 | 23 | 21 | 22 | 16 | 8 | 11 | 8 | 10 |
| Q2 | 7 | 7 | 22 | 22 | 21 | 16 | 9 | 11 | 8 | 10 |
| Q3 | 8 | 8 | 21 | 21 | 20 | 16 | 8 | 12 | 7 | 10 |
| Q4 | 10 | 8 | 21 | 20 | 20 | 15 | 9 | 13 | 8 | 11 |
| 2006 | 9 | 11 | 21 | 20 | 18 | 16 | 10 | 13 | 7 | 10 |
| Q1 | 7 | 11 | 21 | 20 | 19 | 15 | 10 | 13 | 8 | 11 |
| Q2 | 8 | 9 | 20 | 20 | 19 | 16 | 7 | 13 | 6 | 10 |
| Q3 | 9 | 11 | 20 | 20 | 18 | 16 | 7 | 13 | 6 | 10 |
| Q4 | 13 | 12 | 22 | 19 | 18 | 16 | 7 | 13 | 7 | 10 |
| 2007 | | | | | | | | | | |
| Q1 | 8 | 9 | 22 | 19 | 18 | 16 | 7 | 12 | 7 | 10 |
| Q2 | 7.5 | 11.0 | 22.2 | 19.5 | 17.8 | 16.1 | 7.4 | 12.2 | 7.1 | 10.4 |

*Source: NBG and GEPLAC calculations*

*Note: *The money market interest rate in national currency includes an annual weighted average interest rate on up to 1-year maturity loans issued through Interbank Credit Auctions and bank-to-bank market*

***The money market interest rates in foreign currency include an annual weighted average interest rate on up to 1-year maturity loans issued directly at the bank-to-bank market*

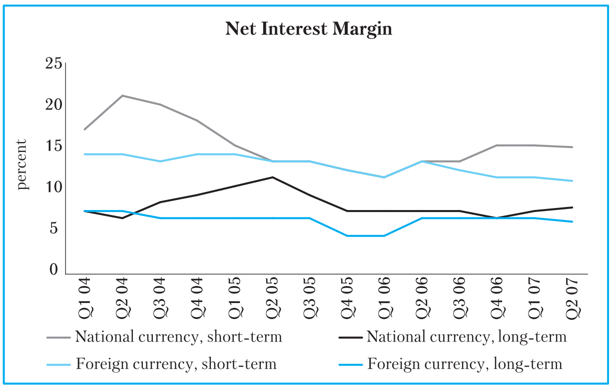
Although the deposits in national currency increased, the weighted average deposit interest rates did not show any significant quarterly change in the analysed period. The weighted average interest rate paid on national currency denominated deposits comprised 8.3 percent whilst that on deposits in foreign currency was 8.4 percent.

By the end of the second quarter, commercial banks' interest rates on legal persons' current accounts in national currency made up 11.1 percent which was 4.6 percentage points higher than in the same period last year. The interest rate on foreign currency denominated current accounts of legal and physical persons also increased and comprised 9.4 percent and exceeded the corresponding last year indicator by 4 percentage points.

A notable annual increase of interest rates was also observed on time deposits in both national and foreign currencies by 1.5 and 1.4 percentage points, respectively. Such changes in interest rates are, presumably, associated with the increase of competition between banks.

In the reviewed period, there were no significant changes observed in weighted average interest rates on short-term and medium-term loans in either national or foreign currencies. By the end of the second quarter, however, the interest rate on loans in lari showed an annual 0.6 percent increase, reaching 21 percent. The increase of 0.3 percent in the average interest rate on loans in foreign currency, which comprised 16.5 percent, was relatively insignificant.

The increase in interest rates, albeit insignificant, reflects the growth of aggregate demand in economy. Moreover, it is noteworthy that interest rates were more dynamic on the loans issued in the national currency which speaks for the stability of the demand for such loans.




*Source: NBG and GEPLAC calculations*

Considering the abovementioned, some changes were also observed in the net interest margin. As the increase in deposit rates was higher than the increase in credit rates, the net interest margin decreased slightly which is absolutely normal as the banking system develops.

In Q2, 2007, the influence of bank-to-bank credit auctions on the formation of interest rates of the national currency market was again insignificant mainly due to the NBG's current policy not to participate in these auctions. The direct bank-to-bank credit market, however, further intensified its activity and recently became the main artery of the redistribution of excess liquidity amongst banks.

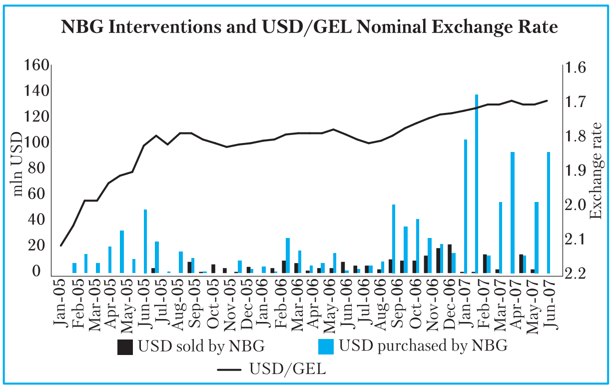
### Table 16: Exchange Rates and NBG Net Interventions

| | Nominal Exchange Rate (average for the period) | | USD/GEL Banknote Rate (average for the period) | Real Effective Exchange Rate December 1995=100 (end of period) | Net NBG Interventions (thousand USD) |
|---|---|---|---|---|---|
| | USD/GEL | Euro/GEL | | | |
| 2000 | 1.9759 | - | - | 110.2 | -71416 |
| 2001 | 2.0723 | 1.8473 | 2.0816 | 108.2 | -35448 |
| 2002 | 2.1945 | 2.0714 | 2.3822 | 102.7 | -40459 |
| 2003 | 2.1459 | 2.4243 | 2.1502 | 94.9 | -42685 |
| 2004 | 1.9168 | 2.3814 | 1.9160 | 107.0 | -182662 |
| 2005 | 1.8126 | 2.2601 | 1.8154 | 110.3 | -42919 |
| Q1 | 1.8272 | 2.3995 | 1.8302 | 103.6 | 10600 |
| Q2 | 1.8250 | 2.3032 | 1.8276 | 104.1 | -10885 |
| Q3 | 1.8046 | 2.2039 | 1.8068 | 104.6 | -24652 |
| Q4 | 1.7936 | 2.1338 | 1.7960 | 110.2 | -17982 |
| 2006 | 1.7766 | 2.2293 | 1.7608 | 109.4 | -341237 |
| Q1 | 1.8148 | 2.1810 | 1.8131 | 105.5 | 11323 |
| Q2 | 1.8033 | 2.2637 | 1.8008 | 111.1 | -74282 |
| Q3 | 1.7552 | 2.2373 | 1.7146 | 110.8 | -47544 |
| Q4 | 1.7331 | 2.2352 | 1.7150 | 110.3 | -230734 |
| 2007 | | | | | |
| Q1 | 1.7115 | 2.2420 | 1.7072 | 110.5 | -143659 |
| Q2 | 1.6845 | 2.2693 | 1.6791 | 110.7 | -245870 |

*Source: NBG and GEPLAC calculations*

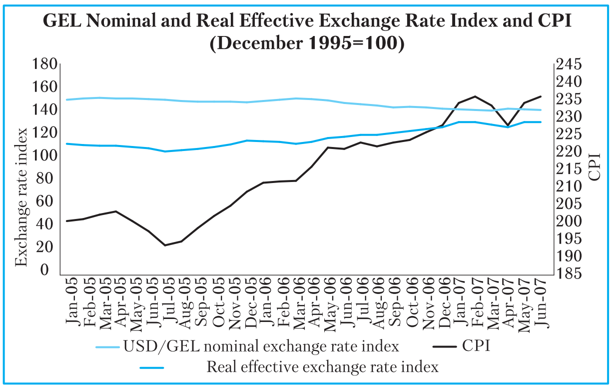
The lari nominal exchange rate continued its long-established trend of appreciation against the USD in the analysed period. As compared to Q2, 2006, it appreciated by the end of the period indicator (5.84 percent) as well as the average period indicator (6.59 percent). It should be noted that the volume of foreign currency supplied by the commercial banks increased annually by 80 percent whereas the volume of demanded foreign currency decreased by 21.6 percent.

The NBG, stepped up its interventions and purchased USD 256.4 million which is 164 percent higher than the corresponding indicator from last year. Similarly to the previous quarter, the NBG interventions were aimed at averting undesirable fluctuations in the lari exchange rate which finally translated into the appreciation of the national currency.




*Source: NBG*

April and May, 2007 saw a steady annual appreciation of the lari effective exchange rate (by respectively, 3.1 and 2.7 percentage points) although this indicator somewhat decreased in June which was caused by a relatively lower inflation in Georgia as compared to its trade partner countries.




*Source: NBG*

The reviewed period saw the coincidence in lari exchange rate movements on the TICEX, bank-to-bank and banknote segments of the currency market. The difference between lari purchase and sale rates was rather slight (standard deviations for purchase and sale rates made up on average 0.008454 and 0.008326, respectively) and, thus, reflected the stability of the foreign exchange market.

# 4. LABOUR MARKET AND HOUSEHOLD BUDGETS

**Table 17: Population and Employment (thousand persons)**

| | Total population over 15 years old | Economically active population * | | Employed | | | | | Total employment rate (%) |
|---|---|---|---|---|---|---|---|---|---|
| | | Total | Labour force participation rate (%) * | Total | Hired | Self-employed | Employment rate amongst people of working age (%) | Employment rate amongst people older than working age (%) | |
| 2000 | 3148.1 | 2051.6 | 65.2 | 1839.3 | 684.3 | 1043.9 | 79.2 | 20.8 | 58.4 |
| 2001 | 3191.1 | 2113.3 | 66.2 | 1877.7 | 654.6 | 1135.9 | 80.2 | 22.0 | 58.8 |
| 2002 | 3239.5 | 2104.2 | 65.0 | 1839.2 | 650.9 | 1184.9 | 80.0 | 20.1 | 56.8 |
| 2003 | 3098.8 | 2050.4 | 66.1 | 1814.5 | 618.5 | 1195.2 | 79.8 | 18.9 | 58.5 |
| 2004 | 3151.1 | 2041.0 | 64.8 | 1783.3 | 600.9 | 1180.8 | 77.9 | 19.2 | 56.6 |
| 2005 | 3162.3 | 2023.9 | 64.0 | 1744.6 | 600.5 | 1143.3 | 82.0 | 18.8 | 55.2 |
| Q1 | 3177.9 | 1999.4 | 62.9 | 1705.1 | 595.1 | 1108.7 | 80.3 | 19.7 | 53.7 |
| Q2 | 3148.7 | 2035.5 | 64.6 | 1763.2 | 604.5 | 1158.0 | 82.9 | 17.1 | 56.0 |
| Q3 | 3131.5 | 2011.8 | 64.2 | 1744.9 | 587.4 | 1156.7 | 81.2 | 18.8 | 55.7 |
| Q4 | 3191.1 | 2048.8 | 64.2 | 1765.1 | 614.8 | 1149.9 | 83.9 | 19.4 | 55.3 |
| 2006 | 3159.5 | 1968.8 | 62.3 | 1700.5 | 583.1 | 1116.2 | 83.2 | 17.6 | 53.8 |
| Q1 | 3169.8 | 1925.1 | 60.7 | 1643.1 | 586.2 | 1055.5 | 82.9 | 17.1 | 51.8 |
| Q2 | 3138.7 | 1952.3 | 62.2 | 1699.9 | 566.9 | 1130.4 | 83.8 | 16.2 | 54.2 |
| Q3 | 3113.0 | 1960.5 | 63.0 | 1691.5 | 574.8 | 1116.2 | 83.5 | 19.4 | 54.3 |
| Q4 | 3216.3 | 2037.4 | 63.3 | 1767.4 | 604.2 | 1162.7 | 82.4 | 17.6 | 55.0 |
| 2007 | | | | | | | | | |
| Q1 | 3397.4 | 1993.4 | 59.0 | 1658.6 | 604.7 | 1053.7 | 82.6 | 17.4 | 49.0 |
| Q2 | 3389.4 | 2043.9 | 60.3 | 1735.6 | 664.6 | 1071.1 | 83.5 | 16.6 | 51.2 |

*Source: Department for Statistics, Ministry of Economic Development and GEPLAC calculation*
*Note: *ILO "strict" methodology*

The labour force participation rate declined in H1 2007 as compared to the previous year persistently following the downward trend of the last years. The total employment share in labour force shrank, and hired employment share in total employment grew. Despite the further decrease in the self-employment share, income generated from this activity was still quite important for many Georgian households.

Those engaged in hired labour comprised 19.6 percent of the adult population with their nominal monthly salaries on an upward trend. Whilst salaries in the public sector grew more rapidly, those in the private sector still were higher. Both the inflation rate and the minimum subsistence level were growing. The unemployment rate in Q2 2007 grew in annual terms.

The labour force participation rate continued its decline during H1 2007 which was in line with the trend established over the last several years. It is a likely reflection of the instances of long-term unemployment when "discouraged" workers having lost hope are hardly seeking job and gradually fall out of the labour force. The labour force participation rate in Q2 2007, having fallen considerably by 1.9 percentage points as compared to a year ago, grew by 0.4 percentage points against Q1 which, as a usual seasonal increase, was much smaller this time than in previous years.

The share of total employment in total labour force shrank by as much as 2.3 percentage points over a year in Q2 2007 and grew by 1.7 percentage points in quarterly terms. It grew, however, in absolute terms both annually and quarterly.

The hired employment share in total employment continued to grow as compared to a year and a quarter ago which is an obvious sign of changing employment patterns wherein the labour force participation rate is shrinking whilst the absolute employment figures are growing apparently as a result of the growth in the number of hired employment opportunities. This overall picture is a reflection of better job creation with more opportunities for employment likely to be found in the private sector rather than the public sector wherein the number of jobs overall has been diminishing.

The self-employment share respectively was decreasing both in annual and quarterly terms by the same percentage points. In absolute terms, however, it grew seasonally which suggested that whilst more people found hired jobs, there was still the vital necessity of engaging in self-employment in order to off set the effects of growing prices which cannot typically be met by a one-income household.

Whilst both the labour force participation rate and the share of employment in total labour force decreased, this occurred against the background of total employment which also grew in absolute terms alongside a growth in the number of the total economically active population. This suggest, that more jobs were available for this age group whose numbers increased this time apparently due to demographic factors.

**Table 18: Unemployment (thousand persons)**

| | Total population over 15 years old | Unemployment * | | Unemployment rate (%) * | | Non-active population between the ages of 15-70* | |
|---|---|---|---|---|---|---|---|
| | | Total | Unemployment Rate (%) * | Amongst people of working age ** | Amongst people older than working age ** | Total | Employed in household |
| 2000 | 3148.1 | 212.2 | 10.3 | 12.2 | 2.6 | 898.8 | 265.0 |
| 2001 | 3191.1 | 235.6 | 11.1 | 13.4 | 1.8 | 872.4 | 250.5 |
| 2002 | 3239.5 | 265.0 | 12.6 | 14.9 | 2.2 | 910.0 | 280.2 |
| 2003 | 3104.9 | 235.9 | 11.5 | 13.4 | 2.3 | 847.1 | 257.3 |
| 2004 | 3151.1 | 257.6 | 12.6 | 14.9 | 1.8 | 895.4 | 257.1 |
| 2005 | 3162.3 | 279.3 | 13.8 | 16.3 | 0.9 | 913.6 | 248.5 |
| Q1 | 3177.9 | 294.3 | 14.7 | 17.3 | 2.3 | 941.5 | 258.8 |
| Q2 | 3148.7 | 272.3 | 13.4 | 15.9 | 1.3 | 902.5 | 241.0 |
| Q3 | 3131.5 | 266.9 | 13.3 | 15.7 | 0.8 | 911.7 | 244.9 |
| Q4 | 3191.1 | 283.7 | 13.8 | 16.1 | 2.7 | 898.6 | 249.4 |
| 2006 | 3159.5 | 268.5 | 13.6 | 15.8 | 0.9 | 957.6 | 259.4 |
| Q1 | 3169.8 | 282.0 | 14.6 | 16.5 | 0.5 | 993.4 | 279.1 |
| Q2 | 3138.7 | 252.4 | 12.9 | 14.3 | 1.1 | 953.2 | 242.1 |
| Q3 | 3113.0 | 269.0 | 13.7 | 15.4 | 0.4 | 921.3 | 253.0 |
| Q4 | 3216.3 | 270.4 | 13.3 | 17.1 | 1.6 | 962.3 | 263.4 |
| 2007 | | | | | | | |
| Q1 | 3397.4 | 305.6 | 15.3 | 19.2 | 2.9 | 948.7 | 265.5 |
| Q2 | 3389.4 | 308.3 | 14.9 | 18.8 | 0.8 | 968.8 | 244.0 |

*Source: Department for Statistics, Ministry of Economic Development and GEPLAC calculation*
*Note: *ILO "strict" methodology*
***Working age is given as 15-60 for women and 15-65 for men*

The ILO "strict" methodology unemployment rate in Q2 2007 grew by 2 percentage points as compared to Q2 of the previous year and decreased by 0.4 percentage points against the quarter before. Whilst the seasonal fluctuation of the unemployment rate usually results in a lower level of this indicator in the second quarter of a year as compared to the first quarter, there was only a slight decrease in this period with an overall considerable growth rate in annual terms.

**Table 19: Wages (GEL)**

| | Average monthly wages and salaries | Average nominal monthly wages and salaries share in minimum subsistence | | Nominal monthly wages and salaries | |
|---|---|---|---|---|---|
| | | of a working man (%) | of a family of four (%) | Pubic sector including budgetary organisations | Private sector |
| 2000 | 72.5 | 62.9 | 35.9 | 54.0 | 106.1 |
| 2001 | 82.6 | 70.0 | 39.9 | 63.0 | 120.6 |
| 2002 | 99.1 | 79.0 | 45.0 | 77.6 | 139.4 |
| 2003 | 101.5 | 77.7 | 44.3 | 79.3 | 145.8 |
| 2004 | 116.4 | 84.9 | 48.4 | 93.7 | 160.0 |
| 2005 | 149.3 | 98.0 | 56.1 | 130.9 | 184.0 |
| Q1 | 128.0 | 84.2 | 47.9 | 108.3 | 162.9 |
| Q2 | 146.1 | 96.5 | 55.0 | 124.0 | 182.4 |
| Q3 | 156.4 | 102.4 | 58.9 | 142.9 | 184.8 |
| Q4 | 166.7 | 109.1 | 62.7 | 148.3 | 206.1 |
| 2006 | 190.2 | 184.3 | 104.1 | 167.5 | 235.1 |
| Q1 | 171.2 | 182.6 | 103.1 | 155.6 | 211.9 |
| Q2 | 188.9 | 187.1 | 105.6 | 161.8 | 233.8 |
| Q3 | 193.2 | 185.4 | 104.6 | 163.2 | 242.7 |
| Q4 | 207.4 | 182.2 | 103.1 | 189.3 | 252.1 |
| 2007 | | | | | |
| Q1 | 223.3 | 186.7 | 119.6 | 205.4 | 255.6 |
| Q2 | 227.1 | 186.8 | 105.4 | 209.2 | 257.5 |

*Source: Department for Statistics, Ministry of Economic Development and GEPLAC calculation*

The average monthly nominal salary of hired workers across the economy has been on the upward trend. The inflation rate and minimum subsistence level have also been growing. The growth of nominal salary and that of minimum subsistence have been largely comparable since the beginning of 2006. The former, however, grew more substantially than the latter in Q2 2007 as compared to a year before. Despite a growth in the nominal salary level, that of the minimum subsistence level, on the contrary, decreased against the previous quarter.

Average monthly nominal salaries in the public sector grew substantially in annual terms. Whilst public sector salaries grew more rapidly than those in the private sector, the level of the latter remains substantially higher overall. The growth of salaries in the private sector is naturally labour-market driven and, therefore, is much less substantial than that in the public sector.

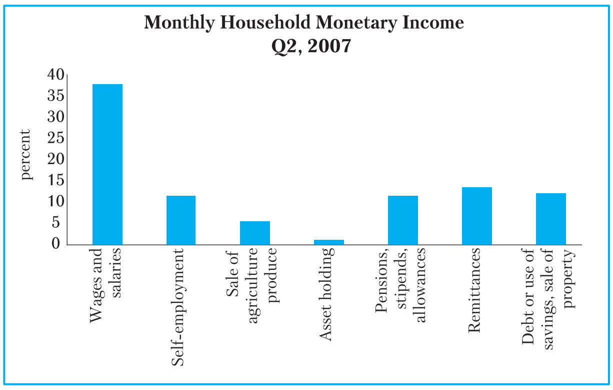
**Table 20: Monthly Household Monetary Income (GEL)**

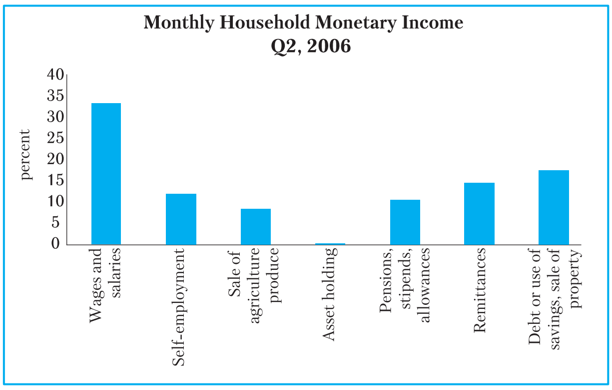
| | Wages and salaries | Self-employment | Income from sale of agricultural produce | Income from asset holdings | Pension, stipends, family allowances, benefits | Remittances | Debt or use of savings, sale of property | Total monetary income | Wages (% of total income) |
|---|---|---|---|---|---|---|---|---|---|
| 2000 | 43.9 | 21.6 | 20.9 | 1.3 | 8.5 | 11.9 | 26.9 | 135.0 | 32.5 |
| 2001 | 52.7 | 24.3 | 21.4 | 1.6 | 12.3 | 18.1 | 18.6 | 149.0 | 35.4 |
| 2002 | 57.5 | 28.9 | 28.9 | 1.0 | 12.2 | 23.6 | 44.4 | 196.5 | 29.3 |
| 2003 | 60.4 | 32.2 | 30.8 | 1.6 | 8.3 | 38.6 | 41.7 | 213.7 | 28.3 |
| 2004 | 67.4 | 36.6 | 34.3 | 2.3 | 15.6 | 34.1 | 42.7 | 232.9 | 28.9 |
| 2005 | 87.5 | 39.5 | 32.1 | 3.3 | 25.6 | 36.6 | 43.1 | 267.6 | 29.7 |
| Q1 | 73.9 | 41.1 | 31.1 | 3.6 | 22.2 | 34.7 | 40.5 | 247.0 | 29.9 |
| Q2 | 87.3 | 41.5 | 24.5 | 3.1 | 26.8 | 32.7 | 36.9 | 252.7 | 34.6 |
| Q3 | 90.6 | 39.7 | 28.6 | 3.1 | 25.5 | 37.5 | 40.2 | 265.2 | 28.1 |
| Q4 | 98.0 | 35.7 | 44.2 | 3.4 | 27.8 | 41.4 | 54.9 | 305.4 | 26.0 |
| 2006 | 107.2 | 40.7 | 32.2 | 1.5 | 32.5 | 43.0 | 46.9 | 303.8 | 27.8 |
| Q1 | 95.9 | 35.6 | 34.7 | 1.9 | 27.7 | 38.4 | 36.4 | 270.1 | 25.2 |
| Q2 | 103.8 | 37.8 | 26.3 | 0.9 | 32.8 | 45.5 | 54.8 | 301.6 | 27.8 |
| Q3 | 112.4 | 42.3 | 31.2 | 1.5 | 33.5 | 43.0 | 52.0 | 316.1 | 28.8 |
| Q4 | 116.7 | 47.2 | 36.5 | 1.5 | 36.1 | 45.2 | 44.4 | 327.5 | 29.4 |
| 2007 | | | | | | | | | |
| Q1 | 125.0 | 35.1 | 28.9 | 5.3 | 40.7 | 54.4 | 50.3 | 341.8 | 29.7 |
| Q2 | 133.8 | 41.0 | 19.9 | 4.1 | 40.8 | 47.9 | 42.8 | 333.2 | 33.0 |

*Source: Department for Statistics, Ministry of Economic Development*

The largest share of the monthly household monetary income is usually accounted for by wages and salaries. In Q2 2007, the share of this source of household monetary income in total household monetary income, having grown in annual as well as quarterly terms, was 40.2 percent as compared to 34.4 percent a year before. Income from remittances (14.4 percent of the total) shrank as compared to the previous year (15 percent) as well as to the previous quarter although it moved up on the list to the second position which indicates the stability of the importance of income from remittances for household budgets.

The share of debt, the use of savings and the sale of property, at 12.8 percent, was in third place on the list of monetary income items, having moved down from second place a year before and decreasing as compared to the same period last year and to the previous quarter.




*Source: Department for Statistics, Ministry of Economic Development*

The share of monetary income from self-employment retained its fourth place on the list of monetary income sources, as in Q2 2006, at 12.3 percent. The share of self-employment generated income shrank in comparison to a year before and grew against the previous quarter.

Pensions, stipends, allowances and benefits, which typically occupy a lower position on the list of monetary income sources, remained in fifth place. The share of this item, however, grew in both annual and quarterly terms from 10.9 percent in Q2 2006 to 12.2 percent during this period.

The share of income from the sale of agricultural produce was in last place having decreased both in annual and quarterly terms and comprising 5.9 percent of the total against 8.7 percent during the previous year when it occupied the sixth place on the list of monetary income sources.

The share of the last item – income from asset holding – occupied a stable seventh position, as during the previous year, having grown from 0.3 to 1.2 percent although decreasing overall in comparison to its share during the previous quarter.

**Table 21: Monthly Household Monetary Expenditure (GEL)**

| | Total Monetary Expenditures* | Consumer expenditure (purchase of goods and services) | Food, beverages, tobacco | Clothing and footwear | Household goods | Healthcare | Electricity and heating | Transport | Education, culture and recreation | Other consumer expenditure | Savings and purchase of property |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2000 | 217.0 | 197.0 | 100.9 | 12.7 | 27.1 | 10.2 | 15.8 | 13.6 | 7.0 | 9.7 | 20.0 |
| 2001 | 222.6 | 201.8 | 106.7 | 12.2 | 25.6 | 11.5 | 17.1 | 12.4 | 7.3 | 9.2 | 20.6 |
| 2002 | 240.0 | 216.7 | 113.0 | 12.4 | 7.6 | 15.7 | 20.0 | 25.7 | 13.3 | 9.1 | 23.2 |
| 2003 | 245.9 | 219.8 | 116.8 | 13.3 | 7.6 | 13.8 | 20.0 | 22.2 | 6.2 | 19.9 | 26.1 |
| 2004 | 268.2 | 245.7 | 131.6 | 14.5 | 9.1 | 15.3 | 21.8 | 23.5 | 6.6 | 23.1 | 22.7 |
| 2005 | 287.0 | 265.5 | 133.9 | 14.9 | 9.8 | 19.5 | 26.1 | 27.0 | 7.9 | 26.5 | 21.5 |
| Q1 | 279.5 | 261.1 | 131.7 | 15.0 | 10.2 | 18.4 | 27.1 | 26.5 | 8.6 | 23.5 | 18.5 |
| Q2 | 273.7 | 257.4 | 132.0 | 12.9 | 8.7 | 20.3 | 22.9 | 27.3 | 9.0 | 24.2 | 16.4 |
| Q3 | 272.2 | 250.0 | 128.6 | 13.3 | 9.2 | 18.8 | 22.7 | 25.5 | 5.8 | 26.1 | 22.2 |
| Q4 | 322.3 | 293.3 | 143.3 | 18.2 | 10.9 | 20.3 | 31.7 | 28.6 | 8.1 | 32.2 | 29.0 |
| 2006 | 314.8 | 289.7 | 146.6 | 15.0 | 10.3 | 23.4 | 29.9 | 26.8 | 9.5 | 28.2 | 25.1 |
| Q1 | 281.0 | 262.2 | 131.6 | 14.7 | 10.4 | 19.4 | 30.2 | 22.2 | 9.1 | 24.6 | 18.8 |
| Q2 | 316.2 | 276.2 | 139.5 | 12.2 | 9.5 | 26.2 | 23.8 | 29.4 | 10.0 | 25.6 | 40.0 |
| Q3 | 307.3 | 285.2 | 150.1 | 12.9 | 10.2 | 23.4 | 27.2 | 27.7 | 6.6 | 27.0 | 22.1 |
| Q4 | 354.6 | 335.1 | 165.2 | 20.5 | 11.2 | 24.6 | 38.1 | 27.9 | 12.1 | 35.4 | 19.5 |
| 2007 | | | | | | | | | | | |
| Q1 | 353.8 | 327.9 | 153.3 | 15.0 | 12.4 | 32.0 | 39.8 | 29.7 | 14.6 | 31.1 | 25.9 |
| Q2 | 329.5 | 302.4 | 150.7 | 13.1 | 10.3 | 25.8 | 33.8 | 27.3 | 12.9 | 28.6 | 27.1 |

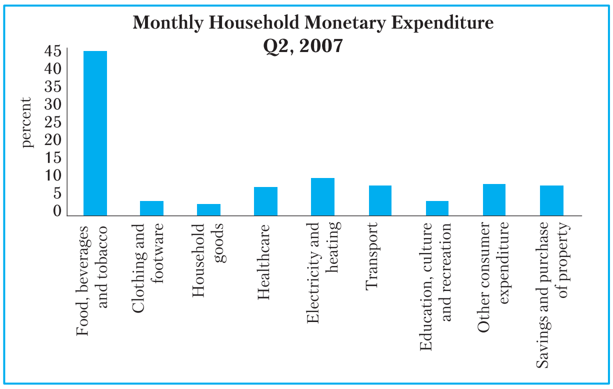
*Source: Department for Statistics, Ministry of Economic Development*
*Note: *Total expenditures in this table do not include agricultural expenditures and transfers*

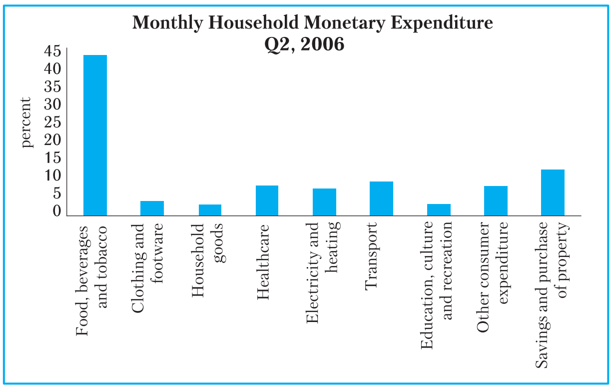
Expenditures on consumer goods and services usually account for the majority of household expenditures in Georgia. Household expenditures falling under this category within this period accounted for 91.8 percent of the total monetary household expenditures against 87.3 percent as compared to a year before. The largest item in this category that is also usually the largest of all monetary expenditures is represented by expenditures on food, beverages and tobacco with its share during this period growing in both annual and quarterly terms to 45.6 percent as compared to 44.1 percent in the previous year. These expenditures also grew in absolute terms which reflected the growing prices of food products.

The share of expenditures on electricity and heating appeared next in the list of monetary household expenditures, having moved up from its six place a year before and increasing from 7.5 percent in Q2 2006 to 10.3 percent in Q2 2007. The share, however, shrank against the indicator of the previous quarter. This pattern likely reflects the increase in the prices of electricity and fuel as well as the seasonally changing demand for heating.

“Other consumer expenditures” occupied the third largest of all the monetary household expenditures as compared to its fifth position in the same period of the previous year. Its share grew to 8.7 percent from 8.1 percent a year before but showed an overall decrease as compared to the previous quarter.

Transport expenditures moved down on the list from the third largest monetary expenditure item a year before to the fourth largest during this period at 9.3 percent and 8.3 percent, respectively. The share of this item also decreased slightly as compared to the previous quarter.




*Source: Department for Statistics, Ministry of Economic Development*

Expenditures on savings and the purchase of property went down from its second position a year before to the fifth position this time (correspondingly 12.7 and 8.2 percent) although it grew in comparison to the previous quarter.

The share of the expenditures on healthcare, having yielded its former fourth position to transport, moved down to the sixth position on the list of monetary expenditures which reflects the pressing need of meeting other requirements first. This item accounted for 7.8 percent of the total monetary expenditures during this period as compared to 8.3 percent a year before whilst showing an overall decrease as compared to the previous quarter.

Clothing and footwear appeared in a stable seventh place on list with a slight growth in annual terms from 3.9 to 4 percent and an overall decrease as compared to the previous quarter. The share of expenditures on education, culture and recreation retained its eighth position and grew from 3.2 percent a year before to 3.9 percent during this period and showed only an insignificant decreased over the quarter.

Household goods again occupied the last item on the list which suggests that Georgian households address these requirements based only upon residual principle. The share of this item remained virtually unchanged in annual terms but showed a reduction compared to the previous quarter.

## 5. EXTERNAL SECTOR

### Table 22: Main Components of External Economic Relations (million USD)

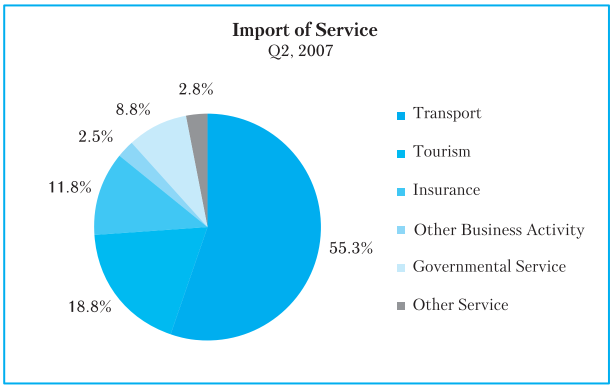
| | Trade Balanceof Goods and Services | Current Account Balance | Current Account Balance (GDP %) | Net Foreign Direct Investments | Portfolio Investments | Change in Gross International Reserves | International Reserves by Import Months | Total Foreign Debt (GDP %) |
|---|---|---|---|---|---|---|---|---|
| 2000 | -533.7* | -161.2 | -5.3 | 131.7 | 2.7 | -28.4* | 1.4 | 50.9 |
| 2001 | -472.3 | -211.4 | -6.6 | 109.9 | 2.0 | 45.9* | 1.9* | 50.0 |
| 2002 | -446.8* | -207.2* | -6.1* | 156.1* | 0.0 | 40.3* | 2.2* | 51.5 |
| 2003 | -578.5* | -375.6* | -9.4 | 330.9* | 0.0 | -6.0* | 1.6* | 45.9 |
| 2004 | -848.2* | -344.3* | -6.7 | 482.8* | -13.1 | 190.4* | 2.3 | 34.2 |
| 2005 | -1134.6* | -700.7* | -10.9* | 542.3* | 15.5 | 92.0* | 2.1* | 27.1 |
| Q1 | -193.6 | -119.2* | -8.7* | 86.1* | 5.6 | -2.2* | 2.3* | 28.8 |
| Q2 | -216.1 | -136.4* | -8.8* | 196.9* | 2.9 | 58.2* | 2.5* | 27.4 |
| Q3 | -320.4 | -187.8* | -11.2* | 79.6* | 7.0 | 8.0* | 2.2* | 27.2 |
| Q4 | -404.5 | -257.1* | -14.2* | 179.7* | 0.0 | 28.0* | 2.1* | 27.1 |
| 2006 | -1845.5 | -1154.1* | -14.9* | 1075.6* | 115.6 | 452.2 | 3.0* | 21.3 |
| Q1 | -311.6 | -192.0* | -12.3* | 143.8* | 0.0 | 4.9 | 2.0* | 22.8 |
| Q2 | -471.8 | -320.2* | -17.2* | 300.1* | 0.0* | 63.4 | 2.0* | 23.0 |
| Q3 | -544.0* | -347.1* | -16.8* | 277.9* | -3.4 | 83.6 | 2.1 | 22.3 |
| Q4 | -518.0* | -294.7* | -12.9* | 353.8* | 119.0* | 300.3 | 3.0* | 21.3 |
| 2007 | | | | | | | | |
| Q1 | -555.2 | -380.3* | -19.1* | 282.3* | -20.2 | 88.2 | 3.1* | 21.4 |
| Q2 | -500.2 | -426.4 | -17.5 | 360.4 | 8.0 | 201.7 | 3.5 | 19.2 |

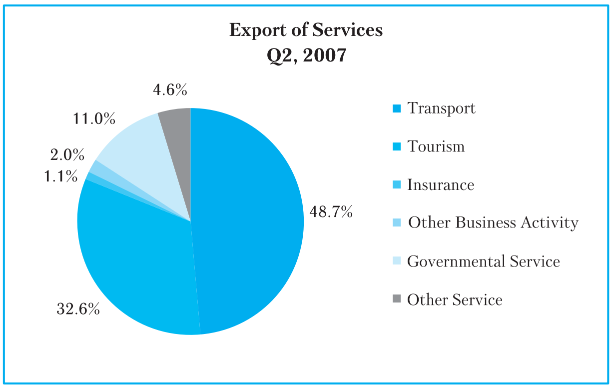
*Source: NBG*
*Note: *Verified data*

As a downward trend in the current account balance persisted in Q2, 2007, its deficit showed high annual and quarterly growth rates. According to the trade statistics, the diversification of exports resulted in a sharp increase in exports as compared to both the same period last year and the previous quarter by 44.2 and 35.6 percent, respectively. It is also noteworthy that the annual and quarterly growth rates of imports significantly lagged behind the corresponding export indicators according to the balance of payments and caused a USD 4.2 million quarterly improvement of the trade balance of goods.

The current account balance was overall adversely affected by the trade balance of goods and the income balance. The deterioration of the latter in annual and quarterly terms was associated with the outflow of money in the form of investment revenues from the country. As a result, the current account deficit of the balance of payment against the GDP deteriorated in annual terms although it improved by 1.9 percent as compared to the previous quarter.

Revenues from transportation comprised 49 percent of external revenues of the service sector. Transportation costs on the part of Georgia, however, reached 55.3 percent of all the service expenditure. Additionally, the revenues from pipeline transportation doubled in annual terms and reached USD 49.1 million. Rail transportation also showed a positive balance. It should be further noted that the road, air and sea transportation indicators continued to show a negative balance.




*Source: NBG*

Under the influence of a seasonality factor, net foreign revenues from business and personal travel exceeded the corresponding indicator of the transportation service by almost 2.5 times. A growth trend in the revenues from government service was maintained in annual terms but decreased by USD 1.2 million in quarterly terms. The insurance service deficit increased by an annual USD 4.3 and the quarterly USD 2.6 million due to the increase in expenditure on cargo insurance and transportation.

The income of Georgian citizens employed abroad showed high annual and modest quarterly growth rates. Nonetheless, an impressive increase in the share of foreigners' profits and dividends from direct investments caused a sharp deterioration of the income account in both annual and quarterly terms in the reviewed period.

Remittances from abroad increased by USD 23.2 million as compared to the same period last year and by USD 10.8 million as compared to the previous quarter which thereby supplied the Georgian population with an additional USD 55.5 million. As regards the governmental and international grants, their volume decreased by 40 percent as compared to Q2, 2006 and halved as compared to the previous quarter. As a result, the current transfer account notably improved and reached USD 150 million.

The annual and quarterly development of the capital account was marked with a high growth rate of which the largest part was again represented by governmental capital grants and migrants' capital transfers.

A positive balance of the financial account was ensured by direct foreign investments with its volume showing an annual 19 percent and quarterly 28 percent increase which was supported by the privatisation process. Almost half of investments accounted for the means invested in equity whilst 12.5 percent accounted for reinvestments.

The largest investment flows came from the Czech Republic during the reviewed period and comprised USD 73.9 million. The second largest investor was Kazakhstan whilst the Netherlands and the USA occupied the third and fourth positions. 36.8 percent of investments made in the energy sector. The service sector attracted USD 95.9 million worth of investments. Significant investments were also made in the construction and manufacturing sectors with inputs of USD 72.8 and USD 53.6 million, respectively, and with American and Kazakh capitals prevailing.

A positive balance of the capital and financial account in the reviewed period ensured the financing of current foreign liabilities. At the same time, international reserves showed an impressive increase in annual and quarterly terms by 3.2 and 2.3 times, respectively.

**Table 23: Imports Structure by Main Commodity Groups**

| | Total imports | | Oil and oil products | | Motorcars | | Oil gases and hydro-carbons | | Pharma-ceuticals | | Telephone, radio and TV equipment | | Wheat and meslin | | Computers and units thereof | | Other | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | mln USD | % | mln USD | % | mln USD | % | mln USD | % | mln USD | % | mln USD | % | mln USD | % | mln USD | % | mln USD | % |
| 2000 | 709.4 | 100 | 71.8 | 10.1 | 15.5 | 2.2 | 50.3 | 7.1 | 45.8 | 6.5 | 17.0 | 2.4 | 29.2 | 4.1 | 1.3 | 0.2 | 478.5 | 67.5 |
| 2001 | 753.2 | 100 | 87.7 | 11.6 | 13.1 | 1.7 | 48.8 | 6.5 | 53.6 | 7.1 | 9.0 | 1.2 | 14.4 | 1.9 | 2.2 | 0.3 | 524.4 | 69.7 |
| 2002 | 795.5 | 100 | 88.8 | 11.2 | 21.9 | 2.8 | 52.4 | 6.6 | 62.0 | 7.8 | 17.3 | 2.2 | 20.1 | 2.5 | 5.0 | 0.6 | 528.0 | 66.3 |
| 2003 | 1141.2 | 100 | 104.8 | 9.2 | 46.5 | 4.1 | 66.0 | 5.8 | 62.9 | 5.5 | 14.7 | 1.3 | 28.0 | 2.4 | 12.3 | 1.1 | 806.0 | 70.6 |
| 2004 | 1847.9* | 100 | 186.2 | 10.1 | 116.3 | 6.3 | 80.1 | 4.3 | 78.0 | 4.2 | 16.2 | 0.9 | 75.0 | 4.1 | 15.7 | 0.8 | 1280.4 | 69.3 |
| 2005 | 2490.9* | 100 | 336.3 | 13.5 | 178.5 | 7.2 | 90.8 | 3.6 | 92.5 | 3.7 | 27.1 | 1.1 | 45.1 | 1.8 | 22.4 | 0.9 | 1698.2 | 68.2 |
| Q1 | 454.4* | 100 | 56.8 | 12.5 | 28.6 | 6.3 | 28.4 | 6.3 | 23.3 | 5.1 | 4.3 | 0.9 | 8.2 | 1.8 | 4.7 | 1.0 | 300.2 | 66.1 |
| Q2 | 527.3 | 100 | 74.0 | 14.0 | 36.5 | 6.9 | 19.2 | 3.6 | 28.0 | 5.3 | 7.1 | 1.4 | 9.9 | 1.9 | 5.5 | 1.0 | 347.1 | 65.9 |
| Q3 | 687.7* | 100 | 104.1 | 15.1 | 48.1 | 7.0 | 14.4 | 2.1 | 18.4 | 2.7 | 9.4 | 1.4 | 12.3 | 1.8 | 5.2 | 0.7 | 475.8 | 69.2 |
| Q4 | 821.5* | 100 | 101.4 | 12.3 | 65.3 | 79.9* | 28.9 | 3.5 | 22.8 | 2.8 | 6.3 | 0.8 | 14.8 | 1.8 | 7.1 | 0.9 | 574.9 | 70.0 |
| 2006 | 3681.2* | 100 | 443.1 | 12.0 | 295.3 | 8.0 | 213.1 | 5.8 | 114.5 | 3.1 | 58.7 | 1.6 | 99.1 | 2.7 | 46.4 | 1.3 | 2411.0 | 65.5 |
| Q1 | 682.7* | 100 | 80.8 | 11.8 | 65.5 | 9.6 | 57.4 | 8.4 | 25.4 | 3.7 | 8.1 | 1.2 | 16.9 | 2.5 | 8.0 | 1.2 | 420.6 | 61.6 |
| Q2 | 887.2* | 100 | 122.5 | 13.8 | 72.8 | 8.2 | 44.7 | 5.0 | 31.1 | 3.5 | 12.5 | 1.4 | 20.7 | 2.3 | 10.3 | 1.2 | 572.6 | 64.6 |
| Q3 | 1023.3* | 100 | 142.1 | 13.9 | 70.2 | 6.9 | 40.6 | 4.0 | 25.5 | 2.5 | 18.6 | 1.8 | 26.9 | 2.6 | 14.2 | 1.4 | 685.2 | 66.9 |
| Q4 | 1088.0* | 100 | 97.7 | 9.0 | 86.9 | 8.0 | 70.4 | 6.5 | 32.6 | 3.0 | 19.5 | 1.8 | 34.4* | 3.2 | 14.0 | 1.3 | 732.4 | 67.3 |
| 2007 | | | | | | | | | | | | | | | | | | |
| Q1 | 1045.6 | 100 | 97.0 | 9.3 | 79.1 | 7.6 | 116.8 | 11.2 | 36.5 | 3.5 | 13.9 | 1.3 | 26.4 | 2.5 | 14.1 | 1.3 | 661.8 | 63.3 |
| Q2 | 1183.8 | 100 | 131.2 | 11.1 | 88.5 | 7.5 | 60.5 | 5.1 | 32.4 | 2.7 | 29.8 | 2.5 | 26.9 | 2.3 | 20.1 | 1.7 | 794.4 | 67.1 |

*Source: Department for Statistics, Ministry of Economic Development*
*Note: * Verified data*

As a result of a further increase in the demand for imported consumer goods and investment commodities, the import volume showed a sharp annual and quarterly increase in the analysed period. Additionally, the import structure has undergone some changes with TV-radio equipment becoming one of the largest commodity categories in contrast to the previous year's corresponding period and that of the previous quarter. Moreover, due to the seasonality factor, the natural gas supply almost halved in quarterly terms.

In Q2, 2007, the value of oil and oil products import increased by 7.1 percentage points as compared to the same period last year. Accordingly, the volume of imported oil products in natural terms increased by a mere 4.2 tons. In quarterly terms, however, this commodity category showed a sharp 35.5 percent increase which can be attributed to the growth of a seasonal demand for this product.

The largest supplier of oil products was Azerbaijan although its share decreased from 52.3 percent in Q2, 2006 to 31.2 percent which can be explained by the increase in the share of oil products imported from Bulgaria, Romania and Greece. It is also worth noting that the value of oil products from Turkmenistan increased by 70 percent in quarterly terms.

The value of motorcar imports in the reviewed period showed a high annual growth rate which was the result of the increase in prices rather than in the physical number of motorcars. 37 percent of this commodity category was imported from Germany with the USA and Japan as the second and the third largest suppliers with their respective shares of 21.2 and 14.1 percent.

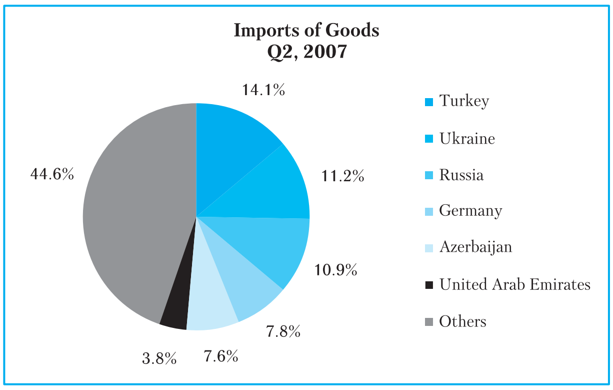
Due to a seasonal decrease in the supply of natural gas, this commodity group downgraded form the first to the third position as compared to the previous period. The annual increase in import of oil gases comprised 35.5 percent which was conditioned by the rise in prices for natural gas. At the same time, the import of this commodity category from Azerbaijan increased by more than 16 times in annual terms. Oil gases supplied from Russia accounted for 60 percent of the market demand.

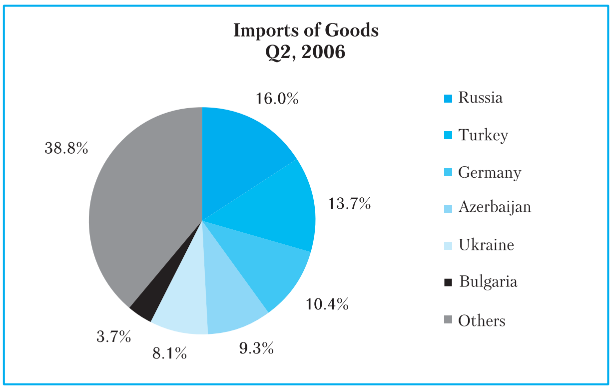
Pharmaceuticals continued to be a larger import commodity in Q2, 2007. The import of this commodity showed an insignificant annual increase and a quarterly 11.2 percent decrease. The share of pharmaceuticals in total imports, therefore, decreased as compared to a year ago and to the previous quarter. The circle of suppliers of this commodity group was quite diversified with Hungary, France, Ukraine and Turkey being distinguished within.

The imports of TV and radio equipment doubled in annual terms and increased by 2.1 times in quarterly terms. If the largest suppliers of this commodity category in previous quarters were the United Arab Emirates, the USA and Turkey, this time they came to be replaced by Sweden with the 46.1 percent share.

The volume of wheat imports increased somewhat in annual terms and decreased in quarterly terms. The value indicator of the wheat imported from Russia exceeded that from Kazakhstan by 2.4 times.

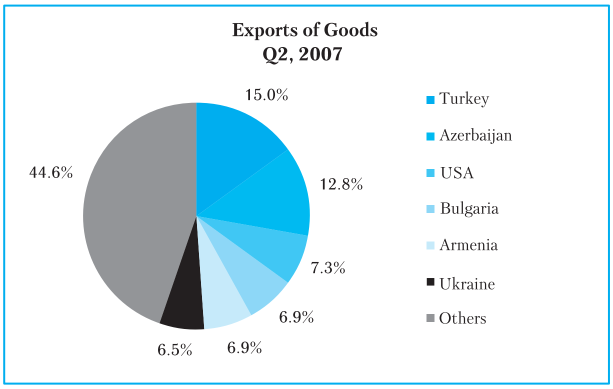
The analysed period again saw an intensive inflow of computers with their value almost doubling as compared to a year ago and increasing by 42.5 percent as compared to the previous quarter. The largest importer of this commodity group was the Netherlands.

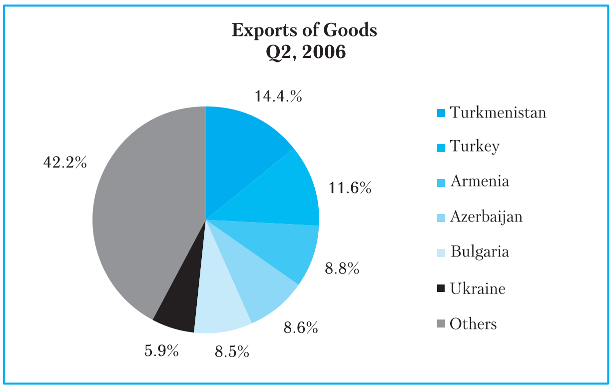



*Source: Department for Statistics, Ministry of Economic Development*

In Q2, 2007, the share of the top six importer countries in total imports comprised 55.4 percent. The value of imports from Turkey showed a notable increase in both quarterly and annual terms. The flow of goods from Ukraine also increased sharply with Russia ranking third amongst the largest importers. Wheat, natural gas and oil products continued to be the main commodity categories imported from this country.




*Source: Department for Statistics, Ministry of Economic Development*

The analysed period saw high annual and quarterly growth rates of export revenues which, along with the economic growth, was the result of the search for new markets.

Q2, 2007 saw some changes in the geographical structure of the market. The shares of Turkey, Azerbaijan and the USA notably increased in total imports as compared to last year's corresponding period. Turkey advanced from the second to the first position, Azerbaijan from the fourth to the second position and the USA from the seventh to the third position whereas Turkmenistan fell from the first to the seventh position. Additionally, the top ten exporter countries no longer included Germany which now ranked twelfth in the list as compared to a year ago.

**Table 24: Exports Structure by Main Commodity Groups**

| | Total exports | | Ferroalloy | | Black metal scrap and waste | | Copper ore and concentrates | | Motorcars | | Cement | | Mineral, chemical, nitrogen fertilisers | | Processed or semi-processed gold | | Other | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | mln USD | % | mln USD | % | mln USD | % | mln USD | % | mln USD | % | mln USD | % | mln USD | % | mln USD | % | mln USD | % |
| 2000 | 322.7 | 100 | 13.6 | 4.2 | 39.0 | 12.1 | 9.8 | 3.1 | 0.3 | 0.1 | 0.5 | 0.2 | 16.2 | 5.0 | 0.0 | 0.0 | 243.3 | 75.3 |
| 2001 | 317.6 | 100 | 17.6 | 5.5 | 33.1 | 10.4 | 9.6 | 3.0 | 0.5 | 0.2 | 0.5 | 0.2 | 4.9 | 1.5 | 12.5 | 3.9 | 238.9 | 75.3 |
| 2002 | 345.9 | 100 | 15.5 | 4.5 | 36.5 | 10.5 | 13.2 | 3.8 | 0.6 | 0.2 | 0.0 | 0.0 | 12.0 | 3.5 | 28.6 | 8.3 | 239.5 | 69.2 |
| 2003 | 461.4 | 100 | 26.1 | 5.7 | 60.1 | 13.0 | 23.4 | 5.1 | 1.1 | 0.2 | 0.2 | 0.0 | 18.4 | 4.0 | 20.3 | 4.4 | 311.8 | 67.6 |
| 2004 | 646.9 | 100 | 42.5 | 6.6 | 95.9 | 14.8 | 31.8 | 4.9 | 3.8 | 0.6 | 4.7 | 0.7 | 28.8 | 4.5* | 18.8 | 2.9 | 420.6 | 65.0 |
| 2005 | 866.2* | 100 | 80.2 | 9.3 | 84.2 | 9.7 | 36.4 | 4.2 | 17.9 | 2.1 | 17.7 | 2.0 | 35.8 | 4.1 | 34.7 | 4.0 | 559.3 | 64.6 |
| Q1 | 170.3* | 100 | 21.4 | 12.6 | 28.0 | 16.4* | 14.0 | 8.2 | 1.5 | 0.9 | 0.6 | 0.3 | 4.9 | 2.9 | 6.3 | 3.7 | 93.6 | 55.0 |
| Q2 | 202.7 | 100 | 16.5 | 8.1 | 24.5 | 12.1 | 8.0 | 4.0* | 2.6 | 1.3 | 3.2 | 1.6 | 7.9 | 3.9 | 9.6 | 4.7 | 130.4 | 64.3 |
| Q3 | 225.1* | 100 | 20.3 | 9.0 | 19.2 | 8.5 | 9.3 | 4.1 | 5.4 | 2.4 | 7.1 | 3.2 | 9.1 | 4.0* | 9.6 | 4.3 | 145.1 | 64.5 |
| Q4 | 268.1 | 100 | 22.0 | 8.2 | 12.5 | 4.7 | 5.2 | 1.9 | 8.5 | 3.2 | 6.8 | 2.5 | 13.9 | 5.2 | 9.3 | 3.5 | 189.9 | 70.8 |
| 2006 | 992.6 | 100 | 89.8 | 9.0 | 72.4 | 7.3 | 79.5 | 8.0 | 50.6 | 5.1 | 28.8 | 2.9 | 46.6 | 4.7 | 49.4 | 5.0 | 575.5 | 58.0 |
| Q1 | 221.1 | 100 | 19.6 | 8.9 | 13.5 | 6.1 | 10.2 | 4.6 | 4.5 | 2.0 | 4.1 | 1.9 | 10.0 | 4.5 | 11.1 | 5.0 | 148.1 | 67.0 |
| Q2 | 236.0 | 100 | 20.1 | 8.5 | 20.3 | 8.6 | 23.0 | 9.8 | 9.5 | 4.0 | 7.4 | 3.1 | 9.0 | 3.8 | 11.8 | 5.0 | 134.9 | 57.2 |
| Q3 | 248.7 | 100 | 30.2 | 12.2 | 19.5 | 7.8 | 21.6 | 8.7 | 15.5 | 6.2 | 7.9 | 3.2 | 13.5 | 5.4 | 12.5 | 5.0 | 128.0 | 51.5 |
| Q4 | 286.8 | 100 | 19.9 | 6.9 | 19.1 | 6.7 | 24.7 | 8.6 | 21.2 | 7.4 | 9.4 | 3.3 | 14.2 | 5.0* | 13.9 | 4.8 | 164.4 | 57.3 |
| 2007 | | | | | | | | | | | | | | | | | | |
| Q1 | 225.2 | 100 | 18.1 | 8.0 | 20.8 | 9.2 | 21.0 | 9.3 | 13.1 | 5.8 | 9.2 | 4.1 | 14.3 | 6.4* | 9.4 | 4.2 | 119.3 | 53.0 |
| Q2 | 323.4 | 100 | 33.9 | 10.5 | 30.2 | 9.3 | 24.0 | 7.4 | 20.0 | 6.2 | 17.5 | 5.4 | 14.5 | 4.5 | 14.5 | 4.5 | 168.8 | 52.2 |

*Source: Department for Statistics, Ministry of Economic Development*
*Note: * Verified data*

In the reviewed period, the top seven export commodity categories significantly differed from the commodity composition of the corresponding period last year with ferroalloy now replacing flying apparatus in the first position. Cement also came to be one of the larger commodity groups. Cement and processed gold occupying the position of walnuts, ethyl alcohol and alcoholic beverages as compared to the previous quarter.

The broadening of an external demand for ferroalloy made this product the largest commodity group with its export 68.7 percent higher than the corresponding indicator a year ago and 87.2 percent higher than that of the previous quarter. The main consumers of ferroalloy were the USA, Mexico and Russia.

A negative tendency of the growth in black metal waste and scrap export persisted in Q2, 2007. Its annual growth comprised 48.8 percent whilst a quarterly indicator lagged behind by a mere 3.6 percent. Almost 86 percent of scrap was exported to Turkey.

Modest annual and quarterly growth rates were observed in the value indicator of the export of copper ore and concentrates. The main sales markets for this commodity category were Bulgaria and Germany. It should also be noted that the list of exporters no longer included Spain, Turkey and Serbia as compared to previous quarters.

The re-export of motorcars increased by 2.1 times in the reviewed period as compared to Q2, 2006. A quarterly increase, however, comprised 52.7 percent. 36 percent of the abovementioned commodity category went to Azerbaijan, 22 percent to the United Arab Emirates, 16.5 percent to Armenia and 10.5 percent to Turkey.

As a result of an impressive annual and quarterly increase in the demand for Georgian cement on the part of Azerbaijan, this commodity made itself into the top seven export commodity groups.

Nitrogen fertiliser exports showed a notable increase as compared to a year ago but only a small increase as compared to the previous quarter. In Q2, 2007, the list of consumers of this commodity category again included Brazil which accounted for 64 percent of exported fertilisers. The USA consumed 29 percent of this commodity.

Processed gold was amongst the larger export categories in the reviewed period with its annual growth comprising 22.9 percent whilst its quarterly growth was 54.2 percent. Traditionally, this commodity category was exported almost entirely to Canada.

**Table 25: Georgia's Foreign Trade with the CIS (million USD)**

| | Imports | | | Exports | | | Total balance | | |
|---|---|---|---|---|---|---|---|---|---|
| | Total | CIS | Other countries | Total | CIS | Other countries | Total | CIS | Other countries |
| 2000 | 709.4 | 229.3 | 480.1 | 322.7 | 128.5 | 194.2 | -386.6 | -100.8 | -285.8 |
| 2001 | 753.2 | 254.0 | 499.2 | 317.6 | 144.3 | 173.3 | -435.6 | -109.7 | -325.9 |
| 2002 | 795.5 | 292.2 | 503.3 | 345.9 | 168.7 | 177.2 | -449.6 | -123.5 | -326.1 |
| 2003 | 1141.2 | 370.1 | 771.1 | 461.4 | 224.8 | 236.6 | -679.8 | -145.3 | -534.5 |
| 2004 | 1847.9* | 657.2* | 1190.7 | 647.0* | 327.7* | 319.3 | -1200.9* | -329.5* | -871.4 |
| 2005 | 2490.9* | 997.7* | 1493.2 | 866.2* | 408.0* | 458.2* | -1624.7* | -589.7* | -1035.0* |
| Q1 | 454.4* | 181.0* | 273.4* | 170.3* | 62.4* | 107.9 | -284.1* | -118.6* | -165.5* |
| Q2 | 527.3 | 210.3 | 317.0 | 202.7 | 110.1 | 92.6 | -324.6* | -100.2 | -224.4* |
| Q3 | 687.7* | 287.1 | 400.6* | 225.1* | 97.7* | 127.4 | -462.6* | -189.4* | -273.2* |
| Q4 | 821.5* | 319.3* | 502.2 | 268.1 | 137.7 | 130.4 | -553.4* | -181.6* | -371.8* |
| 2006 | 3681.2* | 1404.6 | 2276.6* | 993.1* | 394.9 | 598.2* | -2688.1* | -1009.7 | -1678.4* |
| Q1 | 682.7 | 265.7 | 417.0 | 221.1 | 113.2 | 107.9 | -461.6 | -152.5* | -309.1* |
| Q2 | 887.2 | 346.6 | 540.6 | 236.0 | 106.2 | 129.8 | -651.2 | -240.4* | -410.8* |
| Q3 | 1023.3 | 398.5 | 624.8 | 248.7 | 81.9 | 166.8 | -774.6 | -316.6 | -458.0 |
| Q4 | 1088.0* | 393.8 | 694.2 | 287.3* | 93.6 | 193.7* | -800.7* | -300.2 | -500.5* |
| 2007 | | | | | | | | | |
| Q1 | 1045.6 | 395.8 | 649.8 | 225.2 | 87.3 | 137.9 | -820.4* | -308.5 | -511.9* |
| Q2 | 1183.8 | 422.8 | 761.0 | 323.4 | 125.9 | 197.5 | -860.4 | -296.9 | -563.5 |

*Source: Department for Statistics, Ministry of Economic Development*
*Note: *Verified data*

Q2, 2007 saw a sharp intensification of trade relations with CIS countries with a notable increase observed both in exports and imports as compared to the same period last year. Ukraine was the in the lead in terms of imports from these countries with Russia, Azerbaijan and Turkmenistan occupying the second, third and fourth positions, respectively.

It is also noteworthy that there was a 44.2 percent increase observed in exports to CIS countries whilst the increase in imports was limited to only 6.8 percent which should definitely be evaluated as a positive event. By exports, Azerbaijan was singled out with the highest share at 33 percent from amongst the CIS countries. Additionally, the shares of Armenia, Ukraine and Turkmenistan were also significant.

By the end of Q2, 2007, the amount of credits taken by the state and under the state guarantee comprised USD 1702.1 million. The total debt volume was reduced by USD 19.2 million as compared to the previous quarter which resulted from the decrease in liabilities to the IMF by USD 89.7 million and the debt to Turkmenistan by USD 17.2 million. At the same time, an upward trend persisted in the debt balance to the WB as well as to the EBRD which increased by almost USD 9.4 million in quarterly terms. It should also be noted that the decrease in the debt volume and a high nominal growth rate of the GDP ensured the 2.2 percentage point decrease in foreign debt against the GDP as compared to Q1, 2007.

# 6. EU-GEORGIA ECONOMIC RELATIONS

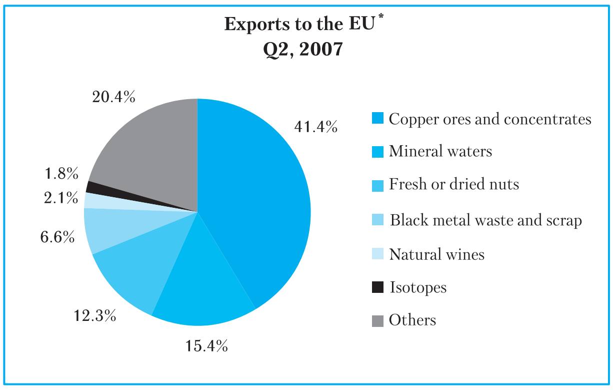
**Table 26: Main Indicators of Economic Relations between the EU and Georgia***

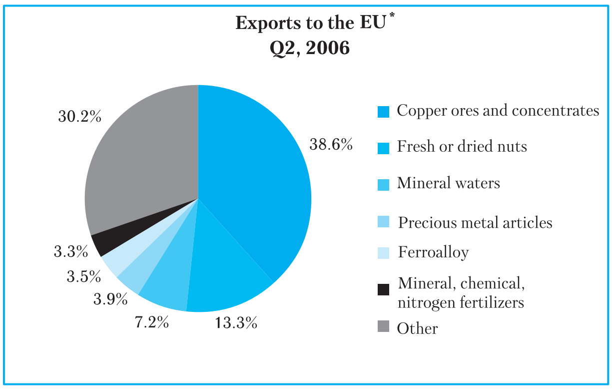
| | Trade | | | | | | FDI by EU countries | |
|---|---|---|---|---|---|---|---|---|
| | Turnover (thousand USD) | Exports (thousand USD) | Share in total exports (%) | Imports (thousand USD) | Share in total imports (%) | Balance (thousand USD) | Volume (thousand USD) | Share in total FDI (%) |
| 2000 | 264559.0 | 76389.1 | 23.7 | 188170.0 | 26.5 | -111780.9 | 39378.6** | 30.0** |
| 2001 | 302454.8 | 61604.9 | 19.4 | 240845.9 | 32.0 | -179241.0 | 69691.2** | 63.4** |
| 2002 | 295496.6 | 63220.5 | 18.3 | 232254.1 | 29.2 | -169033.6 | 58445.9 | 34.9 |
| 2003 | 512756.0 | 81589.6 | 17.7 | 431160.4 | 37.8 | -349570.8 | 95783.3** | 28.2 |
| 2004 | 785452.4 | 128204.3 | 19.8 | 657248.1 | 35.6 | -529043.8 | 195542.3** | 39.2 |
| 2005 | 957078.6 | 216755.7 | 25.0 | 740322.9 | 29.7 | -523567.2 | 243749.0 | 54.2 |
| Q1 | 183543.5 | 47007.0 | 27.7 | 136536.5 | 30.1 | -89529.5 | 38668.3 | 43.3 |
| Q2 | 197113.2 | 31340.7 | 15.4 | 165772.5 | 31.4 | -134431.8 | 44231.8 | 41.8 |
| Q3 | 277091.5 | 67812.2 | 30.2 | 209279.3 | 30.4 | -141467.1 | 49871.3 | 66.0 |
| Q4 | 299330.4 | 70595.8 | 26.3 | 228734.6 | 27.9 | -158138.8 | 110977.6 | 62.0 |
| 2006 | 1366121.6 | 256720.4 | 25.9 | 1109401.2 | 30.1 | -852680.8 | 407189.7 | 34.2 |
| Q1 | 256672.7 | 47057.8 | 21.3 | 209614.9 | 30.7 | -162557.1 | 40629.7 | 27.8 |
| Q2 | 329911.9 | 59646.8 | 25.3 | 270265.1 | 30.5 | -210618.3 | 108829.4 | 35.5 |
| Q3 | 370606.6 | 54164.8 | 21.8 | 316441.8 | 30.9 | -262277.0 | 72748.7 | 25.9 |
| Q4 | 408930.4 | 95851.0 | 33.4 | 313079.4 | 28.8 | -217228.4 | 184982.4 | 40.5 |
| 2007 | | | | | | | | |
| Q1 | 374420.2 | 63576.2** | 28.2 | 310844.0 | 29.7** | -247267.8** | 152238.6** | 53.2** |
| Q2 | 423223.6 | 58019.5 | 17.9 | 365204.1 | 30.8 | -307184.6 | 155136.4 | 41.9 |

*Source: Department for Statistics, Ministry of Economic Development*
*Note: *The above data covers the 25 EU member states until 2004. From 2004 onwards, the data covers the 27 member states to include Bulgaria and Romania*
*** Verified data*

The import diversification ensured the 28.3 percent increase in the EU-Georgia trade turnover in Q2, 2007 as compared to the same period last year. Nevertheless, the share of EU imports in the total imports grew insignificantly. The export development was, however, opposite and showed a decrease in the exports to the EU both in annual and quarterly terms with the shares in total exports decreasing by 7.4 and 10.3 percentage points, respectively.

The decrease in exports to the EU was attributed to the termination of ferroalloy and a notable reduction of nitrogen fertiliser, walnut, vegetable and fruit juice exports. As regards the geographical aspect, a significant annual and quarterly increase was observed in exports to Belgium, Bulgaria and the Netherlands whereas a sharp decrease was observed in that to Spain, Italy and Germany.




*Source: Department for Statistics, Ministry of Economic Development*
*Note: *The above data covers the 25 EU member states until 2004. From 2004 onwards, the data covers the 27 member states to include Bulgaria and Romania*

In the reviewed period, the EU countries continued to be exclusive consumers of copper ore and concentrates from Georgia. The export of this commodity showed a moderate annual and a notable quarterly increase. It is also noteworthy that, in contrast to the same period in 2006 and the previous quarter, the group of consumers of this commodity category no longer included Spain which, in Q1, 2007, accounted for 38 percent of copper ore and concentrate exports.

The second quarter, as compared to last year's corresponding period, saw a sharp increase (by 55 percent) in the export of mineral water. The United Kingdom and Belgium were the consumers of 88.7 percent of this commodity type.

The decrease in walnut exports was observed in the reviewed period and comprised an annual 10.3 and a quarterly 24.2 percent. This was caused by a sharp drop in the export of this commodity to Italy which was not offset by quite an impressive rise in walnut exports (by 8.2 times and 2.1 times, respectively) to Belgium.

The export of black metal waste and scrap to EU countries was 3.2 times higher than in the same period last year and resulted in a notable increase of the share of this commodity in exports to the EU. There was also quite a significant quarterly growth rate of this commodity which comprised 30.5 percent. The main consumers of black metal waste and scrap were Spain, the Netherlands, Germany and the United Kingdom.

Natural wines came to be amongst the main export categories to the EU in Q2, 2007. The wine exports increased by 2.4 times in annual terms and by 19.1 percent in quarterly terms. Nonetheless, the value of Georgian wine exports to the EU was less by almost three times than the corresponding indicator of Ukraine, the largest importer of this commodity from Georgia, although it somewhat exceeded that of Kazakhstan which is in second place to Ukraine.

**Table 27: Exports from Georgia to EU Countries (thousand USD)**

| | 2006 | | | | 2006 | 2007 | |
|---|---|---|---|---|---|---|---|
| | Q 1 | Q2 | Q 3 | Q4 | | Q1 | Q2 |
| Total exports to the EU | 47057.8 | 59646.8 | 54164.8 | 95851.0 | 256720.4 | 63576.2* | 58019.5 |
| of which: | | | | | | | |
| Austria | 1344.2 | 6.1 | 107.0 | 340.7 | 1798.0 | 44.0 | 171.3 |
| Belgium | 929.1 | 2239.6 | 3500.6 | 4343.5 | 11012.8 | 3957.2 | 5267.5 |
| Bulgaria | 11569.3 | 20175.2 | 18346.9 | 12216.2 | 62307.6 | 7924.6 | 22338.1 |
| Cyprus | 39.9 | 431.8 | 35.6 | 292.2 | 799.5 | 78.9 | 62.6 |
| Czech Republic | 1203.9 | 1238.6 | 1019.5 | 2748.7 | 6210.7 | 861.9 | 496.5 |
| Denmark | 555.8 | 6.2 | 0.8 | 84.0 | 646.8 | 280.9 | 23.0 |
| Estonia | 1026.3 | 239.0 | 182.0 | 436.6 | 1883.9 | 332.4 | 132.7 |
| Finland | 0.5 | 0.7 | 25.7 | 157.7 | 184.6 | 44.8 | 3.8 |
| France | 428.9 | 2898.7 | 4249.5 | 23306.8 | 30883.9 | 4655.3 | 901.9 |
| Germany | 6872.4 | 10890.3 | 6804.6 | 21078.0 | 45645.3 | 11751.8 | 9469.7 |
| Greece | 326.0 | 192.7 | 1670.3 | 3315.0 | 5504.0 | 4049.5 | 655.9 |
| Hungary | 0.0 | 0.0 | 0.0 | 138.6 | 138.6 | 37.3 | 0.4 |
| Ireland | 5.7 | 8.9 | 3.0 | 28.6 | 46.2 | 25.7 | 81.2 |
| Italy | 7274.1 | 6287.7 | 2756.7 | 7729.5 | 24048.0 | 7331.5 | 2484.4 |
| Latvia | 347.2 | 418.0 | 920.6 | 2001.3 | 3687.1 | 1399.6 | 776.5 |
| Lithuania | 252.9 | 853.7 | 367.1 | 1469.2 | 2942.9 | 1447.6 | 1434.1 |
| Luxembourg | 0.0 | 0.0 | 0.0 | 342.8 | 342.8 | - | - |
| Malta | 2.0 | 0.0 | 0.0 | 0.0 | 2.0 | - | - |
| Netherlands | 721.6 | 1520.4 | 1508.6 | 2813.6 | 6564.2 | 1987.6 | 3449.0 |
| Poland | 209.6 | 132.7 | 385.1 | 2340.5 | 3067.9 | 812.2 | 336.5 |
| Portugal | 154.8 | 181.2 | 344.6 | 274.5 | 955.1 | 448.1 | 568.3 |
| Romania | 1218.7 | 1009.6 | 1066.3 | 2358.4 | 5653.0 | 314.2 | 1101.0 |
| Slovakia | 483.6 | 121.3 | 84.0 | 637.4 | 1326.3 | 297.8 | 443.1 |
| Slovenia | 0.0 | 0.0 | 1.3 | 13.5 | 14.8 | - | - |
| Spain | 2662.5 | 4933.6 | 7020.2 | 2020.2 | 16636.5 | 9225.3 | 1239.5 |
| Sweden | 0.0 | 8.4 | 1.2 | 0.5 | 10.1 | 64.1 | 0.3 |
| United Kingdom | 9428.8 | 5852.4 | 3763.6 | 5363.0 | 24407.8 | 6203.9 | 6582.2 |

*Source: Department for Statistics, Ministry of Economic Development*
*Note: * Verified data*

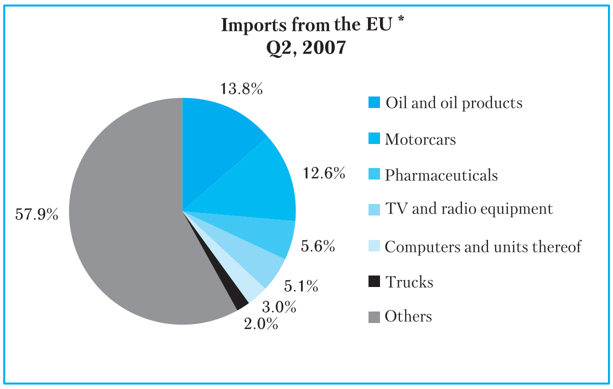
In the analysed period, Georgia's largest partner from amongst the EU states was Bulgaria with its share accounting for 38.5 percent of all the Georgian exports to the EU. The largest part of exports to Bulgaria was represented by copper ore and concentrates.

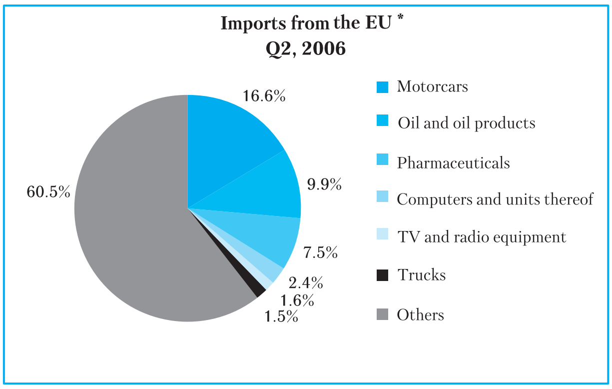
A notable decrease was observed in exports to Germany both in annual and quarterly terms which resulted in downgrading Germany from the first to the second position amongst the EU consumers of Georgian products. Copper ore and walnuts again accounted for 68 percent of Georgian exports to Germany.

The export to the United Kingdom showed a moderate annual and a small quarterly growth which was mainly conditioned by the increase in the demand for mineral waters.

The reviewed period saw quite an impressive annual and quarterly growth of Georgian exports to Belgium which was ensured by the increase in the demand for walnuts and mineral waters. The share of Belgium in the Georgian exports to the EU, therefore, increased significantly.

A high growth rate was again observed in exports to the Netherlands both in annual and quarterly terms. The increase in export revenues was mainly conditioned by the export development in black metal waste and scrap, copper ore and isotopes.




*Source: Department for Statistics, Ministry of Economic Development*
*Note: *The above data covers the 25 EU member states until 2004. From 2004 onwards, it covers the 27 member states to include Bulgaria and Romania*

In the second quarter, as compared to a year ago, the imports from the EU showed a sharp annual and a significant quarterly growth which was mainly caused by the increase in imports of oil and oil products, sugar, computers and TV-radio equipment.

The largest import commodity category from the EU was, in contrast to the previous quarter, oil and oil products. The annual imports in this commodity group was influenced by Greece, Romania and Bulgaria. In quarterly terms, however, the increase in imports of this commodity comprised 41.4 percent despite the 21.6 percent decrease in imported oil products from Romania.

Motorcars, as a traditionally leading import commodity from the EU, moved down the list to occupy the second position and showed a notable decrease of its share in the imports from Member States with 72.6 percent of this commodity coming from Germany. The motorcar imports showed a very small annual decrease and a moderate quarterly increase.

In the analysed period, the import of pharmaceuticals increased insignificantly in annual terms and decreased by 2.8 percent in quarterly terms. The annual development was influenced by the rise in pharmaceutical imports from Bulgaria, the Netherlands and Poland whilst the quarterly dynamics was influenced by the decrease in pharmaceutical imports from Germany, Poland and France.

The import of European radio and TV equipment increased by as many as four times as compared to the same period last year and to the previous quarter. The largest part of this commodity came from Sweden in the analysed period whereas the largest suppliers of TV-radio equipment were Germany and Finland in previous quarters.

As the demand for computers increased, the annual growth of this import category reached 62 percent. A sharp increase (30 percent) was also observed in quarterly terms. High annual and quarterly growth rates of computers led to the doubling of its share in the imports from the EU.

The import of trucks was marked with a rather high annual growth rate although the share of this commodity category in the imports from the EU increased only a little. The trucks were mainly imported from Germany.

**Table 28: Imports to Georgia from EU Countries (thousand USD)**

| | 2006 | | | | 2006 | 2007 | |
|---|---|---|---|---|---|---|---|
| | Q 1 | Q2 | Q3 | Q4 | | Q1 | Q2 |
| Total imports from the EU | 209614.9 | 270265.1 | 316441.8 | 313079.4 | 1109401.2 | 310844.0 | 365204.1 |
| of which: | | | | | | | |
| Austria | 4689.5 | 8074.7 | 9807.6 | 14049.2 | 36621.0 | 9835.0 | 9598.0 |
| Bulgaria | 26817.7 | 32782.4 | 33847.5 | 22088.0 | 115535.6 | 38531.2 | 35548.7 |
| Belgium | 8361.5 | 9256.6 | 8856.3 | 10689.4 | 37163.8 | 9798.4 | 11057.2 |
| Cyprus | 202.7 | 832.9 | 591.7 | 1248.4 | 2875.7 | 1170.8 | 1164.6 |
| Czech Republic | 6176.9 | 5327.5 | 18360.6 | 12828.0 | 42693.0 | 8902.5 | 6745.4 |
| Denmark | 1221.0 | 4396.4 | 1836.1 | 3210.2 | 10663.7 | 3994.8 | 4183.5 |
| Estonia | 161.0 | 170.8 | 407.8 | 265.8 | 1005.4 | 156.9 | 1216.4 |
| Finland | 4932.0 | 5060.4 | 8062.8 | 8508.5 | 26563.7 | 8172.7 | 8127.8 |
| France | 15014.7 | 17853.6 | 20240.2 | 20867.4 | 73975.9 | 19996.2 | 29396.1 |
| Germany | 68063.0 | 92229.6 | 86296.0 | 104564.2 | 351152.8 | 86313.5 | 92607.7 |
| Greece | 3820.0 | 6550.5 | 6615.9 | 5879.3 | 22865.7 | 8013.2 | 17780.1 |
| Hungary | 4595.1 | 3282.9 | 5495.2 | 6797.6 | 20170.8 | 5208.6 | 6730.7 |
| Ireland | 1066.3 | 1469.0 | 1897.3 | 2246.7 | 6679.3 | 984.2 | 1477.0 |
| Italy | 15106.4 | 23452.1 | 33686.5 | 29852.8 | 102097.8 | 25274.0 | 37038.4 |
| Latvia | 1288.3 | 1463.9 | 1225.8 | 2390.8 | 6368.8 | 1766.3 | 2140.4 |
| Lithuania | 900.8 | 1927.5 | 4310.2 | 2185.8 | 9324.3 | 2791.7 | 3671.6 |
| Luxembourg | 131.4 | 53.0 | 329.0 | 421.3 | 934.7 | 449.1 | 1942.4 |
| Malta | 0.0 | 0.5 | 261.0 | 542.4 | 803.9 | 1520.2 | 0.5 |
| Netherlands | 13904.5 | 18151.4 | 20969.3 | 22590.6 | 75615.8 | 22303.8 | 24640.2 |
| Poland | 3479.4 | 4242.1 | 5622.4 | 7284.5 | 20628.4 | 8356.3 | 8417.0 |
| Portugal | 731.7 | 580.6 | 766.2 | 805.9 | 2884.4 | 1008.6 | 969.8 |
| Romania | 8722.5 | 9506.8 | 15013.8 | 7525.8 | 40768.9 | 20506.0 | 16286.2 |
| Slovakia | 978.3 | 855.2 | 1256.0 | 1466.0 | 4555.5 | 702.6 | 1293.3 |
| Slovenia | 1009.2 | 1463.2 | 1293.2 | 1785.8 | 5551.4 | 1559.7 | 1751.4 |
| Spain | 2877.3 | 4156.6 | 3947.7 | 4302.1 | 15283.7 | 4996.6 | 5752.1 |
| Sweden | 601.1 | 1763.6 | 8824.3 | 2422.4 | 13611.4 | 2917.1 | 19450.6 |
| United Kingdom | 14762.6 | 15361.3 | 16621.4 | 16260.5 | 63005.8 | 15613.7 | 16217.0 |

*Source: Department for Statistics, Ministry of Economic Development*

The reviewed period saw the stepping up of trade relations with all EU countries with the exception of Denmark. The highest annual increase in imports was observed from Sweden and Italy.

Although the imports from Germany showed an insignificant annual and a modest quarterly growth, Germany's share in imports from the EU amounted to 25.4 percent. In addition to motorcars, the commodity structure of imports from Germany included trucks, pharmaceuticals, telegraph, telephone and TV-radio equipment.

Italy was the second largest partner from amongst the EU countries in terms of import volume in the reviewed period. The value of imports from this country increased sharply as compared to a year and a quarter ago. The import structure from Italy was quite diverse and included mainly furniture, motorcars, dishwashing machines and footwear. Amusement rides, merry-go-rounds and other equipment of this sort also had a high share in the imports.

Despite a modest annual rise and a notable quarterly drop, Bulgaria was the third by imports in Q2, 2007. Bulgaria continued to supply oil and oil products, black metal articles and pharmaceuticals to the Georgian market.

Quite a high annual and quarterly growth in imports from France made this country the fourth largest partner for Georgia. The structure of commodities imported from France was quite diverse with the main categories represented by sugar, optical devices, motorcars, cosmetic means and pharmaceuticals.

The increase in imports from the Netherlands, as compared to the same period last year and the previous quarter, was mainly conditioned by the import of computers and pharmaceuticals.

**Table 29: Direct Investments by EU Countries in Georgia (thousand USD)**

| Countries | 2003 | 2004 | 2005 | 2006 | | | | 2006 | 2007 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Q1 | Q2 | Q3 | Q4 | | Q1 | Q2 |
| Total | 340070.0 | 499107.0 | 449785.0 | 146012.0 | 306907.0 | 280748.0 | 456708.0 | 1190375.0 | 286316.0* | 370472.0 |
| EU | 95783.3* | 195542.3* | 243749.0 | 40629.7 | 108829.4 | 72748.7 | 184982.4 | 407189.7 | 152238.6* | 155136.4 |
| Austria | 18108.4 | 23157.2 | 14732.2 | 3903.8 | 2245.5 | 3174.3 | 1425.7 | 10749.3 | 341.7 | 3024.4 |
| Czech Republic | 249.8 | 276.6 | 1279.6 | 1096.6 | 12169.5 | 1619.4 | 146.8 | 15032.2 | -1306.5 | 73861.1 |
| Bulgaria | 0.0 | 0.0 | 70.8 | 230.5 | 9.4 | 75.3 | 3.8 | 318.9 | 0.0 | 9.2 |
| Denmark | 0.0 | 0.0 | 319.0 | 7132.6 | 3542.3 | 273.6 | 31529.3 | 42477.8 | 82324.9 | 5471.8 |
| United Kingdom | 37629.7* | 87831.2* | 132925.8 | 9153.0 | 52539.5 | 17853.6 | 107277.9 | 186824.1 | 28305.3 | 7978.4 |
| Germany | 4144.9 | 5140.5 | 5031.8 | 1019.6 | 889.0 | 3524.6 | 14047.6 | 20380.8 | -54.0 | 1215.7 |
| Ireland | 37.5 | 41.5 | 592.4 | 428.2 | -31.0 | 221.2 | 536.9 | 1155.2 | -9.5 | -1666.5 |
| Italy | 15895.7 | 32453.0* | 22833.5 | 2077.8 | 17071.2 | 18448.7 | 9621.4 | 47219.1 | 2694.2* | 2912.0 |
| Cyprus | 675.7 | 21333.1 | 47537.3 | 8718.0 | 17059.7 | 11659.1 | 2634.4 | 40071.2 | 145.6 | 8873.1 |
| Luxembourg | 249.8 | 276.6 | 553.1 | 115.7 | 73.3 | 44.2 | 28.0 | 261.1 | 0.0 | 0.0 |
| Latvia | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 805.0 | 0.0 |
| Lithuania | 0.0 | 0.0 | 0.0 | 2000.0 | 478.1 | 478.1 | 478.1 | 3434.2 | -166.9* | 1991.0 |
| Netherlands | 0.0 | 0.0 | 492.0 | 1390.7 | 480.0 | 1126.7 | 15532.8 | 18530.2 | 32756.0 | 42001.2 |
| Poland | 0.0 | 0.0 | 293.8 | 245.8 | 38.9 | 192.3 | 25.2 | 502.2 | 0.0 | 0.0 |
| Greece | 1967.2 | 2178.3 | 2217.0 | 521.8 | 293.7 | 627.8 | 1064.1 | 2507.4 | 126.5 | 574.8 |
| France | 16709.5 | 22854.3* | 14383.3 | 1300.9 | 1905.7 | 13398.1 | 617.1 | 17221.7 | 6264.3 | 3046.9 |
| Sweden | 81.2 | 0.0 | 160.4 | 152.4 | 21.3 | 11.8 | 4.1 | 189.5 | 12.0 | 5534.2 |
| Hungary | 33.9 | 0.0 | 327.0 | 242.3 | 43.3 | 19.9 | 9.2 | 314.8 | 0.0 | 309.1 |
| EU share (%) | 28.2 | 39.2 | 54.2 | 27.8 | 35.5 | 25.9 | 40.5 | 34.2 | 53.2* | 41.9 |

*Source: Department for Statistics, Ministry of Economic Development*
*Note: *Verified data*

An upward annual trend in direct foreign investment from the EU continued into the analysed period which was ensured by investment inflows mainly from the Czech Republic, the Netherlands and Sweden. It is noteworthy that the decrease in capital investments from Denmark and the United Kingdom by, 15 and 3.6 times, respectively, resulted in a mere USD 2.9 million increase of investments in quarterly terms and led to a sharp drop (by 11.3 percentage points) of the EU share in total investments.

The Czech Republic was in the lead amongst the EU investors and accounted for 47.6 percent of the EU investments with much of the Czech capital being invested in the energy sector. The Netherlands remained the second largest investor with the inflow of investments from this country marked by rather impressive development which was the result of the capital invested in the construction of a sea terminal, manufacturing, trade and a hotel network.

In Q2, 2007, Cyprus and the United Kingdom were the third and the fourth largest in terms of EU investments. Although the investment inflow from Cyprus almost halved as compared to the same period last year, it was 61 times higher than in the previous quarter which was ensured by investments in the energy sector. Most of investment from the United Kingdom was made in mining industry whilst some was used for the purchase of immovable property.

# Part II. Economic Trends and Policy Analysis

## 1. LABOUR MIGRANTS' REMITTANCES TO GEORGIA: VOLUME, STRUCTURE AND SOCIO-ECONOMIC EFFECT

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Internationally, the volume of labour migrants' remittances transferred to their native countries has shown quite an impressive growth over the past few years. According to the estimate of the World Bank, it increased by 73 percent and reached USD 167 billion in 2001-2005 [1, pp. 87-88, 2, pp. 157-159]. Experts believe that this volume is only part of the flows of remittances since it reflects the amounts transferred only through official channels, that is, through bank accounts and other electronic means. In the opinion of experts, the amount of cash sent home varies from between 30 and 250 percent of official remittances to recipient countries [3, pp. 4-5]. According to the estimate of the International Monetary Fund, the total amount of cash remittances including banknote transfers makes up USD 250 billion [4, p. 3].

Today, the actual size of migrant workers' remittances is much higher than the so-called Official Development Assistance to low-income countries and is the second largest source to direct foreign investments in terms of the external financing of developing countries. It is no wonder that international organisations, as well as the governments of donor and recipient countries, show an immense interest towards this phenomenon. There is hardly a year passing without a large-scale survey being conducted on remittances by different regions of the world economy or by individual countries. In this regard, a survey organised by the World Bank (WB) in 2006 [5] covering 28 East European and former Soviet Union countries, including Georgia, is especially worth noting.

The purpose of this paper is to identify an aggregate volume of the labour migrants' remittances to Georgia by collating recent surveys and separate expert assessments and to determine the scale of this volume by comparing it with the GDP and other macroeconomic parameters and its effect upon the country's foreign exchange inflows, economic growth and its social sphere. To this end it is necessary to review the official data on migrant workers' remittances.

**Electronic Remittances Data**

The National Bank of Georgia (NBG) regularly publishes information on the volume of electronic remittances and their origin by countries, which is based upon the data of swift transfer systems, operating in Georgia's banking sector (Western Union, MoneyGram, Anelik, Caucasus Express, etc). These data reflect the money transferred to Georgian citizens or other physical persons in Georgia by physical persons from foreign countries. The amounts include transfers made by foreign citizens, including Georgian nationals who permanently reside outside of Georgia and are not labour migrants as such. The same is true for amounts transferred by citizens of foreign countries to their compatriots in Georgia.

The electronic remittances, therefore, do not always reflect the phenomena in which we are interested especially given the fact that labour migrants' remittances can also be transferred through other channels such as bank accounts or non-bank means, in the form of cash. Nevertheless, the data of swift transfer electronic systems give a rather clear idea about the key countries where these remittances originate.

Table 1 shows that electronic remittance flows in the main come to Georgia from several countries with Russia well in the lead position. Over the past three years (2004-06) Russia accounted for 60 percent of remittances on average, although its average share in earlier years (2001-03) did not exceed 27 percent and was well below the corresponding US indicator. At that time, the swift wire transfer was a comparatively new service both in Georgia and in Russia and was used by a very limited group of migrants especially considering that an intensive transport communication existed between the countries which facilitated the transfer of cash.

The abovementioned type of service was used more extensively by Georgian migrant workers in the countries with strict migration regimes which, along with high travel costs, made frequent trips to Georgia problematic. This may explain the rather low indicators of electronic remittances at the beginning of the 21$^{st}$ century which do not depict a real situation with regard to migrant workers' remittances.

**Table 1: Electronic Remittances to Georgia (thousand USD)**

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007* |
|---|---|---|---|---|---|---|---|---|
| Total | 63269 | 69559 | 72122 | 96085 | 259122 | 403133 | 546340 | 352801 |
| USA | 28196 | 24292 | 20297 | 23641 | 30612 | 42631 | 59497 | 48269 |
| Russia | 14841 | 18776 | 21597 | 26382 | 132129 | 253523 | 364642 | 222141 |
| Germany | 2408 | 3057 | 3380 | 5439 | 5370 | 6025 | 4968 | 2814 |
| Israel | 1903 | 2575 | 2632 | 2922 | 2492 | 3936 | 4189 | 3137 |
| Spain | 1504 | 1775 | 1716 | 2063 | 4170 | 6300 | 11348 | 10470 |
| Greece | 1860 | 2762 | 3729 | 5895 | 7971 | 15671 | 16401 | 8860 |
| Belgium | 1200 | 1559 | 1313 | 1472 | 1796 | 1368 | 1901 | 1637 |
| Ukraine | 1206 | 1458 | 1706 | 1755 | 7361 | 15252 | 11146 | 8569 |
| United Kingdom | 1170 | 1531 | 1677 | 2341 | 5902 | 4904 | 5923 | 3851 |
| Poland | 291 | 215 | 179 | 321 | 282 | 285 | 339 | 222 |
| Netherlands | 532 | 481 | 371 | 732 | 829 | 887 | 1022 | 477 |
| Kazakhstan | 883 | 1002 | 838 | 863 | 2663 | 1638 | 3652 | 3845 |
| Canada | 691 | 710 | 618 | 1266 | 1093 | 1604 | 2049 | 1055 |
| Turkey | 834 | 1221 | 1598 | 2819 | 5721 | 10215 | 13929 | 7299 |
| France | 424 | 946 | 1627 | 3167 | 3148 | 3651 | 3545 | 1580 |
| United Arab Emirates | 510 | 499 | 609 | 670 | 899 | 1200 | 1302 | 457 |
| Azerbaijan | 46 | 52 | 49 | 100 | 160 | 2256 | 567 | 386 |
| Turkmenistan | 140 | 91 | 83 | 115 | 519 | 120 | 231 | 30 |
| Other countries | 4630 | 6558 | 8104 | 14123 | 46002 | 31667 | 39690 | 27703 |

*Source: NBG*
*Note: *Data covering a period of six months*

## Balance of Payment Data

The NBG, since 2007 in charge of the compilation of the balance of payment* collates the results of periodic household surveys with the data of the banking sector, primarily of swift transfer electronic systems. Based upon this data, there are three remittance-related statistical categories which can be distinguished as follows: worker's remittances (money sent by those Georgian citizens who have been working in foreign countries for more than a year), the compensation of employees (remittances of citizens employed for seasonal, temporary or seacoast jobs in foreign countries for less than one year) and migration-related transfers (a monetary equivalent to assets brought by a labour migrant from a foreign country to the home country at the time of his final return). The sum of the indicators recorded under the abovementioned categories represents the official total volume of labour migrant's remittances.

The total labour migrant's remittances to Georgia (see Table 2) substantially differ from the data of electronic remittances. It is especially true for the period between 2000 and 2003 when migrants used swift transfer electronic systems with a much lesser frequency. The State Department for Statistics, in performing its work, had to fill the informational gap as regards the transfer of remittances by collating the data from various sources including the results of household surveys and special statistical studies together with the scarce data from the banking system. This, naturally, did not provide a desired result. Afterwards, as the size of electronic remittances sharply increased and their record-keeping improved, it became possible to obtain more accurate data. The lack of special statistical studies, however, which is linked to the problem of financing such studies, does not provide an opportunity for a more objective quantitative evaluation of remittances.

**Table 2: Structure of the Total Labour Migrants' Remittances to Georgia (million USD)**

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007* |
|---|---|---|---|---|---|---|---|---|
| Total | 274 | 181 | 231 | 235 | 303 | 346 | 485 | 305 |
| Labour compensation of workers | 179 | 94 | 152 | 168 | 236 | 247 | 315 | 182 |
| Workers' remittances | 95 | 87 | 75 | 64 | 64 | 94 | 153 | 101 |
| Migrants' transfers | - | - | 4 | 3 | 3 | 5 | 17 | 22 |

*Source: NBG, World Bank, Migration and Remittances Factbook*
*Note: *Data covering a period of six months*

* *Before 2007, this function was performed by the Department for Statistics.*

The table clearly shows that the compensation of employees–the remittances of those citizens who stay in donor countries for less than a year–prevails in the official remittance flows of migrant workers. The balance of payment statistics, however, does not even regard such citizens as migrants when applying the term by strict definition [see 6, p. 75]. Taking into account a heightened emigration and visa regime applied to citizens of Georgia, especially in recent times, as well as the high costs of and the difficulty to travel, it is hard to believe that short-term migrants send twice as much money to the home country as those migrants who stay in donor countries for extended periods of time. It is, however, this very category of migrants that is the most numerous. Moreover, the share of migrant transfers in the total remittance flows is extremely small. This can be explained by the difficulty of their recording which is a typical problem for all countries concerned and not only Georgia.

Given the above said, there is a need for introducing a more elabourate practice of recording and classifying migrants' remittances. To this end, we deem it necessary for the NBG and the Department for Statistics, now being subordinated to the Ministry of Economic Development, to regularly conduct special joint surveys of remittances. These joint surveys are needed because the study of a number of problem-related issues, such as external migration and household behaviour, for example, falls beyond the remit of the NBG. On the other hand, the Department for Statistics does not have access to the primary data of the banking system. No less important is the fact that the NBG has more means, even without donors' assistance, to finance a relatively large-scale survey which is not the case with the Department for Statistics.

**Unofficial Remittances**

The most recent WB survey, covering 28 European and Central Asian countries including Georgia, showed that 41 percent of migrant workers on average transfer money through informal channels; that is, bypassing banking institutions [5, p. 7]. Usually, this comprises the transfer of cash by means of drivers of various forms of transportation, acquaintances or friends and well-organised courier service networks [5, p. 7]. Given this reality, it is problematic and extremely difficult to quantify unofficial remittances with any precision. In contrast, the remittances through banking institutions and their electronic systems, as well as through post offices, are much easier to record and account.

According to the WB, only two countries–Moldova and Russia–attempt to capture remittances sent through informal channels within the balance of payments [5, p. 7]. The remaining countries, similarly to Georgia, record in BoP mostly registered remittances and, therefore, their data do not fully reflect the real situation. It is no wonder that Moldova has the highest official indicator of remittances against the GDP among the East European and former Soviet Union countries. It is also noteworthy that the volume of officially recorded remittances in this country does not show a high growth rate whereas Georgia, in this respect, ranks fourth from amongst the 28 countries of this region [4, p. 60]. It should be assumed that a six-fold increase in the volume of electronic remittances to Georgia between 2003 and 2006 reflects the process of containing remittances within banking channels rather than the sharp growth of their volume.

The results of a survey conducted in 2003 under the aegis of the International Organisation for Migration (IOM) offer a certain indication about the amount of migrants' unofficial remittances to Georgia [7]. Fifty percent of migrants sent money via banking institutions whilst 17 percent made the dispatch via post [7, p. 49]. The remaining 33 percent, then, send cash by physical persons. This indicator is lower than the same indicators for Moldova and Armenia in the same period 38 and 47 percent, respectively.

It should be noted that the share of non-bank remittances was much higher in Georgia at the end of the 1990s (1999-2000). According to the expert estimates at the time, the total volume of the flow of remittances ranged between 600 and 720 million USD [7, p. 51]. The comparison of the given data with the official remittances indicator in 2000 suggests that the share of unofficial remittances varied from between 54 and 62 percent at that time. Considering that Russia did not impose a visa regime and travel procedures with other countries were not as strict as they are now, thereby favouring non-bank remittances, it can be assumed that the unofficial remittance share reached and even exceeded 60 percent. In the following period, however, it showed a downward trend which was somewhat strengthened over the past few years (2004-06) and led to a notable decrease in the share of unofficial remittances in total flows by the year 2006. We will revisit this issue later in this paper.

The opinion about the downward trend in migrant workers' unofficial remittances is also supported by empirical data showing that remittances to Georgia came mainly from those countries where Georgian citizens used to travel intensively; namely, from Russia and Greece. According to an IOM survey, more than half of the remittances from these countries were transferred through acquaintances, friends and long-haul bus drivers whereas 84 percent of migrants' remittances from the US came in the form of bank or other types of electronic transfers [7, p.49].

An extreme aggravation of Russia-Georgia relations, which resulted in imposing a transport, visa and mail blockade on the part of Russia and the deportation of Georgian citizens from this country, increased official remittance flows significantly. The communications blockade made it very difficult for Georgian migrants to transfer money through informal channels, thus forcing them to use the service of banking institutions and their swift transfer systems more extensively. In Q2, 2007, the amount of more money transferred to Georgia from Russia through the abovementioned systems grew by 50 percent compared with the same period of the previous year. Moreover, an observation suggests that illegal migrants tend to accumulate money in larger amounts than usual in order to send it to Georgia at the first possible opportunity.

**Aggregate Value of Remittances**

A quantitative assessment of the aggregate flow of labour migrants' remittances, which is in fact difficult to verify, normally relies upon empirical data. Most likely, the simplest solution in this respect is to multiply the number of Georgian citizens having left the country in search of a job by the average value of remittances which can be empirically defined with sufficient accuracy.

According to the results of several surveys and expert assessments, the number of Georgian citizens having left for foreign countries as job-seekers ranges between 250-300 thousand [7, p. 51; 8, p. 9]. This indicator starkly contrasts with an official statement made by Boris Gryzlov, Speaker of the Russian State Duma, on 2 October 2006 that there are 300 thousand illegal labour migrants in Russia coming from Georgia alone. By the assessment of Russian experts, however, the number of Georgian migrants is much lower at 117 thousand [9]. The assessment of E. Turukanova, a prominent Russian expert in labour migration issues, however, seems more reliable with one labour migrant in Russia per every fourth Georgian household [10]. Accordingly, the total number of Georgian citizens having left to work in Russia–including legal migrants–should be approximately 250 thousand. As regards a concrete number of legal migrants from Georgia, this number should be approximately 30-40 thousand based upon the information of the Federal Migration Service of Russia according to which 15 percent of migrant workers on the average have the legal right to work in that country.

As regards other CIS countries, there should be approximately 40-50 thousand migrant workers, both legal and illegal, from Georgia [5, p.115-122] with as many as 300 thousand migrant workers from Georgia in the whole of the CIS alone. Collating this figure with the abovementioned estimate of the total labour migration value (about 300 thousand citizens), it means that there are no migrants from Georgia in non-CIS countries which is simply not true. A recent assessment that the upper limit of the aggregate indicator of migrant workers from Georgia is 450 thousand seems more accurate [11, p. 90]. In our view, 66.7 percent of this amount accounts for Russia and other CIS countries whilst 150 thousand; that is, 33.3 percent accounts for other countries.

One should not forget that a large part of migrants from Georgia obtained the citizenship of a corresponding country, primarily that of Russia. According to WB data, the number of such citizens exceeds 400 thousand. It is true that the majority of them were of Russian or other non-Georgian origin [5, p. 115, pp. 122-123]. But the number of ethnic Georgian emigrants is also thought to be quite large and forms a so-called "New Georgian Diaspora." This diaspora, together with the old diaspora of the Soviet vintage, is quite numerous in Russia and provides regular financial assistance to relatives and friends living in Georgia. These types of remittances, however, cannot be categorised as those of migrant workers.

Empirical studies show that 20-28 percent of Georgian migrants do not send remittances to the home country for various reasons [7, p. 49; 8, p. 16]. Therefore, we can assume that the total number of labour migrants regularly sending money to Georgia is 360 thousand. If we take an average monthly amount of migrant remittances of USD 180*, as set by empirical studies [12, p. 112], an aggregate annual volume of remittances would reach 770-800 million US dollars.

A 2006 estimate by the UN Global Commission on International Migration (GCIM) shows a much higher figure of remittances to Georgia – USD 1 billion annually [13, p. 28]. If this aggregate remittance estimation is added to regular remittances to Georgia by the Georgian diaspora in Russia and other countries, the sum would far exceed USD 1 billion.

* *According to other sources, the average monthly amount of migrant remittances comprises USD 162.4 [7, p.50] and USD 176 [8, p. 17].*

If we subtract the total amount of official remittances (see Table 2), from the aggregate remittances, the size of unofficial remittances to Georgia in 2006 would be around USD 315 million, or 39.4 percent of total.

The following table, which is based upon the abovementioned data, clearly illustrates the quantitative characteristics of total remittance flows to Georgia. It is obvious that the aggregate annual indicator of remittances somewhat increased in 2006 as compared to 2000 but the share of official remittances showed significant growth. It is noteworthy that the volume of electronic remittances in six month of 2007 increased by 62 percent as compared to a year ago. This cannot be explained by the enhancement of remittance flows through banking channels alone especially given the fact that there was also a growth in electronic transfers from those countries (the US and Spain, for example) which traditionally used only official means for making transfers to Georgia.

**Table 3: Aggregate Labour Migrants' Remittances to Georgia and their Scale**

| | 2000 | 2006 |
|---|---|---|
| Aggregate volume of remittances* (USD mln) | 720.0 | 800.0 |
| Ratio between aggregate volume of remittances and GDP, % | 23.5 | 10.2 |
| Ratio between aggregate volume of remittances and export volume, % | 223.1 | 80.6 |
| Ratio between aggregate volume of remittances and the volume of foreign direct investments, % | 548.8 | 67.2 |

*Source: Department for Statistics of the Ministry of Economic Development, NBG, World Bank*
*Note: *Expert assessment. This includes both official and unofficial remittances of labour migrants*

It is also interesting that the aggregate volume of remittances against the GDP substantially decreased in 2000-06 which can be explained by a sharp increase in the GDP, on the one hand, and less impressive dynamics in total remittance flows, on the other. The strengthening of the national currency has also contributed to this process.

The ratio of migrant remittances to GDP is still quite high, although it remains modest in international comparison: the corresponding ratios of the top three countries from the abovementioned 28 (Moldova, Bosnia-Herzegovina and Albania) range between 15 and 30 percent of GDP even upon the basis of official remittances.

**Foreign Exchange Effect**

The influence of labour migrants' remittances upon the economy of a country depends, first of all, upon their size as a source of foreign currency inflows. In order to determine this size, the amount of remittances is compared to the export and foreign direct investment indicators of a country. The table above (see Table 3) clearly shows that the 2000 aggregate remittance indicator in Georgia–that is, the official and unofficial components of remittances taken together–exceeded the Georgian export volume by as many as two times whilst that of investments was greater by 5.5 times.

The real volume of Georgian exports was so insignificant at the end of the last century that the remittances, even taking into account a huge scale of contraband, would still be higher than the country's export revenues let alone their ratio to direct foreign investments, then extremely small in size, given the unfavourable investment climate of the time. It is apparent that remittances to Georgia represented the main source of foreign exchange inflows six or seven years ago, reflecting an extremely grave state of the country's economy.

In the course of time, the situation drastically changed due to a moderate growth of remittances, on the one hand, and an increasing of the volume and legalisation of exports combined with a sharp rise in foreign investment inflows, on the other. Presently, the total amount of remittances is lower than the indicators of both exports and foreign investments. This means that remittances are no longer the largest source of foreign currency inflows although they continue to play a significant role in generating foreign exchange flows.

It should be noted that maintaining the stability of labour migrant remittances–even under the circumstances of a sharp increase in foreign investments–is of the utmost importance given the fact that remittances represent a reliable source of financing an increasing deficit in the trade balance of goods and services (almost USD 2 billion). An investment boom, in a small open economy is only of a temporary nature whereas the remittance flow is far more stable and predictable. Empirical data [14, p. 4] show that the countries with high remittance activity are marked with a high current account deficit (20 percent of GDP on average) whilst the countries with smaller remittance flows tend to have a moderate deficit (about 5 percent of GDP). In the event of the increase in export products upon the basis of foreign investments and the decrease in the scale of labour migration, however, it is less desirable for the country's economy to further strengthen its dependence upon remittances. Until this point, it is expedient to contain remittances within such a frame that will bring maximum benefit to the Georgian economy.

A very interesting opinion within the body of literature on the topic is that a strong and stable flow of labour migrant remittances may become a cause for a real appreciation of the national currency in a small-sized economy [1, p. 104]. This hypothesis has been partially proven by the experience of Albania and Moldova [15, p. 37]. In the case of Georgia, the reasons for a significant appreciation of the lari in real terms over the past three years have been the legalisation of the economy, strengthening of fiscal administration and, most importantly, a strong inflow of direct foreign investments rather than remittances, the role of which was limited to financing imports and alleviating the burden of the current account deficit and, thereby, contributing to the establishment of a rather long lasting trend of excess supply to the domestic foreign currency market. The stability of the flow of remittances against the background of investment activity and the deep structural changes in the economy, therefore, have become factors contributing to the appreciation of the national currency rather than causing it directly.

**Multiplier Effect**

The influence of the remittances of labour migrants upon the economic activity in a recipient country is expressed in the growth of the consumer demand of households or in making savings and investments. It is assumed that remittances bring about more of a macroeconomic effect if invested in business or placed in a financial sector than expended on consumption although this belief has been challenged in the recent years [15, pp. 25-28].

Empirical studies have long proven the significant multiplier effect of remittance flows. The results of one such study showed that every "migrodollar" entering a developing economy generates USD 4 worth of demand for goods and services in the long run [4, p. 66]. The determination of a corresponding indicator for Georgia is a subject for a separate study but the available empirical data already provide the opportunity to define in general terms how serious the multiplier effect of remittance inflows in the country can be.

First of all, it is desirable to define how strong is the disposition to consumption of households receiving remittances. The WB studied the income spending of remittance-recipient households in six East European and former Soviet Union countries–Bosnia-Herzegovina, Bulgaria, Georgia, Kyrgyzstan, Romania and Tajikistan–through surveying returned labour migrants. It appeared that the households of the abovementioned countries spend, on average, over 30 percent of the remittances on consumption, almost 15 percent on education and more than 10 percent on savings. In contrast, they invest in business only 5 percent of their income from remittances [5, p. 64], which is a relatively modest share. More than one-third of remittances are oriented on consumption whilst approximately 16 percent goes towards savings and investments.

This information does not reflect fully the real situation since the results obtained from surveying the returned migrants include the spending of large amounts of money which was brought in by them. An EBRD study of micro and small entrepreneurs in five countries of the abovementioned geographical area, including Georgia, showed that 93 percent of the respondents (micro and small entrepreneurs) who used the remittances in their entrepreneurial activity to some extent mainly applied this money for starting up a new business. In the view of the authors of the study, these are the amounts which have been accumulated by returned migrants [14, p. 6]. Another study on this type of Georgian migrant revealed that 63 percent of them were making their savings whilst being abroad and often did not send money back to the home country [8, p. 17].

As empirical observation shows, migrants accumulate the abovementioned amounts for specific purposes such as, for example, the purchase of an immovable or other property, paying off education fees, refurbishing apartments, depositing in banks or investing in business. According to a WB survey, almost 60 percent of the total remittances are spent on average for the abovementioned purposes [5, p. 64]. A typical migrant worker in Georgia, for example, mainly uses the money which was earned abroad for the purchase of an immovable property or a car and the refurbishment of an apartment and only less frequently for his engagement in small business. As the results of the survey show, only 20 percent of returned migrants succeeded in starting up a profitable business whereas 40 percent have no other way but to spend the savings on primary needs as they fail to find jobs upon returning home. Presumably, approximately the same amount of returned migrants spend their savings on the purchase of cars, apartments and other immovable property [12, p. 108].

The expenditure pattern of current remittances–regular transfers by residents working abroad–by households significantly differs from the abovementioned behaviour. Such remittances are almost completely oriented towards consumption costs. The amount is quite small in order to afford any property let alone to make savings and invest in business. Studies have shown, for example, that a Georgian migrant worker on the average sends home USD 179.5 per month from Russia, USD 204.2 from Greece, USD 397.3 from the US, USD 232.9 from Belgium, USD 149.8 from Turkey and so on [12, p. 106].

Current remittances are a very important source of the recipient households' income. According to surveys of labour migrants, more than half of them considers the remittances as a major source for the subsistence of their families whilst 40 percent views them as one of the major sources [12, p. 107]. Households with remittances being a primary source of income are more tend to spend them on consumption than those, who have other income sources as well. An average "migrodollar" recipient household should, in our view, reveal the expenditure pattern characteristic for a typical Georgian household and spend approximately 80 percent of its monetary income on consumption. As regards saving and investment, their shares in household monetary spending are insignificant.

The abovementioned study conducted by the EBRD proves in part the fact that the remittances of labour migrants to Georgia represent a relatively insignificant source of financing micro and small enterprises. Of the 149 interviewed micro and small entrepreneurs in Georgia, only 20 were remittance recipients and only six of them used this source of income for business [14, p. 6]. At the same time, the study showed that even those households which are involved in business use remittances to cover consumption costs.

Given the above information, it could be concluded that the remittances of migrant workers to Georgia are clearly oriented on consumption with their impact on economic growth, therefore, limited to the multiplier effect which mainly expresses itself in the increase in consumer demand. In this regard, Georgia bears more resemblance to the Moldovan pattern than with that of Armenia [5, p. 66]. A higher statistical share of savings in the use of remittances in the Armenian pattern can also be explained by the fact that the survey of Armenia regards the so-called Old Diaspora–with representatives being neither Armenian citizens nor migrant workers–as the subject of remittances [16, pp. 3-5]. Their transfers are of a less regular character but comprise a larger volume than the transfers of migrant workers and provide more opportunity for making savings. In our view, the inclusion of the Old Diaspora in the study of remittances is unjustified. Excluding the amounts sent by the Old Diaspora, it could be assumed that Armenian households reveal the same expenditure pattern as that of Georgia and Moldova.

A clear-cut orientation on the consumption of the remittances of migrant workers is a serious factor contributing to the growth of imports, as the domestic production in Georgia does not meet the consumer demand. The share of imported goods, both industrial and food products, is quite high in the consumption structure with the remittances pushing up the demand for imported rather than domestic production. It is our view, then, that the multiplier effect of remittances on the Georgian economy is only moderate at best.

**Social Effect**

Labour migrants' remittances are one of the most important factors for the improvement of the social conditions of Georgia's poorer population, which is proven by the results of questionnaires completed by the former Georgian migrants. According to these questionnaires, 65 percent of respondents reported that the financial state of their families improved as a result of the receipt of remittances whilst half of them said that it sharply improved [8, p. 17]. Nevertheless, judging by the expenditure pattern of recipient households, it can be said with all certainty that the remittance flow to Georgia is a strong factor for alleviating poverty rather than a tool for eliminating it and establishing a middle class in the country.

The fact that 37 percent of the surveyed returned migrants are still unemployed and live on the savings accumulated in migration is quite expressive [12, p. 108]. It is easy to imagine the problems which Georgia may face in the event of the large scale return of migrants forced out of Russia. As noted above, every fourth household in Georgia has a migrant worker in Russia alone with the number of such households amounting to 250 thousand by a conservative estimate. In order to avert this threat, the Georgian Government should pursue a consistent migration policy and begin topical negotiations with countries experiencing labour deficits and reach agreements with them on labour migration quotas. One such country, for example, is Estonia, where there is an obvious shortage of labour force in a number of fields, let alone Russia itself where the deficit is quite large, especially in provincial regions.

Of further note is the fact that the distribution of remittance flows inside countries is unequal. Whereas remittances to Central Asian countries are mainly channelled towards rural places, in Georgia and

Armenia they mainly stay behind in the capital city and larger urban centres [5, p. 70]. Of the five countries studied by the WB–Albania, Armenia, Georgia, Kyrgyzstan and Tajikistan–the highest urban concentration of remittances is observed in Georgia at about 70 percent [5, p. 70] but the share of the rural population in Georgia's total population is notably lower than in Albania and the surveyed Central Asian countries.

A high urban concentration of the remittances of migrant workers to Georgia speaks for an unequal distribution of the resulting social effect. The migrants from Tbilisi usually have a higher educational and professional status and are better informed about the events around them all of which ensure their higher reimbursement. A migrant from Tbilisi, for example, sends 1.5 times more money home than a migrant from Tkibuli, 1.3 times more than a migrant from Zugdidi and Senaki, 1.2 times more than that from Ambolauri and 3.3 times more than a migrant from Akhalkalaki. An empirical error should be blamed for a notably higher volume of remittances by a migrant from Telavi as compared to that from Tbilisi [12, p. 106]. Given the abovementioned information, it is worth considering the conclusion of the WB survey that relatively better-off households receive more remittances than poor and poorest households which make the social inequality somewhat graver [5, p. 73]. It is worth mentioning that remittances are of vital importance for the poorest of the country's households.

A social effect of remittances in Georgia, as well as in any other country with intensive remittance flows, largely depends upon the development of the national currency exchange rate and inflation. A steady appreciation of the lari since 2004 until today has delivered a serious blow to remittance recipient households and, especially, to the poorest of households. Whereas in 2003 an average monthly remittance in the national currency amounted to GEL 348, it decreased to GEL 289 in 2006 and currently does not exceed GEL 270. Taking into account that consumer prices kept rising by at least 7 percent on the average in 2003-06, it will not be difficult to imagine the scale of the devaluation of remittances.

**Conclusions and Recommendations**

The existing statistics do not reflect the actual size of total labour migrant remittance flows accurately enough. Moreover, more extensive use of electronic remittances and improvements in their record-keeping over the past few years provide the opportunity for a better analysis of the geographic structure of remittances and common tendencies.

The aggregate annual volume of labour migrants' remittances to Georgia has not changed much as compared to the year 2000. Moreover, the share of unofficial remittances in the total remittance flow has decreased over the past few years and stands below the average indicator of Eastern Europe and the former Soviet Union countries. Besides, the share of electronic and bank remittances notably increased and exceeded 60 percent of total.

A rather insignificant growth of aggregate remittances, on the one hand, and the increase in remittance transmission via electronic means, on the other, were largely conditioned by the imposition of a much tougher visa and emigration regime as well as the communications blockade on the part of Russia as the leading donor country.

The objective of maintaining remittances from Russia and protecting the rights of Georgian migrant workers calls for the implementation of an effective migration policy on the part of the Georgian Government. The top objective of this policy should be the legalisation of migrants in Russia and other countries and the establishment of realistic labour migration quotas in the future.

The evaluation of the aggregate remittance flow and its components is of an expert type and requires statistical substantiation which, in its turn, necessitates regular statistical surveys of remittance flows. This will enable the NBG, together with the Department for Statistics of the Ministry of Economic Development, to prepare and publish periodic surveys of remittances.

Although the volume of remittances of labour migrants has sharply decreased against the GDP as well as against the total export volume and the size of direct foreign investments since 2000, such remittances still remain one of the most important sources of foreign currency flows and the maintenance of their intensity represents an important factor for macroeconomic stability.

Remittances to Georgia, as compared to Eastern European and some post-Soviet countries, are more oriented on consumption rather than on saving and investment. The impact of remittances upon the national economy, therefore, is limited to the multiplier effect which, in its turn, is quite restricted due to a clear-cut orientation of consumption on imports.

The remittances of labour migrants signify a vital source for a large part of Georgian households although the distribution of remittances flows reveals a certain inequality. The majority of recipients are inhabitants of the capital city and larger urban centres for whom remittances often represent an additional source of income and serve as a means of improving their social standing.

Remittances received by relatively more affluent households can become a significant source of credit resources in the country if banking institutions develop products oriented towards a remittance flow which will enable migrant workers to transfer amounts at lower costs, on the one hand, and enjoy favourable deposit rates, on the other. The introduction of such products requires proper incentives for banks which should be the concern of the NBG.

The recent appreciation of the national currency, occurring in parallel with the inflation processes, has significantly damaged poorer recipient households and has contributed to the deterioration of their social condition. When co-ordinating macroeconomic and social policies, therefore, the scale of the devaluation of remittances and the possibility of indirect compensation of the poorest of households should be taken into consideration.

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## 2. PROSPECTS OF EXPORT ORIENTATION OF THE GEORGIAN ECONOMY

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The aim of this paper is to discuss the possibilities of the export orientation of the country's economy. To this end we will review generalised indicators of the Georgian exports and some of the recent tendencies. Special attention will be paid to the changes in the geographical structure of Georgian exports, particularly to the expansion of the exports towards the EU which is regarded to be a key direction of Georgia's external trade in the nearest future. At the same time, some specific forms and methods of promoting exports and the need for their adjustment to the political and economic realities in the region will also be addressed and discussed. Finally, practical suggestions will be made and offered in order to better utilise Georgia's export potential.

### The Need for Export Orientation

Georgia's striving towards Euro-Atlantic integration raises the issue of the introduction of such a model of economic growth that will, first of all, promote the development of export-oriented production. The liberalisation of the business environment is a necessary but not sufficient prerequisite for the efficient utilisation of the country's export potential. A flat refusal to acknowledge the export promotion as a top priority indicates the lack of political will which is based upon a rather unsubstantiated economic hypothesis [1]. This hypothesis in itself implies that Georgia's export potential is not large enough to become one of decisive factors for a sustainable economic growth in the medium term.

According to this hypothesis, the economic activity should be oriented towards domestic savings and consumption as well as on the attraction of foreign investments. Such a model could be effective in the short term but in the longer term, however, it will be very difficult to maintain a high growth rate if the country fails to take a clear orientation towards exports. On the other hand, contemporary world trade represents a two-way traffic model whereby the growth of imports is a necessary prerequisite for the growth of exports. In general, the liberalisation of the economy steps up external trade and promotes the development of its infrastructure; that is, it creates large universal trade companies although this development has yet appeared in Georgia.

### Export Data

An upward trend in exports, which has been outlined over the past few years, is a promising sign. Its average annual growth rate comprised 13.5 percent in 2003-06 and well exceeded the GDP annual growth rate in the same period which comprised 9 percent on the average. Nevertheless, the growth of exports lagged behind the growth in trade deficit and comprised an annual 15.3 percent on the average during the abovementioned period.

**Table 1: Export Dynamics and Structure by Groups of Countries (million USD)**

| | 2003 | 2004 | 2005 | 2006 | 2007 January-August |
|---|---|---|---|---|---|
| Total exports | 461.4 | 646.9 | 865.5 | 992.5 | 784.5 |
| CIS | 224.8 | 327.6 | 407.2 | 394.7 | 301.5 |
| BSEC | 250.3 | 343.2 | 498.8 | 505.0 | 418.1 |
| GUAM | 46.7 | 41.1 | 120.6 | 149.3 | - |
| EU | 81.6 | 111.4 | 165.2 | 188.5 | 172.9 |
| OECD | 212.4 | 272.0 | 360.7 | 423.1 | 372.7 |
| Trade deficit | -679.8 | -1198.7 | -1624.5 | -2685.2 | -2340.5 |

*Source: Department for Statistics, Ministry of Economic Development*

In addition to a higher import growth rate, such a situation was also determined by an extensive model of the Georgian export growth; that is, a clear-cut orientation of the existing export products towards traditional markets which remained unaltered despite the recently imposed Russian embargo against Georgia.

Last year, however, saw a certain enhancement of the role of Europe and, primarily, the EU, as a market for Georgian exports. In particular, the share of exports to the EU increased whilst that to the CIS decreased. This was the result of the Russian embargo rather than the targeted diversification of Georgian exports. Besides, huge discrepancies between the Georgian and partner countries' trade statistics makes it extremely difficult to draw more meaningful conclusions.

The data of Georgian exports significantly differs from corresponding indicators of the EU countries (for a comparison, see Table 2). Indicators are different in the trade with the US as well. In particular, the US figures show USD 194.3 million and USD 105.3 million worth of exports from Georgia in 2005 and 2006, respectively, whereas exports to the US comprised USD 26.7 million and USD 58.9 million in these years, respectively, according to the data of Georgian customs. The discrepancies of such magnitude cannot be explained by the application of various accounting methodologies. In our view, it is more correct to assume that Georgian exporters decrease real contract prices for the purpose of reducing profit tax amounts.

**Table 2: Georgia's Export to EU: EU Data, (million USD)**

| Years | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|
| Turnover | 469.9 | 607.4 | 990.8 | 1009.4 |
| Import from Georgia | 190.5 | 244.0 | 366.4 | 351.1 |

*Source: EU, http://ec.europa.eu/external_relations/georgia/intro/index.htm*

Despite serious changes carried out at the Georgian customs, it seems that the reforms have not affected the customs statistics to any great extent. Without an increase in the reliability of the statistics, however, it is impossible to adequately react to the tendencies. We think it expedient for the customs department to carry out quarterly mirror comparisons with the main trade partners and, upon the basis of the revealed discrepancies, to detect those exporter companies which deliberately reduce contract prices through custom clearing procedures.

### Product Structure

An analysis of the commodity structure of the exports shows that Georgian export has been represented by the same ten top commodities over the past decade as it was in earlier years. Besides, the orientation towards the export of lesser added value products, such as raw materials, is obvious.

**Table 3: Georgia's Export Products (million USD)**

| Commodity categories | 2005 | 2005, (%) | 2006 | 2006, (%) |
|---|---|---|---|---|
| Exports | 865.5 | 100 | 992.5 | 100 |
| Ferroalloy | 80.2 | 9.3 | 89.8 | 9.0 |
| Copper ore and concentrates | 36.4 | 4.2 | 79.5 | 8.0 |
| Black metal scrap | 84.2 | 9.7 | 72.4 | 7.3 |
| Fresh or dried walnuts | 70.3 | 8.1 | 56.6 | 5.7 |
| Motorcars | 17.9 | 2.1 | 50.5 | 5.1 |
| Flying apparatus | 69.0 | 8.0 | 49.7 | 5.0 |
| Processed or semi-processed gold | 34.7 | 4.0 | 49.4 | 5.0 |
| Mineral and chemical nitrogen fertilisers | 35.9 | 4.1 | 46.6 | 4.7 |
| Natural wines | 81.3 | 9.4 | 41.1 | 4.1 |
| Copper waste and scrap | 11.5 | 1.3 | 30.2 | 3.0 |
| Other products | 34.4 | 39.7 | 42.7 | 43.0 |

*Source: Department for Statistics, Ministry of Economic Development*

The export of manufacturing products is limited to a few commodity categories: ferroalloy, mineral and chemical fertilizers and wine. In January-June 2007, this list was extended to include cement. As regards motorcars, Georgia remains engaged only in their re-export whilst the export of flying apparatus is in fact limited to their repair and overhaul and which has long served the purpose of repaying the country's debt to Turkmenistan.

### Export Geography

The geography of exports from Georgia is in the main streamlined in two directions; that is, towards the EU and the CIS with Russia holding the leading position from amongst the CIS countries. Unfortunately, however, Russia has not proven to be a reliable trade partner for Georgia because its relations with the post-Soviet countries are traditionally politically motivated which was clearly demonstrated by the embargo it imposed against Georgia last year which led to serious changes in the geography of Georgian exports. In particular, 17.8 percent of Georgian exports to Russia in 2005 dropped to 7.6 percent in 2006.

It is obvious that Georgia is not such an important trade partner for Russia that an embargo will cause serious damage to its economic interests. The orientation of exports towards Russia, then, given Georgia's geo-political priorities, will make Georgia a hostage of its own decision and will keep it under the constant threat of a blockade or economic sanctions. Other CIS countries, considering their trade potential, will never be able to replace Russia although the maximum diversification of Georgian exports in their direction is both necessary and feasible to do. In particular, the share of exports to Ukraine and Armenia increased in 2006 whilst trade relations with Azerbaijan and Kazakhstan also notably expanded.

**Table 4: Key Export Countries (million USD)**

| Countries | 2005 | 2005, (%) | 2006 | 2006, (%) |
|---|---|---|---|---|
| Total exports | 865.5 | 100 | 992.5 | 100 |
| Turkey | 121.9 | 14.1 | 124.9 | 12.6 |
| Azerbaijan | 83.4 | 9.6 | 92.2 | 9.3 |
| Russia | 153.7 | 17.8 | 75.7 | 7.6 |
| Armenia | 39.7 | 4.6 | 73.6 | 7.4 |
| Turkmenistan | 75.8 | 8.8 | 71.8 | 7.2 |
| Bulgaria | 42.8 | 4.9 | 62.3 | 6.3 |
| US | 26.7 | 3.1 | 58.9 | 5.9 |
| Ukraine | 36.9 | 4.3 | 57.0 | 5.7 |
| Canada | 35.6 | 4.1 | 48.9 | 4.9 |
| Germany | 28.4 | 3.3 | 45.4 | 4.6 |
| Other countries | 220.3 | 25.5 | 282.0 | 28.4 |

*Source: Department for Statistics, Ministry of Economic Development*

The European Union represents a significant destination for Georgia's export diversification. The position of Georgian products within this market should be strengthened through the expansion of the trade geography–which is favoured by EU expansion as well–and the diversification of the export commodity structure [2]. At the same time, it should be taken into consideration that Turkey, as Georgia's largest partner, has a customs union with the EU. The establishment of a free trade regime with Turkey, therefore, will be virtually impossible without having a similar regime with the EU.

Additionally, there is the European Free Trade Association (EFTA) in Europe which enjoys a free trade regime with the EU. The EFTA unites Iceland, Norway, Switzerland and Liechtenstein. The EFTA is, of course, much smaller in size than the EU but it is possible to find opportunities for exporting a variety of products to this market as well. First of all, we should think about high-quality wines and organic agricultural products. High living standards and high prices provide exporters with favourable conditions within the EFTA internal market. Even a small-sized export can become a source of large revenues. The agreement upon a free trade regime with the EU will make it easier to establish similar trade relations with the EFTA and with third countries having a customs union or free trade regime with the EU.

Free trade with the EU will not sharply increase imports to Georgia since it exports mainly machinery and transportation goods to the Georgian market whose the import is duty-free. The import of technologies promotes the innovative process and raises the competitiveness of Georgian products. Moreover, the agreement upon free trade with the EU will create additional incentives for attracting investments from the EU as well as from third countries. In this event, Georgian products will reach the EU market without customs duties and with less non-tariff barriers.

It is also noteworthy that the expansion of the EU to include the former Soviet block countries makes the exports somewhat easier because those countries have been traditional consumers of Georgian products. Poland, Bulgaria, the Czech Republic, Slovakia, Hungary and Romania, which comprise this group, are naturally very convenient trade partners although one should not forget that there are objective factors restricting exports in these countries such as the similarity of export products and the relatively smaller internal markets therein. Considering these factors, there are some prospects for creating joint ventures in these countries and carrying out exports to the third country markets, primarily in the EU, based upon mutually beneficial terms.

To the best of our knowledge, the EU reaction to the proposal to conclude a free trade agreement with Georgia is not yet clear-cut although there has been an initiative on the part of the EU, and under its funding, to conduct a special study to determine the possible consequences of such an agreement. What is certainly true, however, is that free trade with Georgia will not have any serious impact upon the EU.

**General Conditions of Exports**

Quite a favourable background to the export diversification has been long established in Georgia. In the first instance, Georgia is a WTO member and enjoys a preferential trade regime with the EU, the

US, Canada, Japan and Switzerland. At the same time, it has mutual agreements with the CIS countries although their implementation, as described above, is impeded due to political grounds as has been demonstrated by the Russian embargo imposed upon Georgia

The diversification of export markets towards the EU encounters quite serious non-tariff barriers which are mainly associated with the problem of the accreditation and certification of products [3]. Unfortunately, none of the certification labouratories currently operating in Georgia has a European accreditation and this seriously impedes the export of products to the EU. It is noteworthy that the UNDP, upon the initiative of the Association of Georgian Exporters, funded a project to set up a quality certification labouratory in 2003 which was implemented with the involvement of relevant private sector representatives from Georgia and Germany. Practical steps have been made towards the EU recognition of quality certificates issued by the labouratory although any final decisions have yet to be taken. It seems that this problem needs more attention on the part of the state. In particular, we believe that it is quite acceptable for the state to create quality certificate labouratories and to enable private structures to take over their management rights through an open tender.

Georgia's attaining membership of the WTO in 1998 accelerated the process of the formation of an open economy in Georgia and created favourable conditions for the attraction of investments. Due to the small size of the internal market and a low consolidation level of the regional market, however, foreign investments in the manufacturing industry are still relatively small. This, in its turn, emphasises the need for creating additional conditions for orienting investments towards export although current flows of FDIs in the energy, construction and service sectors and a future enhancement of the country's energy security and the development of the infrastructure and the service sectors will have a positive impact upon Georgian exports. In this regard, it is rather important to attract foreign tourists because this, in essence, is a hidden export [4] wherein a buyer is brought to a product rather than a product is supplied to a buyer.

**Additional Promoting Mechanisms**

There are no proven promoting mechanisms in Georgia, such as credits and the insurance of exports, which seriously impedes the creation of new export products and the diversification of markets. The refusal of the Georgian Government to provide exporters with special credit lines is somewhat motivated because of, let us say, the potential threat of corruption but the reason for not applying an export insurance mechanism is absolutely unclear. Relevant structures supported by the state exist in almost all Eastern and Central European countries and they are based upon one and the same scheme [5]. Their aim is to reduce the political and economic risks of exporters. The organisational forms of these structures are also typical such as the BAEZ in Bulgaria and the EGAP in the Czech Republic. The application of the abovementioned mechanism in the Georgian economy was viewed as a crude interference on the part of the state and was rejected at the very beginning.

**Institutional Challenge**

Georgian producers of export commodities are in a certain sense often helpless when they have to export their products by themselves. The experience of almost all of the developed countries clearly proves the very important role of multi-product trading companies in exports [6,7]. It is precisely these types of companies that account for at least 50 percent of exports. As export-oriented trading-intermediary companies failed to be established in Georgia due to a flawed taxation mechanism, this function can be best fulfilled by large trading importer companies.

Large importer companies have a professional knowledge of potential export markets and the experience in working with foreign partners with whom it is possible to set up export alliances. This is a quite wide-spread practice in several Western European countries. Export alliances are created around a large multi-product trade company which find new markets or offer new export products to those already existing. It is precisely such a universal trade company that carries out the analysis of the market and identifies new market segments.

Export alliances are established both vertically and horizontally. Vertically, an alliance is set up by technologically interconnected companies (in other words, suppliers). In this case, an export market is penetrated by one company which produces an end product. The aim of the alliance is to support this company to the maximum possible extent since the increase in orders on exports increases the orders on the manufacturing of their own products. The unification within an alliance relieves these companies of the problems related to the payment of VAT and a protracted procedure of its subsequent refund. In the case of a horizontal export alliance, companies manufacturing the same product can unite with the aim of finding new markets or increasing orders on exports for existing markets. The companies in such alliances agree to manufacture export products under one trademark.

An export alliance built up around a trading company represents a vertical alliance. This practice is extensively pursued in Western Europe as well as in the US and Japan. In Georgia, a special attention should be paid to the organisational aspects of the formation of an alliance. In particular, the registration of such alliances should be simplified and relevant changes introduced to the law on entrepreneurial activity.

It is expedient to consider some tax breaks for export alliances such as, in particular, the introduction of a regressive profit tax. Under this mechanism, the profit tax rate decreases as the profit increases and, therefore, encourages exporters not to hide their real profits. This may also help improve the quality of export statistics.

**The Problem of Competitiveness**

It should be noted that a low competitiveness–namely, the high price of Georgian production–is a serious problem. Frequently, for both objective and subjective reasons, Georgian products are more expensive, even within the domestic market, than the imported ones. First of all, it should be noted that Georgian manufacturers are deprived of the advantage of the economies of scale which is normally characteristic of all small-sized economies. At the same time, inputs are quite expensive in Georgia such as, for example, the price of electricity let alone the quality and reliability of its supply especially outside of the capital.

It is common opinion that there is an inexpensive workforce in Georgia. This may appear to be the case, if judged by a wage level, but a unit labour cost analysis proves that this idea is unsubstantiated. In other words, although wages are low in Georgia, the recalculation of these wages per unit of manufactured product will not reveal any comparative advantage. The reason for this, of course, is the low level of productivity. Further information thereon can be found in the WB paper, entitled "Georgia: An Integrated Trade Development Strategy," [8] and will not be discussed with any further detail herein.

In our view, the competitiveness of Georgian products should be regularly assessed and relevant recommendations developed. The benefit of this approach is well proven in Ireland which has shown quite an impressive export dynamics due precisely to the improvements in the competitiveness factor. The Irish Government pays particular attention to the preparation of special Competitiveness Reports which provide a detailed analysis of the factors of the country's economic competitiveness as well as make corresponding recommendations [9].

**Export Commodities with High Potential**

The economic literature focuses much upon the identification of export products with comparative advantages [2]. This activity is important, of course, but one should bear in mind that methodologies applied in the majority of cases analyse already existing export products based upon which comparative advantages are identified.

Such an approach has the potential to restrict the identification of export opportunities in full. This is further demonstrated by the following example. The past 30 years has witnessed a constant growth in the production and sales of wires, for example, to include all types from high-voltage to the simplest of telephone or household wires. This commodity is not exported from Georgia even though the country has the relevant experience to do so (in Soviet times, the Zestaponi cable plant could not keep up with the demand from across the Soviet Union) as well as the local resources (ferroalloys which are key components therein, and manganese).

Through an analysis of the world trade development trends of the past 10-15 years, it is necessary to identify those commodities which are constantly in high demand within the world market. Moreover, this kind of study should be undertaken as regards different products as well as different regions of the world market. The results would then single out those commodities which Georgia does not export but has the internal favourable conditions for their manufacture.

**Free Trade Zones**

We cannot bypass such an important issue as the creation of special export zones which are often considered to be the most effective mechanism for promoting exports [10]. It should be noted at the very beginning that the formation of these abovementioned zones is always considered in conjunction with the existing conditions and their efficiency depends upon a concrete situation rather than upon the general principles of their operation.

The creation of special export zones in Georgia does not seem expedient since the benefits, which exporters already enjoy, can hardly be complemented by anything else. The creation of a similar zone in any part of the country, therefore, will not have a serious countrywide effect although it will promote the economic growth of a certain region.

Given the above said, it is better to consider free economic (trade) zones in order to create favourable conditions for Georgia to become a regional leader in trade. In addition to a favourable geographical location, Georgia can benefit from a rather specific political environment which has taken shape in the region; that is to say, there are no intensive trade relations between Turkey and Armenia, on the one hand, and between Armenia and Azerbaijan, on the other. Any trade activity between these pairs of countries is carried out in a semi-legal form through Georgia. In order to legalise these relations and produce a corresponding economic benefit, it is expedient to create a free trade zone in the Samtskhe-Javakheti region which borders Turkey and Armenia and whose communications infrastructure is in a satisfactory condition and which provides the shortest route for Turkish products to reach Armenia and vice versa.

It should also be taken into consideration the economic effect from which the region would benefit as a result of the implementation of this project. The territory of Russia's former military base, with quite a well developed infrastructure (control across the perimeter, internal communications, existing public facilities, warehouses, etc.), would ideally fit this function and could begin to function in this capacity from the end of 2007 after the military base would be completely withdrawn. It is possible to announce a tender on the management of the free trade zone with the winner ensuring its operation. The experience of former Yugoslav republics in operating such zones could be used as a model.

**Conclusions and Recommendations**

The liberalisation of a business environment is a necessary but not sufficient prerequisite for the promotion of exports. The reorientation of the Georgian economy from imports towards exports should become a top priority of the state policy.

The available data on Georgian exports does not often match with the corresponding indicators of partner countries which casts doubt upon their reliability. The need for elabourating customs statistics and verifying export data through mirror comparisons comes clearly onto the agenda. Without accurate statistics it is impossible to pursue an effective export promotion policy.

Russia's politically-motivated trade embargo against Georgia has increased the urgency of Georgian export diversification. In a created situation, the main direction in this process should be the EU and Europe, in general.

The agreement upon free trade with Europe, with prospects of reaching it somewhat outlined, will, on the one hand, provide an opportunity for modernising and diversifying export production and, on the other, pave the way for new markets including those of third countries having a customs union with the EU.

A factor impeding the expansion of Georgian exports to the EU is the existence of non-tariff barriers. To overcome these barriers, the country needs to set up a modern quality certification infrastructure; namely, the network of testing labouratories with European accreditation.

In order to promote exports, it is expedient to insure the risks faced by exporters which can be done by means of a special insurance fund set up by the state which would accumulate a certain percentage (3-5 percent) of the customs duty on imports. For the sake of minimising administrative costs, the relevant activity should be carried out by an already existing state body such as the National Investment Agency.

For the optimisation of the export production, it is necessary to create a favourable environment for the operation of export alliances. The preference should be given to the alliances oriented towards the export of high value added production such as, for example, articles made of wood rather than of timber. This provides an opportunity of getting much higher export revenues with the same or less amount of raw materials.

For a better utilisation of the export potential it would be beneficial to organise an annual forum of exporters wherein export companies would be able to express their views and proposals regarding the measures implemented or to be implemented by the state for the diversification of exports. The Organisational aspects of the forum should be regulated by the exporters' association and relevant state bodies with the decisions adopted at the forum being of a recommending character.

It is expedient to annually evaluate the competitiveness of the Georgian economy and to draw up a relevant report to be considered at the abovementioned forum. This type of activity should be carried out with the technical assistance of the EU or any other donor country.

The creation of special export zones in Georgia cannot be considered as an effective mechanism. It is better to shift the focus towards the creation of free trade zones whose operation would assist Georgia in becoming a leader in regional trade. It is expedient to create such a zone in the Samtskhe-Javakheti region which is well suited for carrying out trade activities between Turkey and Armenia and between Armenia and Azerbaijan via Georgian territory.

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# Part III. Economic Reform Agenda

## CONVERGENCE OF THE REGULATORY FRAMEWORK WITH THE EU: AN IMPORTANT CHALLENGE FOR TRADE AND INVESTMENT

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Does the European Neighbourhood Policy (ENP) serve the aim of EU expansion? Irrespective of diverse views upon the issue, it can be said that the abovementioned policy is definitely about closer integration within the European neighbourhood; namely, the intensification of economic co-operation and trade. The EU-Georgia Action Plan adopted in the framework of the European Neighbourhood Policy "…offers the opportunity for the EU and Georgia to develop an increasingly close relationship, going beyond co-operation, to involve a significant measure of economic integration" [1, p. 2].

There are different forms of economic integration. These forms or models differ by the depth of mutual openness of economies, co-ordination of policies and the harmonisation of the legal and regulatory institutional framework. The most significant dimension of European integration lies within the economic integration which is realised in such notions as free trade, customs unions, economic unions, monetary unions and single markets, amongst others.

**Rational Basis**

The forms of co-operation or rapprochement require a different rate of harmonisation of the legal and regulatory environment in partner countries.

At the global level, this harmonisation is achieved through the implementation of the rules prescribed by the WTO or the international financial institutions whose internationally recognised commercial, agricultural, industrial, financial and good governance standards are respected and applied by many countries. The only exception are the so-called "sole riders." Those rules have helped to establish a minimum level of integration between member states of the abovementioned organisations. Statistics have shown that the countries having more similar rules of the game in their internal markets also have higher rates of trade and economic co-operation. This concerns not only the movement of goods but also of services and capital as well.

In the EU, the basic motivation behind the regulatory convergence in the form of approximation of national laws is the need to avoid 'regulatory competition' amongst member states [2, p. 84]. The possibility of environmental or social 'dumping' may allow the countries with less strict environmental or social protection regulations to have an 'unfair' advantage in international trade because their production costs are lower. The EU regulations, therefore, often refer to the so-called 'process-oriented standards.' The same rational is applied to the public procurement or state aid systems. That is why the EU's GSP+ scheme* requires Georgia and the other 14 beneficiary countries to fully implement international labour, social and environmental conventions.

There is also another very important reason for the EU to 'require' partner countries to implement very strict regulations in a number of spheres, such as consumer protection, food safety, sanitary and phyto-sanitary and product safety. This requirement is aimed at protecting the interests and the health and safety of citizens. The countries with high levels of regulatory control in such spheres will not allow the goods from countries with a lower level of safety standards to be imported into their market. The introduction of the legislation geared at raising standards in the abovementioned spheres also requires that an adequate system of quality and conformity assessment and certification is created. Mutual recognition of the conformity assessment rules is one of essential conditions for encouraging trade relations between the countries.

The most ambitious and interesting process of the approximation of regulatory frameworks was carried out in accordance to the European Commission White Paper during the EU's last wave of enlargement wherein candidate countries were required to adopt 100 percent of the EU Internal Market legislation. What results were expected from such an exercise? This issue was well explained by Peter Holmes: "As CEEC** exporters to the EU already have to meet EU standards, the alignment of regulations will not

* *GSP – the Generalised System of Preferences refers to the tariff reductions or suspensions under which developed countries assist developing ones in order to improve their trade balances.*

*** Central and Eastern European candidate countries.*

enhance their access to EU markets. The alignment of regulations would, however, force other CEEC producers to meet EU-equivalent regulations and might lead to an increase in the number of CEEC firms that export to the EU" [3, p. 146-163] .

**Georgian Context**

According to the government resolution of 24 February 2006 [4], Georgia unilaterally acknowledged the technical regulations of the OECD member states which, thereafter, significantly eased the imports from these countries to Georgia. This, however, is a unilateral gesture and does not facilitate Georgian exports to other countries. It is a matter of a conceptual dispute on whether or not a one-sided simplification of non-tariff barriers is favourable since this is the measure generally used as a bargaining chip by countries in the effort to reap mutual benefits.

The first serious attempt at establishing closer ties between Georgia and the EU was the signing of the Partnership and Co-operation Agreement [PCA] in 1996. The trade part of the agreement was based upon GATT* provisions. The agreement gives no promise of either closer co-operation or further integration but the well known Article 43, Legal Approximation, is aimed at creating a legal environment in Georgia which is close to that of the EU internal market.

The abovementioned article reflects only part of the spheres covered by the EU Acquis and its proper implementation in the country ensures quite a high degree of approximation with the rules and standards of the EU Internal Market. The implementation of the article would create the best possibilities for trade exchange and co-operation leading to the natural need for further integration. The incorporation of such provisions by the EU in the agreement proves its implicit intention to provide the ground for deeper relations than those offered by PCA.

**Various Models of Integration**

The gradual rapprochement with the EU could be tracked by looking at the different models of co-operation which other countries have with the EU.

The EU's trade relations with countries like Georgia are based upon the Most Favoured Nation (MFN) treatment. This is an analogue of the regime applied within the WTO. Having a low rate of regulatory rapprochement, Georgia's trade turnover with the EU comprises 25 percent of the country's turnover. The share of Georgia in the EU external trade, however, constitutes less than 0.07 percent of the EU's whole external turnover. Even if Georgia's trade turnover with EU reaches 70 percent, it will still remain an insignificant trade partner.

It should also be considered that the GSP+ treatment for Georgia is not a "gift forever." It will be lifted as the country overcomes economic difficulties. Naturally, Georgia is currently more interested in integration with the European Union than the EU is in strengthening ties with Georgia. The situation may change, however, if Georgia sharply improves its economic performance and succeeds in aligning itself with EU standards. Obviously Georgia needs to simultaneously improve its economic performance and raise the level of approximation with EU standards.

The regional context is also important for a small state such as Georgia. The Black Sea region is becoming a serious forum for co-operation and it is well within Georgia's interest to have a deeper co-operation in the region with an accelerated process of institutional Europeanisation. The EU-Georgia ENP AP puts emphasis upon regional co-operation [5, p. 9].

Multilateral trade co-operation is another model of integration which can be well tracked by looking at the Barcelona Process (1995) with most of the South and East Mediterranean countries having free trade arrangements with the EU (and with each other) under associated agreements. Its full implementation in the form of the so-called Euro-Mediterranean Free Trade Area was planned to become operational by 2010 but this date seems doubtful. Even though the trade turnover between the EU and those countries is very high, the underdevelopment and incompatibility of their legal and regulatory frames make it impossible to speed up the integration. Accordingly, it is not economically attractive for the EU to fully open its market to these countries.

**Customs Union**

The peculiarities of creating a customs union can be tracked by the example of Turkey (established only in the sphere of industrial products). Turkey and the EU established a customs union in 1995 under

* *GATT – General Agreement on Trade and Tariffs is an international agreement on trade and tariffs (1948) which was later replaced by the WTO (1994).*

the Association Agreement (1963). Interestingly, the Agreement itself does not much emphasise the approximation of the legal and regulatory framework but, instead, obliges the country to fully align trade regulations, especially customs legislation, with relevant EU regulations [6]. This can be explained by the fact that there was neither a common market formed by that time nor a system developed for its regulation. In 1995, however, when the customs union came into effect by a special decision of the Association Council, a special chapter in the founding protocol was dedicated to the legal approximation which provides for the legal alignment in such spheres such as competition, public procurement, intellectual property rights, tax and customs, etc. As it is noted in the 1998 Regular Report of the European Commission on Turkey's progress towards accession: "Some internal market legislation–company law, data protection and free movement of persons–does not currently fall within the Customs Union Decision" [7, p. 45]. Additionally, this Agreement does not refer to the laws which cover agricultural production standards, transport, energy or environmental protection. Nevertheless, Turkey, as the abovementioned report shows, had already had some EU standards implemented within many different spheres.

**European Economic Area**

The ultimate model that offers the highest degree of co-operation is the European Economic Area (EEA).* The agreement, establishing its creation, was made between the EU and the seven member states of the European Free Trade Association (EFTA) in 1992.** As Article 1 of the agreement states: "The aim of this Agreement of association is to promote a continuous and balanced strengthening of trade and economic relations between the Contracting Parties with equal conditions of competition and the respect of the same rules with a view to creating a homogeneous European Economic Area" [8]. It should be noted that ensuring equal conditions of competition means, first of all, observing such general rules as the prevention of companies from abusing a dominant position, the supervision of trust agreements, company mergers and acquisitions and the proper regulation of public procurement and state aid amongst other issues. Moreover, a necessary condition for a fair competition is, as mentioned above, the full homogeneity of the legal and regulatory institutional framework in partner countries.

The EEA is not a customs union. The type of relations between its members could be called a deep free trade regime. This model involves a high degree of integration and the participation in common EU policies and various programmes and agencies. The member states of the EEA have committed, in accordance with 22 annexes of the EEA Treaty, to apply a significant portion of the Acquis Communautaire within their respective countries. Such countries as Norway, Iceland and Liechtenstein, have implemented the EU Acquis in near entirety. These countries enjoy "four freedoms." Having harmonised industrial, agricultural and other standards, they recognise each other's conformity assessment rules, certificates, licenses and permits. The trade turnover between these states and the EU reaches 80% of their whole trade.

As regards Switzerland, which voted in a referendum against joining the EEA, it achieved the highest level of integration as a result of a broad and deep framework of bilateral agreements. It is also worth mentioning that Switzerland, which is a small country with 7.5 million inhabitants, is nonetheless the fifth largest trade partner of the EU wherein the degree of the regulatory (legislative) convergence with EU standards reaches 95 percent. Amongst its important bilateral agreements with the EU are the Agreement on Free Trade, Air Transport, Land Transport, Technical Barriers to Trade, Public Procurement and a number of agreements on trade in specific products [9, pp. 22-42].

**Common Market**

The common market is a form of economic co-operation which, along with the full realisation of the famous four freedoms, implies a 'supra-nationalisation' of many of the economic policies of the countries which it unites. The best example of such integration is the European Communities; that is, 'the first pillar' of the EU. The idea of creating a common market was reflected in the Rome Treaty in 1957 [10]. Although its name–Common Market–had changed and was later referred to as the Internal Market in the so-called consolidated versions of the Treaty Establishing the European Economic Community, its purpose remains unchanged as defined in Article 2 of the original copy of the treaty [10, Article 2].

Articles 81-102 of the abovementioned treaty contain provisions on the protection and ensuring of free competition within the common market. It clearly outlines the necessity to pursue a strong competitive policy within the common market. It is noteworthy that the legal approximation is incorporated in

* *Signed in May 1992, it came into effect on 1 January 2004.*

** *Subsequently, three members of this association–Sweden, Finland and Austria–joined the EU whilst Switzerland rejected its participation through a referendum. In fact, only three countries of the EFTA–Norway, Iceland and Liechtenstein–are now participants of the EEA created with the EU.*

the abovementioned articles and its indispensability is aimed at preventing unfair competition between partner countries. It is symptomatic that the legal approximation has become a subject matter of such a supranational institution as the European Commission which, in studying the differences in the legislation of various member states, provides suggestions for their elimination.

The Treaty allows for a decision on the harmonisation of legislation to be taken collectively which, upon the recommendation of the European Commission, is considered by the EU Council and adopted through consensus or by a qualified majority vote. This Treaty, as a result of later addenda which were introduced in accordance with the 1985 Single European Act, establishes the internal market of the EU. Its new Article 95, with reference to the procedural Article 251,* states, in fact, that the EU Council can adopt legislative acts, needed for the operation of the internal market as proposed by the European Commission and after consultation with the Social and Economic Committee and the approval of the European Parliament, by means of a qualified majority vote. These acts require partner countries to harmonise their internal regulations with them. The EU Court of Justice will consider any dispute arising from the implementation of these acts (laws, regulations and directives) and its verdict will be binding.

These changes indicate that the common market, in its new form, represents a higher degree of supranational administration in which it is necessary to unify the legal approximation mechanisms in order to ensure its proper functioning. In terms of promoting trade relations, the common market is certainly the strongest form of institutionalisation.

There are, of course, other forms of closer economic integration like economic or monetary unions** but these activities deal with the co-ordination of policies just indirectly affecting the development of trade relations between the countries*** and dealing less with the alignment of the regulatory frameworks.

**Transatlantic Dialogue**

Practice shows that investments and the flow of capital are higher between those countries which have (a) the best and non-discriminative treatment for investments and (b) goods and similar rules and standards. The latter is derived from the fact that business – especially small- and medium-sized business – is keen to establish itself in places where environment is friendly and in which the rules are known and close to that of their origin.

The US and the EU, as the world's two largest competing trade actors, are also trying to harmonise standards [11, p. 3]. It can be said that the US system is "lighter" because it is less regulated although it is not an easily reached market as competition rules are very strict and the demand quite sophisticated.

At the US Senate Committee Session in October 2003, the Assistant Secretary of State for European and Eurasian Affairs, Charles Rice, spoke of the need for intensifying trans-Atlantic dialogue with the EU on regulatory issues for defending the global interests of national business and introducing safe products on the internal market of the country. In particular, he was speaking in favour of an initiative such as the Transatlantic Legislators' Dialogue on Regulatory Policy Issues. As regards the economic activity of separate sectors, like aviation service, food production, pharmaceuticals and cosmetics, car manufacturing and others, the EU and the US already have quite a successful practice in converging standards.

**Alternative to Full Convergence**

It is a fact that "a country's desired degree of compliance with the EU's Internal Market Acquis is closely connected to the costs that such a compliance will bear" [12, p. 14]. Georgia is not a EU accession country and is free to choose an optimal degree of compliance after assessing and weighing the country's overall objectives against the associated costs [12, p. 22]. Regulatory impact assessment practices will make this objective easier to fulfil [13].

The experience of country participants of the Barcelona Process has revealed a certain dilemma faced by a particular state in choosing between the convergence of regulatory standards by sectors of economy or separate narrower fields which are of major commercial interest at the time.

Convergence in the spheres wherein Georgia may have comparative advantages such as, for example, processed agricultural products, which is the strongest protected field in the EU, may, make the prospects for the penetration of such products into the EU Internal Market realistic. According to Georgian

* *See, http://eur-lex.europa.eu/en/treaties/dat/12002E/htm/C_2002325EN.003301.htm*

** *ibid, Article 2.*

****The elimination of the negative impact of the fluctuation of the exchange rates by means of introducing a common currency, for example.*

wine producers, customs duties do not constitute a major impediment for their product to enter the EU markets but, rather the problems are greater as concern non-tariff barriers like the recognition of geographic nominations, EU standards and the recognition of certification and conformity assessment practices. The elimination of these problems would, then, naturally increase the export of Georgian wines to the EU.

**Neighbourhood Policy Format**

The European Neighbourhood Policy offers Georgia an opportunity to develop closer trade relations with the EU than envisaged by the PCA [14. p. 5]. The ENP, as a political framework, not only goes beyond the PCA but in some extent beyond the possibilities driven by an Association agreement and offers the country the opportunity of joining the EU Internal Market.

A December 2006 communication of the European Commission, reviewing the ENP achievements and future prospects, contains an important statement which reads that "the mutual free trade regime shall cover all the industrial products including a certain level of asymmetry, if appropriate." At the same time, the European Commission offers states a so-called 'deep free trade' instead of simple forms of trade in goods and services which also includes further so-called 'behind the border' issues addressing non-tariff barriers and progressively achieving a comprehensive convergence in trade and regulatory areas. The communication identifies those concrete spheres which need to be gradually harmonised in order to bring trade and integration to a new level.

The main targets of the reforms in ENP participant countries, including Georgia, are customs, standardisation, certification and accreditation systems, veterinary and phyto-sanitary issues, food safety standards and product origin certification procedures. A competition policy is also regarded as quite important. The EU also refers to the need for legislative reforms in the spheres of intellectual property rights, tax administration, entrepreneurship, public procurement and financial service which will facilitate the trade exchange between partner countries, including Georgia, and the EU [15, p. 4-5]. The success of the reform will also have influence upon the decision by EU institutions to deepen the trade regime with Georgia towards more openness which could develop in specific sectors representing the interest of the parties concerned and wherein the rules have been harmonised to a larger extent.

**Integrative Ambition**

Since 2007, Georgia and the EU have been working together on the implementation of an agreed action plan. This plan envisages a study in which to determine the possibilities for and the degree of readiness to establish a free trade regime between the EU and Georgia. The abovementioned study, which is commissioned by the EU, is being conducted by a European consultancy with the results envisaged to show the possibilities and prospects for the trade relations. A similar study conducted in Ukraine revealed that the country is yet not ready but has the significant potential to establish a so-called deep free trade regime with the EU. More importantly, both sides will receive an economic benefit from such an agreement.

The EU views the liberalisation of the trade regime, both in bilateral and multilateral formats, in the context of the approximation and convergence of the legal and regulatory market which has been demonstrated in the communication of 14 April 2007 wherein the development of trade relations of the Black Sea countries and the EU are presented upon the basis of the various action plans: "The implementation of the ENP Action Plans' trade and economic provisions, in particular the practices to the EU trade-related Acquis, continue to play an important role in regional trade facilitation and integration" [16, p. 7]. The EU also underlines that "…in the light of their complexity and ambitiousness,* deep FTAs are medium-term** or, for some ENP countries, even long-term objectives. Before engaging in negotiations on deep and comprehensive FTAs, the EU needs to consider the partners' ability to implement and sustain such agreements as well as their level of ambition" [15, p. 5]. Accordingly, before engaging in negotiations with the EU, it is important for the country, and especially for the government, to reach a political consensus not only upon the creation of a free trade regime with the EU but also upon the implementation of the legislative and institutional reforms in all of the abovementioned spheres.

Finally, it should also be noted that the success of the European Neighbourhood Policy as such depends on the success of particular cases like Georgia, Ukraine or Morocco. The EU attributes a very high importance to this policy and in all likelihood will differentiate deeply between those states which

* *Edward Best defines integrative ambition, in relation to the participation in a free trade zone, as the vision and depth of a free trade regime area and the ambition to achieve it. According to his description, the first level of such ambitions includes sectoral, bilateral (reciprocal) partial integration or unilateral (non-reciprocal) integration forms of preferentialism. A free trade regime may cover the whole of industry or all possible spheres within. Customs unions and common markets can also differ by the degree of intensity in the covering of the different spheres [17, p.55].*

** *As it is known, Ukraine has already started negotiations on the creation of such a regime.*

successfully implement the commitments taken under the action plan and those which do not pay proper attention thereto. Our aim, therefore, is to get as much assistance and support as possible in achieving our goal.

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