

GEORGIAN ECONOMIC TRENDS

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About Tacis and GEPLAC

Georgian Economic Trends is a publication which is now funded by the Tacis Programme through the Georgian-European Policy and Legal Advice Centre.

The Tacis Programme is a European Union Initiative for the New Independent States and Mongolia which fosters the development of harmonious and prosperous economic and political links between the European Union and these partner countries.

Tacis does this by providing grant finance for know-how to support the process of transformation to market economies and democratic societies. It is the largest programme of its kind operating in the region, and has launched more than 3,000 projects worth over ECU 4,220 million since its inception in 1991 and through 1999.

Tacis works closely with its partner countries and provides know-how from a wide range of public and private organisations including advice and training, developing and reforming legal and regulatory frameworks, institutions and organisations, and setting up partnerships, networks, twinings and pilot projects.

Tacis also cultivates links and lasting relationships between organisations in the partner countries and the European Union to promote understanding of democracy and a market-oriented social and economic system.

The Georgian-European Policy and Legal Advice Centre (GEPLAC) was established in 1998 by Tacis in order to support economic and legal reform in Georgia. Activities under GEPLAC's programme include the production of Georgian Economic Trends and of the Georgian Legal Review, and the provision of economic policy and legal advice to the Georgian Government. One of the major tasks of "GEPLAC III" is the elaboration of the "National Programme of Harmonisation of Georgian Legislation with that of the European Union", pursuant to the PCA.



This publication is financed by the European Union's Tacis Programme, which provides grants finance for know-how to foster the development of market economies and democratic societies in the New Independent States and Mongolia.

APPENDIX II: THE POSSIBILITY OF GLOBAL ECONOMIC CRISIS AND GEORGIA'S STRATEGY

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The horrible act of terrorism of 11th September against the USA has been a tremendous shock to the whole world. However, this event and the ensuing consequences are likely to have an even greater impact on the international economy.

Debates concerning the stability of the US Dollar and the chances for America to maintain, together with its economy, a leading position in the world in the long run, had started long before the drama of 11th September.

1. RUSSIAN SCENARIO OF THE US DOLLAR CRISIS

Let us consider a scenario providing a quite sensational prognosis suggested by Russian experts Michael Khazin and Oleg Grigoriev insisting on the inevitability of the downfall of the US Dollar (Khazin, Grigoriev, 2001).

What is this prognosis based on?

Growing imbalances between the "new" (informational) and "old" (traditional industrial) sectors are regarded as factors provoking a global crisis. While income generation in the "old economy" has remained at a comparatively moderate and at the same time stable growth rate, in the "new economy" it has been rising at rates of up to 10 per cent per month (Khazin, Grigoriev, p.16, 2001).

It is noteworthy that in the economic report of President Clinton before the US Congress made on 12th January 2001 the most attention in the national economy was drawn to the leading role of the "new economy", however, this phenomenon (as well as its definition) has not yet been fully explored (Deikin, p.3, 2001). This is not surprising, given that many American theorists have expressed doubts about introduction of the term "new economy" (Deikin, p.22, 2001). In particular, it is still being analysed on a theoretical level whether the "new economy" is an advanced phase of the postindustrial society or a new one - an "upper postindustrial" stage (Deikin, p.20, 2001).

Despite this, let us try to specify the meaning of the so-called "new economy" in a few words (For example, ECE, 2000, pp. 3-5).

One of the significant features of the "new economy" (e.g. Internet technology) is that it requires huge primary investment, the benefits from which may be realized only through a very large scale development of a given project. Starting from the initial level of profitability, even a slight increase in investment is then likely to stimulate a significant growth in profits. At the same time, some controversy has arisen concerning profitability and productivity; in particular, from the very beginning there was high expectation that the "new economy" might facilitate a sharp rise in the level of productivity but this did

not occur: it was the Nobel Prize laureate Prof. Robert Solow, who was the first to express doubts concerning the important role of computerization in the growth of productivity, which were recently proved by empirical estimations performed by other American economists (Deikin, 2001, pp. 22-23).

According to the assessment by Bill Gates - a living legend of the computer business - if the previous epochs of economic development were characterized by evolutionists as a long-term stability with short-term revolutionary interventions, called "an interrupted equilibrium", today electronic information is creating a permanently changeable environment, which he refers to as "interrupted chaos" (Gates, 2001, p.417).

It is interesting that, while the prices for "old economy" products are determined by demand and supply, the prices for "new economy" products are dependent on the future yield.

As a result, in contrast to the old economy, the new economy follows a divergent, so-called "investment" pattern. This is when large initial costs are borne by those investors who expect the highest returns over a relatively long period. Moreover, on the stock exchange the equity value of the "new economy" companies is defined from future, in a sense, "virtual" profit and not from the current balance of income and expenditure (Khazin, Grigoriev, 2001, p.19).

As stated by the authors of the proposed scenario, this hampers stock market stability, as it displays the features of a financial pyramid and its sustainability is based on psychology.

Insofar as the initial base of the "new economy" assets is rather dubious, any essential slowdown in the stock market growth rates is likely to entail a large-scale crisis.

The study underlines that after the upturn of the 70's the continuing stable economic growth of the US derived from the collapse of the USSR and the US expansion into its former markets on the one hand, and the creation of the "new economy", which "pulled over" extensive financial resources on the other hand. Hence, the USA returned the phenomenon of the 20's - fast economic growth without inflation.

The authors acknowledge the peculiarity of the American case, when the "old economy" had started to lose in competition against the "new economy" for credits and investment and in the labor market, leading to an increase in the cost of factors of production which in its turn affected overall production costs (Khazin, Grigoriev, 2001, p.23).

Thus, a steady decline in the relative profitability of the "old economy" with the ensuing outcomes is regarded as a "release mechanism" for the global economic crisis. In particular, should producers raise prices they will fail to compete with importers, resulting in growth of imports and deterioration of the trade balance deficit; while in case of maintaining supply at low prices local producers will face a real danger of loss.

Following this scenario, a substantial enlargement of financial capacity of the "new economy" resulted in a reduction in the share of savings and an upsurge in consumption provoking inflationary processes along with the rise of interest rates.

An additional factor, which intensified the inflationary process is the appreciation of the USD against other currencies resulting in import stimulation. In particular, during the 7-months period of the current year the trade balance deficit reached US 20.6 billion dollars which is 46 per cent in excess of the same indicator for the relevant period of the past year (Khazin, Grigoriev, 2001, p.24).

Inasmuch as imports begin to dominate over consumption and US companies refuse to contract production in order to avoid a risk of their shares falling, start to stockpile (with stock substantially growing - by some 1 per cent of the GDP per quarter) and publicly present this as expansion of production, there is a danger of "excessive" production (Khazin, Grigoriev, 2001, p.25).

An important factor which is expected to intensify the above-described processes is the colossal amount of US Dollars and securities placed outside the USA available for return at the first sign of a global crisis.

Under the given scenario, proceeding from the analysis of the stock market the "Dow Jones" (of a traditional sector) and "NASDAQ" (of a high technology sector) indexes should no longer have an objective basis for growth (for instance, Dow Jones index, after falling from 11000 to 10000 points in the first 2 months of 2000 was then maintained within the same range over the year), which is an indication that profitability of investment in the US stock market has diminished. At the same time, the variation of indices has become wider pointing towards the speculative behavior of "market makers". Namely, after coming out of the shock of the first days after 11th September the above-mentioned indices were 8681.42 (Dow Jones) and 1499.04 (NASDAQ), respectively and by 12th October - one month since the act of terror - 9410.45 points for Dow Jones and 1701.47 points for NASDAQ, respectively.

It is interesting to mention that the US stock market is given a similar appraisal by other Russian experts (Doronin, Zagashvili, Pripisnov, 2001). According to them, the fall in the price of shares of high technology "growth companies" at the end of 2000 and the beginning of 2001 was caused by (Doronin, Zagashvili, Pripisnov, 2001) :

- excessive capitalization; the share of high technology companies in total sales and employment did not exceed 10 per cent of the corresponding indicator for non-financial companies, it represented 36 per cent of US stock market capitalization;
- ineffective use of the attracted capital; namely, in 1995-1999 80 per cent out of US 150 billion dollars was spent by the US Internet companies on advertising, investment banks' fees for primary distribution of shares and on subsidizing the cost of the services offered;
- the speculative nature of the up-trend on the high technology stock market causing over valuation of the "growth companies".

It is noteworthy that, according to an assessment by the **Merill Lynch** experts, the fall in share prices in the USA is likely to be followed by a fall in consumption by up to US 100 billion dollars, in its turn resulting in 1 per cent reduction of the GDP.(Doronin, Zagashvili, Pripisnov, 2001). It is interesting that half of the total shares in the USA is owned by individuals. Owing to this, devaluation of "paper assets" may significantly change current consumption which will tell on demand and exacerbate (and perhaps prolong) a potential economic crisis (Rubtsov, 2001, p.44).

According to this Russian scenario of the US Dollar crisis, November 2001 is identified as the beginning of the economic crisis, as this is the time when traditionally, enterprises publish their quarterly statements of balance (Khazin, Grigoriev, 2001, p.29). Under the scenario, if by this time the rate of inflation is high, the US Dollar shall experience further depreciation.

According to one of the authors of this scenario - Michael Khazin, EURO 0.96-0.97/USD 1 is a critical rate; upon reaching this level the exchange of global holdings of US dollars into EURO could be much accelerated resulting in the fall of share prices which in its turn shall provoke a large-scale international economic crisis (Kvitko, 2001, p.7).

The conclusions presented in this scenario with regard to the effects of the crisis are quite pessimistic (Khazin, Grigoriev, 2001, p.29-32):

First, collapse of the exchange market by various estimates could entail a loss of US 7-15 trillion dollars. At the same time, it would lose its function of the "hot money" neutralizer further intensifying inflationary processes and leading to the return to the USA of the Dollars accumulated outside the country after World War II.

Second, financial institutions, the biggest part of whose assets consist of securities, would be bankrupt.

Third, budgetary incomes diminish which in its turn would be reflected in the reduction of financing for social programs. With a 1.5-3 times reduction in average consumption throughout the world, a cutback of private consumption in order to recover a long-term saving rate would still lower living standards in the USA.

Fourth, collapse of the World Trade Organization would be inevitable and this will encourage protectionism. Under such circumstances, the US dollar shall lose its function of an international currency while the EURO is not yet in the position to replace it. As a result, a multicurrency system in the world would be restored.

Fifth, countries would shift to the budgetary crediting of production. While raising competitiveness of native production this shall also serve as an impulse to the growth of inflation.

Sixth, the major exporters to America such as Japan, China and countries of South-East Asia and Russia and the countries of Latin America shall suffer a damage, the former - through reduction of exports to the USA and the latter - through depreciation of the US dollar (as for them it is a parallel currency).

As we know, in the short-term there is a positive correlation between the markets of the USA and most of the developed and developing countries (Rubtsov, 2001, p.41), providing a base for a large-scale distribution of this crisis. If one generation ago it took weeks and even months for the stock and currency crisis to expand, now when the world financial market is based on electronic contacts, the speed of the crisis distribution has been reduced to one day (Gates, 2001, p.417-418).

The authors of this scenario consider that, provided Russia creates a relatively flexible Labor Code and succeeds in assuring investors of the immutability of "the rules of the game" then, given a highly qualified work force, it would be possible to invest free capital released from the US financial markets in Russian natural resources (Khazin, Grigoriev, 2001, p.p. 29-31).

However, in our opinion it is rather doubtful that there will be any large-scale investment given the high level of corruption, existence of a high risk factor and low protection of foreign investors.

Since under the considered Russian scenario of the US dollar crisis, protectionism is expected to prosper, the Russian experts regard the practice of financial and economic policy exercised in China as rather attractive in providing maximum protection from the anticipated global crisis. However, it is notable that there is a progressive trend in the present day China which is openly aimed at reaching economic and perhaps even political domination over the rest of the world and the key slogan is "XXI century - is the century of China" (Gelbras, Kuznetsov, 2001, p.119).

The Chinese financial strategy, positively appraised by the Russian experts, can be characterized as follows (Anisimov, 2001, pp.124-138):

- a comparatively high level of regulation of price-formation (sectors producing raw-material are fully state-owned allowing the state to control prices by stimulating exporters on one hand and through protection of home produce by customs-tariffs on the other);
- average level of Tax Burden and customs-tariffs encouraging economic competition;
- high concentration of physical persons providing large financial inflow in credit institutions;
- performance of a function of a large investor by the state (total amount of state credits totals on average USD 3 billion p.a. of which medium and long-term credits issued exceed USD 1 billion);
- managed exchange system which also implies two currencies: firstly, Hong Kong Dollar efficiently used on foreign markets and a relatively "soft" but on the whole sufficiently strong "Yuan".

It should be mentioned that the state executive system and financial and economic structure of China is so specific that it is less possible to "replicate" this pattern to other states. However, it should also be taken into account that as the history proves undertaking a number of significant functions of a market on behalf of the Government puts under question sustainability of this pattern in the long-run.

In order to make an assessment of the Russian scenario of the US Dollar crisis discussed above it should be underlined that the processes described therein have been long known, which is no wonder at least because the specialists are well aware of a gradual fall of the NASDAQ index and also the reasons provoking such fall. We consider that the weakest point of the scenario prepared by Russian specialists is over-dramatization of the events, by assuming that the current strains in the economy of the USA will inevitably grow into dollar crisis and global economic collapse.

Although we partially agree with the main approaches presented in this scenario, but it is difficult to share the idea that the Dollar crisis has definitely been caused by development of new technologies. In particular, the main arguments in favor of the "new economy" are that new information technologies and market liberalization have changed the principal macro-economic interrelation between expansion of production, inflation and unemployment. New technologies ensure more effective management of reserves; enhanced management of information flows allows a more economical use of resources while the Internet provides the consumer with a wider choice of products and increasing competitiveness, which then things being equal finally leads to low inflation (ECE, 2000, pp.2-5).

2. POTENTIAL OF A GLOBAL ECONOMIC CRISIS IN THE CONDITIONS OF ANTITERRORIST WAR

The Russian scenario of the US Dollar crisis does not allow for correction of the above-mentioned processes by possible wars (Khazin, Grigoriev, 2001, p.33).

With a qualitatively new antiterrorist war having broken out in the world today, there are naturally questions arising with regard to the possibility of global economic crisis and whether the USA will retain its economic hegemony in the world.

The answer to these questions depends on the scale of this antiterrorist campaign and its territorial spread.

Two scenarios could be considered:

First, limiting the antiterrorist campaign to Afghanistan and if (as in fact was the case) on behalf of the terrorists there are no response assaults on the USA or allied states. Otherwise, this antiterrorist war initiated by the USA would have acquired the features of the war waged by the USA against Vietnam or Iraq or that of the NATO against Yugoslavia.

The economy of the USA may perhaps even benefit from such a course of events as regards the unfavorable symptoms of excessive production, since in the conditions of war military needs may "drain" it of excessive financial and material resources, hence the further extension of the stage of economic upturn.

In addition, the claiming of the leadership of the antiterrorist campaign by the USA and its continuation had to some extent prepared companies and the population to take account of the risk of war in their decisions.

Thus, according to the first scenario a global economic crisis is practically excluded.

As for the second scenario let us consider the case whereby there might occur successive acts of international terrorism and that the fight against it goes beyond the boundaries of one particular state.

Taking into account that, in case of expansion of terrorist aggression, it would be quite difficult to defeat international terrorism by means of so-called "targeted attacks", events may develop in a quite complicated way.

Firstly, if against the background of antiterrorism operations the terrorists again succeed in committing any impressive act of aggression this may seriously undermine confidence in the effectiveness of these operations as well as their main performer - the United States. If this happens it will most probably result in the loss of trust in financial institutions of the USA. In particular, the notion of the omnipotence of the United States and its currency may be damaged, resulting in a notable contraction of the extent of use of the US dollar as an internationally applicable means of settlement.

Anyway, the immediate signs of this trend unfortunately, could have been observed during the last decade: if for 1989 the share of the USD in the total exchange markets turnover was 45 per cent, for 1995 it has made up just 41.5 per cent (while the share of the USA in the gross domestic product world-wide is 20.7 per cent and in world exports - 15.2 per cent); similar indicators for European Union are correspondingly, 20.4 and 14.7 per cent; during the relevant period, the share of German Mark increased from 13.5 to 18.5 per cent and that of the French Franc from 1 to 4 per cent; impact of Swiss Franc decreased from 5 to 3.5 per cent; as to Japanese Yen, it fluctuated within 13.5-12 per cent (Tavlas, 2001, p.4). It is interesting that for 1996-2000 the analysis of the growth rates of M2 (money multiplier) gives the same picture: in particular, in 1996-2000 in the USA M2 fell by 4.7 per cent, while on the contrary M2 increased by 47.9 per cent for Japan, by 47 for the EURO zone, by 47 per cent for Great Britain, by 39.7 per cent for the Asian Four (Korea, Singapore, Taiwan and Hong Kong) and by 3 per cent for Switzerland (IMF, 2001A, p.802; IMF, 2001C, p.216). It should also be taken into account that appreciation of the major world currencies was not of inflationary nature and was mainly predetermined by the extension of the international area of their application; for instance, in Japan, in 1996-2000 there was a 6.6 per cent deflation against an essential growth of monetary aggregates (by 47.9 per cent). As concerns Great Britain, during the relevant period a rise in prices had insignificantly exceeded that of the USA and made up 13.6 per cent, the growth of monetary aggregates was much more significant, though (47 per cent) (IMF, 2001C, p.205). Following these trends, a further constriction of the area of application of the USD is to be expected.

Secondly, a negative balance of payments of the USA may continue to grow in the short-term which, together with the reduction of the area of application of the US Dollar, may provoke its devaluation.

Thirdly, the antiterrorist campaign of the USA shall to some extent result in utilization of the excess resources and postpone a possible crisis of excessive production.

Fourthly, the demand of the US Government for the production of safety measures on high technologies shall increase causing a "diversion" of private investments to state investments (the effect of "crowding out" of private investments by state ones). In its turn, this may stimulate a rise of interest rates which, considering the high transparency of the economy of USA would cause a perceptible growth of capital inflow, leading to the improvement of the balance of capital movement and correspondingly, to appreciation of the US Dollar again (though, it may be difficult to return its position of primacy).

Fifth, aviation and insurance have suffered serious damage which may also have effects on other sectors as well.

Remarkably, the USA has already indemnified losses to American airlines; the US Government publicly announced its decision to allocate USD 100 billion to support the industry (Kvitko, 2001).

As regards insurance business, it would be reasonable to mention that an average sum of insurance of a medium-ranking official at the World Trade Center made up to US 50-100 thousand dollars. Considering that on the average there were up to 50 thousand people employed in this building, a loss incurred by insurance companies is tremendous (as estimated by experts the expenses of insurance agents make up to US 25-40 billion dollars) (Gabashvili, 2001).

It might be that insurance and re-insurance companies generally increase the rates of insurance premium, ultimately resulting in an increase of production costs and hence, in price rises.

Taking into account the fact the Europe is also actively involved in the antiterrorist campaign, it is not at all excluded that Islamic terrorists may try to carry out acts of aggression against Europe as well. Naturally, under such conditions the demand for insurance would increase in Europe too.

One of the most serious forms of aggression is via computer through which terrorists try to disrupt electronic connections in various fields. In case of use of this form of aggression in financial markets, a world-wide financial and economic crisis would be inevitable.

Under the second discussed scenario, with the antiterrorist war underway a possibility of evading a global economic crisis is largely dependent on the success of military actions by the USA and its partner countries and on the perfection and timeliness of the preventive antiterrorism measures on their part. The success of the antiterrorist operations carried out in Afghanistan has much lowered the potential for a second occurrence.

3. DANGER OF A GLOBAL ECONOMIC CRISIS AND GEORGIA

Regarding the trend of developments in the world, a significant rise in prices for oil is not very likely to occur. As regards a moderate rise, this could be reflection of the increase of insurance components in costs of oil production and transportation on one hand and of certain delays in supply on the other hand. It should also be underlined that the possibility of carrying out acts of terrorism by terrorists

against oil-producing Islamic countries is practically excluded as this would deprive them of a potential justification to declare "Jehad" - a religious war - against the West.

Proceeding from the above-referred, it is dubious whether this will contribute an additional argument on economic advantages to the political attractiveness of the investment Baku-Tbilisi-Ceyhan project of the oil pipeline (Papava, 2001, p. 20).

Taking into account that Georgia is a small economy it is not in a position to influence global economic developments, but pursuing a more or less reasonable economic policy may even bring certain benefits, though, if we say nothing about minimization of the impact of negative effects.

It is unlikely that antiterrorist hostilities would somehow hamper functioning of the Georgian transport corridor for a definite period. If this is to happen anyway, it will provide a certain argument for the development of Russian transport links and Russia will naturally make the maximum use of this opportunity.

The fact that under the decision of the US Government, the American military will in the near future undertake preparation of Georgian army units for carrying out antiterrorist operations will qualitatively improve the national security situation which in its turn, will contribute to the further increase of the international role of the Georgian transport corridor.

It is worth noting that, in the war of the USA against terrorism, the understanding and support of such Europe-oriented Islamic countries as Turkey and Azerbaijan has been growing. This would further increase the international role of the Georgian transport corridor for transportation of energy resources from Azerbaijan to Turkey.

Naturally, when Russian experts regard the perspective of a global economic crisis as inevitable (which in our opinion is somewhat exaggerated), questions arise concerning Georgia's monetary policy in case of a possible devaluation of the USD and the advantages and disadvantages of maintaining the current rate of the Lari.

One of the important characteristics of the post-communist economy is a large-scale shadow economy mostly "served" by the US Dollar. The shadow economy would suffer most in case of a significant devaluation of the USD, which does not presently entail its substitution by legal economy as this last is, though relatively less, but still is quite dependent on the US dollar. In Georgia the share of statistically unrecorded production in total output was 32.5 per cent in 2000 and 31 per cent during a nine-month period in 2001, while in the entrepreneurial sector the indicators are correspondingly, 55.0 and 54.1 per cent (SDSG, 2001, p.5). A severe devaluation of the USD would place almost one third of Georgian economy (i.e. shadow economy) and over half of the entrepreneurial sector under the risk of total destruction. As regards shifting to the legal sector, it will be prevented by a similar situation inside the shadow economy, when as of September 2001, deposit liabilities and the amount of loans in the USD issued to non-governmental sector from the banking system exceeds 80 per cent (SDSG, 2001, p.29,31).

For the legal sector of the Georgian economy a positive effect resulting from the possible devaluation of the USD is the reduction of the Lari equivalent of the amount of the foreign debt representing a relief for the State Budget of Georgia.

At the same time there are negative effects that should also be regarded.

Firstly, import stimulation which would further increase the deficit in the balance of payments;

Secondly, reduction of payments to the Budget from foreign investments;

Thirdly, less possibilities of covering budgetary liabilities from external sources.

Georgia faced certain challenges, owing to the financial and economic crisis in Turkey, its major trading partner. However, thanks to the support by the IMF the tension has relieved.

We believe that, along with tightening customs control, Georgia should introduce certain restrictions based on international quality standards so as both to protect the interests of consumers in Georgia and to achieve an improvement of the balance of payments.

It is important to maintain stability of the exchange rate of the Lari. According to the conception not so infrequently expressed by some economists in Georgia (as well as in other post-communist countries), for exports and economic growth stimulation devaluation of the Lari would be reasonable. However, it has been demonstrated theoretically that, with the technical backwardness of production and noncompetitiveness on international markets, devaluation of the currency would rather promote a rise in inflation and not of production or exports (Papava, 1997, 2000). Taking Georgia's case as an example, the State Department of Statistics gives practical proof to this theoretical certainty: in January-September 2001, the real exchange rate of the Lari fell by 18 per cent against the Ruble and by 5.5 per cent against the USD but this failed to ensure improvement of the balance of payments against the relevant period of the past year: during a 9-month period in 2001, the trade deficit was US 288.5 billion dollars while during the relevant period in 2000 this indicator was US 218.4 billion dollars (SDSG, 2001, p.34,43).

In a situation of a possible devaluation of the US Dollar, diversification of the currency reserves by the NBG is regarded very important, presently counting all more or less stable currencies in these reserves.

According to the idea of some experts, in view of the confrontation between United States and their allies and the Islamic terrorists, it is likely that the highest stability will be preserved by those currencies of those countries which are less involved in military action. First of all this includes Japanese yen and Swiss franc. Hence, currency reserves of the National Bank of Georgia should reflect at least a five-pole economy (USD, EURO, Yen, Pound sterling, Swiss franc).

Taking into account the fact that the value of the IMF unit of account - SDR, in contrast to the component currencies, is characterized by high stability (as the changes in the exchange rate of one of the currencies comprising the basket is usually compensated by the dynamics of the exchange rate of other currencies), the second model of the currency reserves of the National Bank of Georgia can be based on the SDR structure; In particular, to achieve maximum security of these reserves the basket should have the same composition as the SDR with regard to the percentage of each comprising currency.

Starting from 1 January 2001 till now, the SDR has been evaluated basing on the basket composed of: 45 per cent - the USD, 29 per cent - EURO, 15 per cent - Japanese yen and 11 per cent - Pound sterling (IMF, 2001B).

It is important to note that the NBG recommended to commercial banks and generally to all legal or private entities to diversify their deposits in order to minimize risk.

And last but not least, the biggest threat to Georgia is not external shocks but the existing crisis situation inside the country. This last can never be overcome unless corruption is deprived of its economic basis and poverty is eliminated through economic upturn, which in turn requires carrying out serious system reforms.

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