



GEORGIAN FOUNDATION FOR STRATEGIC AND INTERNATIONAL STUDIES

RONDELI BLOG

<https://www.gfsis.org/blog/view/1141>

COVID 19 Pandemic Economic Crisis and Reducing the Instability of Georgia's National Currency

2020 / 12 / 17

Author: Vladimer Papava, Senior Researcher at Rondeli Foundation

Maintaining the stability of the exchange rate of Georgia's national currency – GEL is not directly related to the COVID 19 pandemic economic crisis as the depreciation of the currency **started much earlier** (Anguridze, Charaia, Doghonadze, 2014) than the pandemic did. The basis for the depreciation of GEL were economic, psychological, administrative and political **factors** (Papava, 2018). The problem of maintaining the stability of the GEL's exchange rate was exacerbated in the conditions of the **pandemic** (Lomsadze, 2020).

In order to maintain the stability of GEL, short, medium and long-term tasks need to be resolved, some of which are discussed in this post.

During the COVID 19 pandemic economic crisis, short-term measures take priority as it is necessary for both businesses as well as the population to maintain trust towards GEL during this specific crisis.

Before introducing GEL, as well as after its introduction, opinions have been voiced periodically, as is the case today, that we must renounce GEL as the only legal tender and move the country to a multi-currency regime where each individual or entity will be free to choose the currency that they would like to use. In such a case, not only the economic sovereignty of Georgia will be damaged but it will turn the country into one big currency exchange booth as performing multi-currency exchange operations will become a top priority for businesses.

There are also opinions presented periodically that a convertible foreign currency should be introduced in circulation, instead of GEL, or a “Currency Board” must be established instead of the National Bank of Georgia (NBG) where GEL will be pegged to a convertible foreign currency with a fixed exchange rate. Even if both of these approaches were justified, they are still impossible to implement as the economy of Georgia is not capable of generating sufficient amounts of foreign currency. The confirmation of this is that imports exceed exports almost three times over which means that the country loses USD 3 in imports for each USD 1 generated by exports. If the economy of a country is not able to generate sufficient amounts of convertible foreign currency, it will not have enough of it to use as legal tender or maintain its fixed exchange rate with regard to the national currency.

In a short-term perspective, we consider it advisable to move from GEL’s floating exchange rate to a managed floating exchange rate which the NBG has practically been doing with the recommendation of the International Monetary Fund (IMF) [since March 2020](#) (meaning after the beginning of the pandemic), albeit not very successfully (IMF, 2020).

At the same time, the NBG must also renounce its [inflation targeting regime](#) (NBG, 2020b) in monetary policy as this tool simply does not work in import-dependent countries as pointed out by Nobel Prize winning [Joseph Stiglitz](#) (Stiglitz, 2008). It is worth noting that similar opinions have been stated by other famous [economists](#) (Weber, 2015) as well.

Precisely due to the fact that Georgia is an import-dependent country, the [inflation rate](#) is very important as it reflects the changes in prices of that specific part of the consumer basket which is comprised of imported goods and services.

It is necessary for the NBG to move to the [complex inflation targeting](#) (Papava, Charaia, 2019) regime when not one but two indicators are targeted – inflation and imflation. In such a case, in order to achieve the target indicator of imflation, it will be necessary for the NBG to properly regulate the exchange rate of GEL which is of special importance not only today, which is to say during the COVID 19 pandemic economic crisis, but will also be a priority in the post-crisis period as well.

During the COVID 19 pandemic economic crisis, the negative sides of the large-scale measures performed by the NBG with the goal of [larization](#) (NBG, 2020a) have revealed themselves rather starkly. Namely, artificially increased demand on the national currency in import-dependent Georgia forced the NBG to also increase the amount of refinancing loans given to the commercial banks. Consequently, this caused the increase of the volume of money in circulation (M2). It is advisable for the larization measures to be stopped at least during the pandemic and the upper margin of loans to be given in GEL in the post-crisis period be reduced significantly.

It is necessary for the NBG to be constantly involved in currency trade operations through the Bloomberg system, buying or selling convertible foreign currency not in priorly announced amounts, but rather in amounts necessary to exclude the possibility of jumps in the dynamics of the exchange rate.

It is also necessary for the governance of the NBG to be in constant public communication with society, commercial banks and other businesses with the aim of the stabilization of the currency market.

In the medium-term perspective, it is necessary to take measures that will facilitate the development of the real sectors of economy in Georgia as a result of which the share of the home-produced goods in the consumer basket will increase from current 20% at the expense of reducing the share of imports (currently at 80%).

With this goal in mind, the funding of the *Produce in Georgia* project must increase. It must fund only the real sector of the economy – not the companies in the field of services. Given the name of the program, it must be focused on production alone and not recreation (the name of the program is *Produce in Georgia* and not *Relax in Georgia*). This program must create factories near every settlement (for example, factories for the processing of agricultural products).

The possibility of the government investing in the creation of various types of factories and then privatizing them must not be excluded either.

In a long-term period, it is absolutely necessary to start producing the kind of export products that contain large amounts of added value as exporting those would significantly increase the inflow of foreign currency into the country. This will cause both the export potential of the country as well as the volume of the gross domestic product (GDP) to jump up. Achieving this is only possible by moving the country to a *knowledge-based economy model*. In this regard, it is advisable for the Government of Georgia to revisit and implement the initiative of producing electric cars through Chinese technologies in Kutaisi. It is necessary for the state to support the implementation of other projects that are based on modern technologies.

The work of the government with those potential foreign investors that are looking for places for factories removed from China due to the pandemic needs to become more active. In this regard, Georgia must use the already existing free trade agreements with the European Union (EU) and China. A rather realistic prospect that such an agreement may be signed [with the United States](#) (Rapoza, 2020) as well in the near future must also be taken into account.

In order to move to the aforementioned economic model, education and science must become a national priority (not only education, as it is today) as the new technological products created by science contain the largest volume of added value. Supporting science is necessary at the very least in order to have good teachers (professors) who will train teachers in the country.

It is necessary for scientific work to become prestigious which will allow talented youth to search for the development of their careers not only in businesses and the public service but in science as well. For this, it is necessary to significantly increase the funding of the Ministry of Education and Science which should ensure a sufficient increase in the remuneration of the work of scientists and the improvement of their working conditions. Citizens of Georgia should be provided not only with full budgetary funding for PhD (at the initial stage and later the same should apply to Master and Bachelor degrees) programs in state universities but with a sufficient amount of scholarship as well so that a young person interested in science does not have to look for work elsewhere.

Vocational education needs to be substantially improved as well so that citizens of Georgia are able to be employed in factories equipped with modern technologies. In such a case, the necessity of importing qualified foreign labor will be reduced to a minimum.

The COVID 19 pandemic economic crisis creates new opportunities and not using them to their fullest will be an utterly unjustifiable mistake.

References

- Anguridze O., Charaia V., Doghonadze I., 2014. *Security Problems & Modern Challenges of the Georgian National Currency*. Tbilisi, TSU Publishing House, <[http://press.tsu.ge/data/file_db/nashromebi/Security-Problems-Modern-Challenges-of-the-Georgian-National-Currency2%20\(1\).pdf](http://press.tsu.ge/data/file_db/nashromebi/Security-Problems-Modern-Challenges-of-the-Georgian-National-Currency2%20(1).pdf)>.
- Charaia V., Papava V., 2017. "From Inflation to Imflation, Agflation and Munflation." *The Market Oracle*, April 6, <<http://www.marketoracle.co.uk/Article58686.html>>.
- IMF, 2020. "Georgia Sixth Review Under the Extended Arrangement and Requests for a Waiver of Nonobservance of Performance Criterion, Modification of Performance Criteria, and Augmentation of Access; Press Release; Staff Report; And Statement by the Executive Director For Georgia." *IMF Country Report*, No. 20/149, May, <<https://www.imf.org/~media/Files/Publications/CR/2020/English/1GEOEA2020001.ashx>>.
- Lomsadze G., 2020. "Georgian Currency Falls Ill as Virus Spreads." *Eurasianet*, March 26, <<https://eurasianet.org/georgian-currency-falls-ill-as-virus-spreads>>.
- NBG, 2020a. "Larization." *National Bank of Georgia*, <<https://www.nbg.gov.ge/index.php?m=566&lng=eng>>.
- NBG, 2020b. "Monetary Policy Strategy of the National Bank of Georgia." *National Bank of Georgia*, <<https://www.nbg.gov.ge/index.php?m=628&lng=eng>>.
- Papava V., 2018. "Depreciation of the Georgian National Currency: Economic, Psychological, Administrative and Political Factors." *Rondeli Blog*, September 17, <<https://www.gfsis.org/blog/view/864>>.
- Papava V., Charaia V., 2019. "On Complex Inflation Targeting and Modified Inflation Indicators (Experience of Georgia). *Finance: Theory and Practice*, Vol. 23, No. 3, <<https://financetp.fa.ru/jour/article/view/855/575#>>.
- Rapoza K., 2020. "Why Does Everyone Suddenly Want A Free Trade Deal With Georgia?" *Forbes*, 2020, March 5, <<https://www.forbes.com/sites/kenrapoza/2020/03/05/why-does-everyone-suddenly-want-a-free-trade-deal-with-georgia/#4ec8165750e6>>.
- Stiglitz J. E., 2008. "The Failure of Inflation Targeting." *Project Syndicate*, May 6, <<https://www.project-syndicate.org/commentary/the-failure-of-inflation-targeting?barrier=accesspaylog>>.

Weber A., 2015. “Rethinking Inflation Targeting.” *Project Syndicate*, June 8, <<https://www.project-syndicate.org/commentary/rethinking-inflation-targeting-price-stability-by-axel-weber-1-2015-06?barrier=accesspaylog>>.