GEORGIAN ECONOMIC TRENDS

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

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ABOUT GEORGIAN ECONOMIC TRENDS

Georgian Economic Trends quarterly publication aims to provide all those interested in the progress of economic reform in Georgia with a review of developments. *GET* was established in 1995 and is published in Georgian and English. This and previous editions of GET are available on the internet at:

www.geplac.org

This edition draws on information from a wide range of government and non-government sources including in particular the State Department for Statistics, the National Bank of Georgia, the United State Social Safety Fund, the Ministry of Finance, the Ministry of Trade, the Ministry of State Property Management, the Minister of Labour and Social Affairs as well as other Government ministries and departments. Wherever possible every care is taken to ensure that data sources are fully acknowledged since without the full co-operation and support of information providers, including regular consultation, it would not be possible to produce this review. The purpose of *GET* is to offer an independent analytical account of economic trends drawing on information made publicly available. As part of this work, comments and advice are offered on policy and on the collection and dissemination of economic and other information. These are always intended to support the process of economic reform in Georgia and represent the view of the authors and editors only and do not represent any official view of the European Commission, the Tacis Georgian-European Policy and Legal Advice Centre or the Government of Georgia. Readers may quote any information used provided it is properly acknowledged.

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EDITORIAL: RESULTS OF THE YEAR

By Gustavo Rinaldi, Chief Economic Adviser, GEPLAC

Georgian Statehood can be strengthened only if the economy develops and the state regains control in some key fields as law and order, justice and generally speaking the public administration, and becomes able to enforce the law.

National resources should be directed as much as possible to investment, the strengthening of the organs of the state, and to social cohesion.

These can be achieved with two tools: better action of the tax system and support to investments.

The tax system works if the tax administration is properly managed and if the state enjoys the trust of its citizens. Chasing those who do not pay taxes is necessary, but cannot be the only tool. Citizens should start believing that the State really operates in their favour and is committed to the cohesion of the society. Widespread corruption and mismanagement of public resources does nothing to support this and is an open invitation not to pay taxes: this will further undermine the integrity of Georgia.

It destroys the statehood of Georgia when people see luxury business cars bought for state officials, while pensions are not paid or paid in extremely small amounts.

It is true that at most business is in the shadow economy. This is estimated to be between 25 and 40 per cent (probably much more)[1] of the total. It is also true that to tax shadow activities is not simple. The shadow economy is not an exclusive feature of Georgia. Combatting the shadow economy is a an international problem. Techniques learned elsewhere have to be introduced and fully applied in order to find new sources of revenue. To attain this objective a strong political determination is required.

In 2000 the Georgian economy has slightly improved. GDP has grown in almost every sector, excluding agriculture. Agriculture is still very weak and much dependant on weather conditions. Foreign trade has improved. The trade deficit remains, but it is (in GDP terms) smaller than in the past. Several activities have seen significant increases. Industrial production in 2000 grew by 3 per cent and services by 7 per cent. This result is even more interesting if we consider that services in private ownership[2] have on average grown by 8.2 per cent. The consumption of energy has increased by 16 per cent.

In 2000 the debt/GDP ratio decreased by 4 precentage points and this is certainly good news, as it is good news that foreign debt as a share of GDP has decreased as well. The Georgian Government and Parliament can be proud of this, since the debt can become a bad enemy of the country. Today, debt service takes up already almost one third of the central budget, subtracting resources from the strengthening of the statehood and from social purposes. It is important when a country, even in difficult macroeconomic conditions, is able to decrease its indebtedness.

The positive step of this year remains as a commitment for the future.

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[1] See IMF, Georgia: Recent economic developments and selected issues, Washington, May 2000. and Ministry of Economy, Industry and Trade of Georgia, Program on social and economic rehabilitation and economic growth, Tbilisi, 2001 (in Georgian language). 40 per cent is an EU estimation.

[2] With this expression we mean: trade, hotel and restaurants, transport, telecommunication, financial intermediation, operation with real estate and commercial activities.

CHAPTER ONE: SUMMARY

NATIONAL ACCOUNTS AND MAIN TRENDS

In 2000, growth has been weak: it was only 1.9 per cent, the lowest figure since 1995. The distinctive feature of 2000 is the rise of national product in almost all sectors of the economy (industry, transport, telecommunication, construction), excluding the agrarian sector. A lasting drought negatively affected agriculture. The total loss exceeded GEL 400 million and the drop in value added in agriculture compared with 1999 was about 12.6 per cent. Like in previous years, growth in services sectors (transport, telecommunication, financial mediation) continued at a high rate. In 2000, growth in manufacturing was 10.7 per cent and in extractive industries was 75.6 per cent. Investment activity remained quite weak. Gross investment in fixed capital was 5.6 per cent of GDP (about the same as in 1999), that remains one of the lowest indicators among the transition economies.

Georgian state debt amounted to GEL 4,548.5 million. Its ratio to GDP (73.5 per cent) has decreased by 5.2 per cent compared with 1999. It was mainly caused by a reduction in the ratio of foreign debt to GDP from 55.2 per cent to 49.3 per cent. In February 2001, the Georgian Parliament has ratified the so-called "zero option" on the arrangement for the legal succession of foreign state debts and assets of the former Soviet Union, that gave Georgia opportunity to restructure the foreign debt. The state internal debt continues to grow. In 1997-2000, it increased from GEL 944.6 million to GEL 1,497.5 million and its ratio to GDP was 24.2 per cent, compared with 20.2 per cent in 1997.

Despite the substantial growth in exports of goods, the current account deficit increased in 2000 compared with 1999. The main reason is the reduced inflow of official transfers and also incomes from short-term and long-term Georgian emigrants abroad. Also in 2000 there was a substantial drop in foreign direct investments (by 18 per cent) compared with 1999.

GOVERNMENT FINANCE

In 2000 as in the previous year, the Georgian state collected approximately 12 per cent of GDP in tax revenues. The revenues of the Central budget in GDP terms decreased. The low tax collection remains the main problem of public finance. Almost one third of the expenditure of the Central budget has been used to service debt. Almost all other expenditure items to be reduced.

MONEY AND FINANCE

According to the State Department for Statistics, the annual inflation in 2000 was 4.6 per cent, which was less than the targeted 6 per cent. In 2001, targeted inflation is also 6 per cent.

In the “Law of the State Budget” for 2001 the total revenues are planned to be GEL 840 million, total expenditure GEL 1,120 million, and the total deficit GEL 278 million. GEL 20 million is to be financed by the T-Bills emissions. To reduce the inflationary effect of the financing of the budget deficit and following a tight monetary policy, the NBG will issue credits to the Central Government only for external debt service.

The official exchange rate has shown a small fluctuation in H2 2000. There was a seasonal demand increase for GEL before the New Year and Christmas holidays, from households and taxpayers. Thus there was a seasonal appreciation of the GEL against the USD. At the very beginning of January, the

GEL depreciated as it usually does, since the new financial year is just starting. The depreciation continued in February 2001.

Taking into account the 2-year history of the free-floating exchange rate of the lari, one can expect a further nominal appreciation of the lari. However, the Turkish currency crisis (see Money and Finance Chapter) can negatively effect the trade balance and the lari nominal exchange rate.

INTERNATIONAL TRADE

The normalization of Georgian trade relations with the rest of the world has made some further progress, in particular with the USA. In a statement issued in December 2000, US President Clinton extended nondiscriminatory treatment – normal trade relations – to Georgian products. Despite Georgia's accession to the WTO, the obligations of the WTO were not applied between the USA and Georgia. This is because Georgia's trade status was still conditioned by the Jackson-Vanik amendment.

The trade deficit keeps on reducing even though a large part is out of the Georgian official registration. Georgia's trade deficit was USD 370.3 million, that is USD 12.6 million less than in 1999. It represents 12 per cent of GDP while in the previous year it was 13.6 per cent of GDP. Georgia's export to import ratio in 2000 was 47.1 per cent. Despite the fact that the export/import ratio is higher than it was in 1999 (39.6 per cent) Georgia needs to increase this indicator significantly. CIS, EU and Turkey remain the main trade partners of Georgia.

PRIVATISATION

In the second half of 2000, the privatisation process saw some progress. This progress was mainly achieved in the preparation of enterprises for sale or liquidation. The objects easy to privatise have been already transferred into private ownership, while the enterprises of special importance to the economy need more examination and time to be privatised. Some large enterprises such as the joint stock companies (JSC) Metekhi Ceramics, Saktungoeterzeti, Intelsat and Georgian State Insurance were privatised in the second half of the year. However, the investors in two large enterprises Chiatura Mangenese and Rustavi Metallurgical Plant failed to fulfil the conditions set by the tenders and it is likely that the enterprises will need new investors soon. Preparation work to privatise the assets of the energy and telecommunication sectors, water supply and sewage system is under way. It is important to note that bankruptcy cases have been raised against some large enterprises. The actual introduction of bankruptcy procedures may speed up the overall privatisation process in the country.

EMPLOYMENT, INCOMES AND THE SOCIAL SAFETY NET

LABOUR MARKET

The employment situation remains largely unfavourable and unstable. While unemployment rate figures suggest optimistic conclusions, persisting underemployment and widespread hidden and disguised unemployment behind these figures blemish the overall picture, aggravated further by long-term unemployment. A vast proportion of those employed work substantially less than full-time and earn much less than a living subsistence. The national unemployment rate is highly biased by the rural figures. The majority of those employed are self-employed and majority of the latter are self-employed in agriculture. Many of them are hardly earning a living, yet that cannot be considered unemployed. Urban unemployment, though, is almost twice as big as national. Counting long-term unemployed, or "discouraged workers" would show a picture much closer to reality.

Many public sector employees are paid only token salaries, the cases of non-payment of salaries is widespread, arrears in the payment of budgetary employees' salaries persist, and the growth in salaries is eroded by inflation.

Social policy reform is among the top priorities in the country, as it is apparent that the existing system is unsustainable. The current social safety net system is largely the heritage of the soviet past and in the conditions of transition economy appears to be ineffective as poverty refuses to subside. The pay-as-you-go pension system is not in a position to ensure payment of the extremely low, flat rate benefits payable to all the pensioners and the tightly targeted and token social benefits are unable to alleviate poverty. However, even these are too high a burden for the current government budget. The fundamental restructuring of the state social protection system is indispensable and should be aimed at creating economically viable, affordable and equitable social safety net, promoting growth. The Government, in its interim Poverty Reduction Strategy Paper, has laid out structural reforms to reduce poverty and stimulate economic growth.

THE EU-GEORGIAN RELATIONS

The EU Ministerial Troika (Mr. Javier Solana – Secretary General/High Representative of CFSP, Mrs. Anna Lindth – Minister of Foreign Affairs of Sweden, and Mr. Chris Patten – EU Commissioner for External Relations) visited Georgia during in February 2001. The Troika visit emphasized the EU interest towards Georgia with a view to supporting peace, stability, prosperity and regional cooperation.

During the last year the trade relations intensified between Georgia and European Union and trade turnover amounted to USD 235.4 million. This is USD 50.9 million more than in 1999. In 2000, Georgian exports amounted to USD 68.3 million and imports to USD 167.1 million. The trend of the last year shows a decrease of Georgian imports from EU Member States and an increase of Georgian exports to the European market.

Georgian-Greece economic relations intensified after the restoration of Georgian independence. These relations cover economic, financial, technical assistance and other spheres.

According to State Department for Statistics of Georgia, last year trade relations between two countries amounted to USD 18.9 million. However, official data on Greece-Georgian trade relations provided by the National Statistic Service of Greece are different.

In terms of investments Greek business people are cautious. They prefer to develop trade relations with Georgia than to invest in the country.

CHAPTER TWO: NATIONAL ACCOUNTS AND MAIN TRENDS

GDP and main trends: Agriculture is a worrying exception to generalised growth

In 2000, the rate of growth was weak at only 1.9 percent, the lowest figure since 1995. GDP was GEL 6.186 billion or in per capita terms GEL 1,340 (USD 678). This corresponds in purchasing power terms to a GDP per capita of about USD 2,750. With a similar methodology, five low income Phare countries have an average GDP per capita of more than EUR 4,900.

A distinctive feature of 2000 was the rise of national product in almost all sectors of the economy (industry, transport, telecommunication, services, construction), excluding the agrarian sector (see table 2.1). The events of the years 2000 and 1998 have indicated a high vulnerabiliity of agriculture to climatic shocks.

Under the relative stability of GEL against USD, the inflation rate in 2000 was 4.6 per cent, that is the lowest level since 1993. This was induced by the strict monetary policy of NBG. The prices of food products, beverages and tobacco increased by 7.5 per cent and services by 1.9 per cent. Other prices did not change much.

Table 2.1: Dynamics and structure of Georgia's GDP, 2000
(1999 = 100)

	2000 versus 1999	**Share in GDP 2000**
Agriculture etc.	**87.4**	**21.5**
Agriculture, forestry and fishing	87.4	21.5
Industry and construction	**103.0**	**21.5**
Industry	104.7	13.3
Domestic processing of agricultural products	97.5	4.7
Construction	104	3.5
Services	**106.9**	**51**
Trade	108.5	11.8
Hotel and restaurants	104.6	2.2
Transport	109.3	11.5
Telecommunication	115.5	2.5
Financial intermediation	115.5	1.6
Operation with real estate, commercial activities	102.5	7
State management, Defence	98.4	3
Education	106	3.2
Health care	103.9	4.9
Communal, social and perosnal services	106.9	2.9
Services hired by the households	95.4	0.4
Net taxes	124.5	5.9
GDP	**101.9**	100

Source: State Departments for Statistics

Investments: still at a low level

Investments in fixed capital in 2000 amounted to GEL 349 million, a bit more than in 1999 (GEL 312 million). The ratio to GDP (5.6 per cent) remained almost the same as in 1999. It is one of the lowest levels among the transition economies[1] and substantially falls behind the Central European and Baltic levels. The lack of investment can threaten a fast recovery of the national economy. A peaceful environment, the reduction of corruprion and the enforcement of law are preconditions to attract higher investments; it seems necessary to grant additional incentives to investments, e.g., tax reductions for those who invest.

SECTORS OF ECONOMY

Industry: a growth of 3 per cent

In 2000, the value added of industry grew by 3 per cent. The registered industrial output amounted to GEL 1,051 million, 10.8 per cent more than in 1999. Extraction of minerals (oil, gas and manganese ore) has substantially increased (by 75.6 per cent); production of alcoholic and nonalcoholic beverages, sugar, chemical products, electrical appliances have grown as well. Manufacturing has grown by 10.7 per cent.

Another positive trend in 2000 was the expansion of the share of the non-state sector from 48.7 per cent to 51.3 per cent of total industrial production. The share of industrial products produced by small enterprises has grown from 12.9 to 15.3 per cent. Constructions keep on being a very vital sector of the economy with a growth of 4 per cent. The shadow economy is widely present in this activity.

A stronger restructuring of industry can only take place if the bankruptcy mechanism becomes effective and if industrial investments find a better tax treatment.

Agriculture: weather conditions have affected it very badly

Hard climatic conditions adversely affected agricultural production, especially in the regions of Eastern and South Georgia. The value added created in agricultural sector in 2000 was 12.6 per cent less than in the relatively successful 1999. The total loss exceeded GEL 400 million[2].

A downward trend was observed in almost all the branches of plant-growing. The lasting drought heavily damaged the production of cereals (wheat, barley, maize), sunflower and haricot beans (See table 2.2). The lack of forage induced farmers to slaughter their cattle.

Table 2.2: Agricultural Products Output
(Thousand tonnes)

	1995	1996	1997	1998	1999	2000
Grain, total	516.2	652	902	598	773	407
Wheat	76.5	114	311	145	226.1	89
Maize	386.5	491	546	420	490.5	283
Sunflower	7.1	4	31.4	22.8	40.5	3
Tobacco	1	1	0.7	3.4	2.1	1.5
Haricot bean	14.3	21.7	15	9.2	9.3	3
Potatoes	353.3	285	353	350	433.3	350
Vegetables	428.3	386	513	380	417	360
Fruits	383.9	361	299	279	296	250
Grapes	422.4	311	309	238	220	210
Tea	38.5	86.8	33.2	47.2	60	24

Source: State Department for Statistics, the Ministry of Agriculture and Food products

[1] The ratio of gross fixed capital invetsment to GDP in Bulgaria is 15.9 per cent, Czech Republic 26.4 per cent, Estonia 25.1 per cent, Hungary 23.9 per cent, Latvia 25.0 per cent, Lithuania 22.5 per cent, Poland 26.2 per cent, Romania 18.5 per cent, Slovakia 30.8 per cent (1999 data).
[2] Main results and the priority tasks of Georgia's economy 2000. Ministry of Economy, Industry and Trade of Georgia.

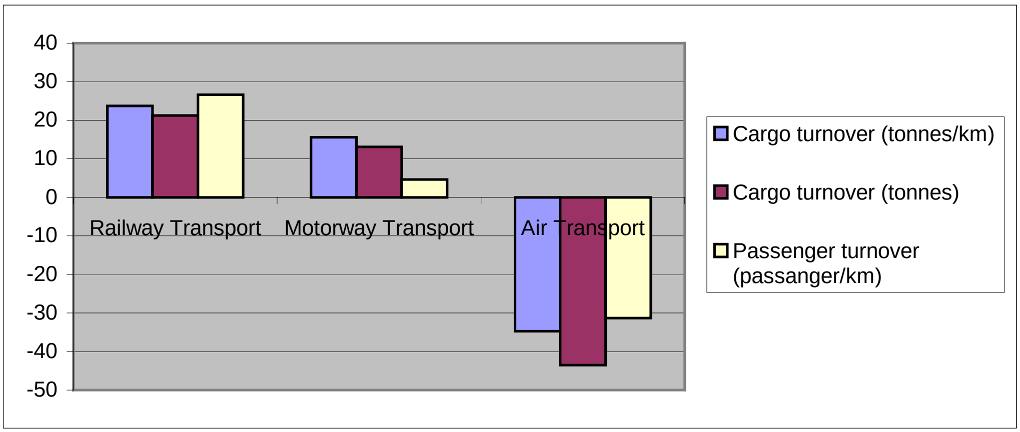
Structural problems

Agriculture has a labour productivity much lower (about 4 times) than in other industries. Most households are too small and rely on manual work, agricultural techniques are commonly obsolete, the fertility of soil is decreasing and the irrigation and drainage system needs restoration. Solving these problems is related to the creation of favourable conditions for investment in agriculture. This requires the creation of a market for agricultural land; a necessary step in this direction is the complete introduction of a land registration system. As of October 2000, 1 million plots were titled[3], i.e. only about one fourth of all plots in private ownership. The formation of a land market can promote credits to agricultural producers, because land could become collateral for loans. The capitalisation and consolidation of farms could follow. An alleviation of the tax burden on agricultural producers would be probably necessary as well.

Transport and telecommunications

In 2000, railway and motorways transported significantly more cargoes and passengers than in 1999 (see Figure 2.1). The railway transported around 7 million tonnes of Caspian oil. The average speed of Georgian trains is still very low, largely becasue of the old age of tracks and carriages. Cargo turnover in Poti and Batumi sea ports increased by 28 per cent to 10.5 million tonnes. Supsa exported 4.9 million tonnes of oil. Data on the Georgian fleet are still unreliable and we do not publish them. In 2000, air transport experienced a sharp decline. The main reason is the outdated fleet of air carriers; the reduction of traffic affected passenger turnover in Georgian airports (-16.4 per cent).

Figure 2.1: Growth in transport sectors in 2000 compared with 1999
(Per cent)



Source: State Department for Statistics

Growth of mobile telecommunication network

In 2000 there was a substantial extension of the mobile telephone communication network. The number of mobile consumers has increased by 2.6 times. Today there are 185,500 subsdcribers of mobile telephones, i.e., 4 per cent of the population.

[3] State Department for Land Management.

ENERGY

ENERGY BALANCE OF GEORGIA: SOME IMPROVEMENTS AND A LONG WAY AHEAD

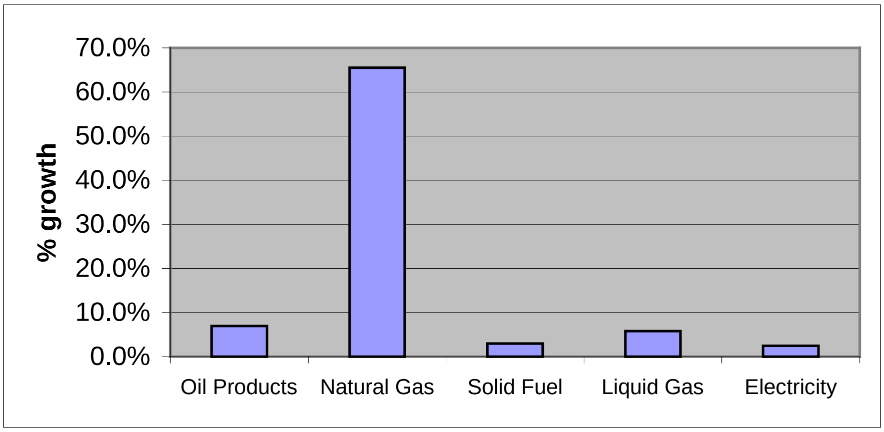
Table 2.3: Consumption of Energy Resources (thousand tonnes of oil equivalent)

Energy	1999	2000 (estimates)
Oil Products	2,150.0	2,300.0
Natural Gas	725.0	1,200.0
Solid Fuel	500.0	515.0
Liquid Gas	52.0	55.0
Electricity	722.0	740.0
Total Consumption	**4,149.0**	**4,810.0**

Source: Ministry of Economy, Industry and Trade

In the last years the country had an extremely limited supply of energy and some increase is quite needed. A Georgian citizen consumes on average less than half of what is consumed by a citizen of Central Europe or the Baltics. Figures show that in 2000 energy consumption in Georgia increased in physical terms by almost 16 per cent compared to the previous year. However, this is the registered consumption only, but for sure certain amount of fuel is smuggled through the Shida Kartli border with Russia, with losses of revenues for the budget.

Figure 2.2: Growth of Energy Consumption

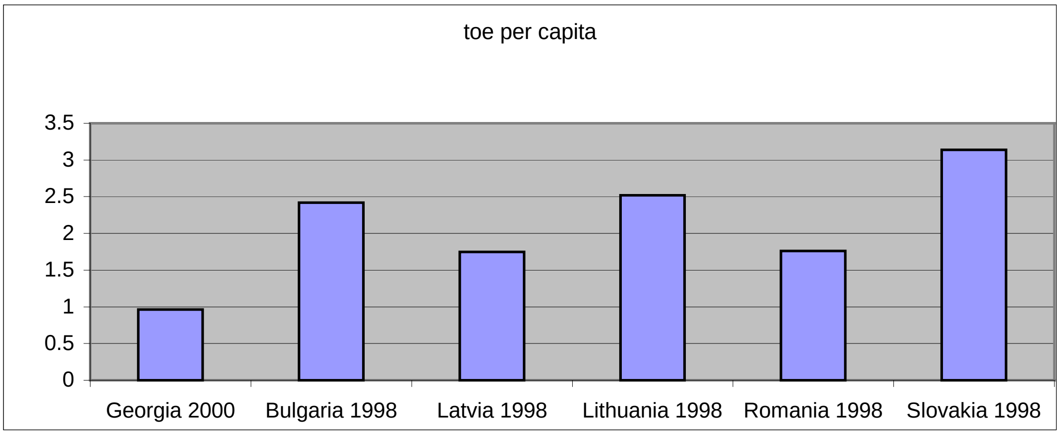


Source: Ministry of Economy, Industry and Trade

In 2000 much more natural gas was available; this is probably a result of rehabilitation of the distribution network and of some commercial agreement with foreign and national suppliers. Some national production of gas re-started.

The Figure 2.3 shows that on average the Georgian population still has an extremely limited amount of available energy. In the Figure 2.3, energy is measured in tonnes of oil equivalent (toe). The scarcity of energy is a great constraint for the development of new productive activities and for the creation of new jobs.

Figure 2.3: Energy Supply per capita



Source: IEA, www.iea.org and Georgian Ministry of Economy, Industry and Trade

Table 2.4: Production and Import of Energy Resources
(thousand tonnes of oil equivalent)

Production	1999	2000 (estimates)
Crude oil	91.3	110.0
Natural gas	-	64.0
Solid Fuel	460.0	470.0
Electricity	701.0	715.0
Total Domestic Production	**1,252.3**	**1,359.0**
Share of domestic resources	**30.2**	**28.2**
Import	**1999**	**2000 (estimates)**
Oil Products	2,058.7	2,190.0
Natural Gas	725.0	1,136.0
Solid Fuel	40.0	45.0
Liquid Gas	52.0	55.0
Electricity	21.0	25.0
Total Import	**2,896.7**	**3,451.0**
Share of Import	**69.8**	**71.7**

Source: Ministry of Economy, Industry, and Trade

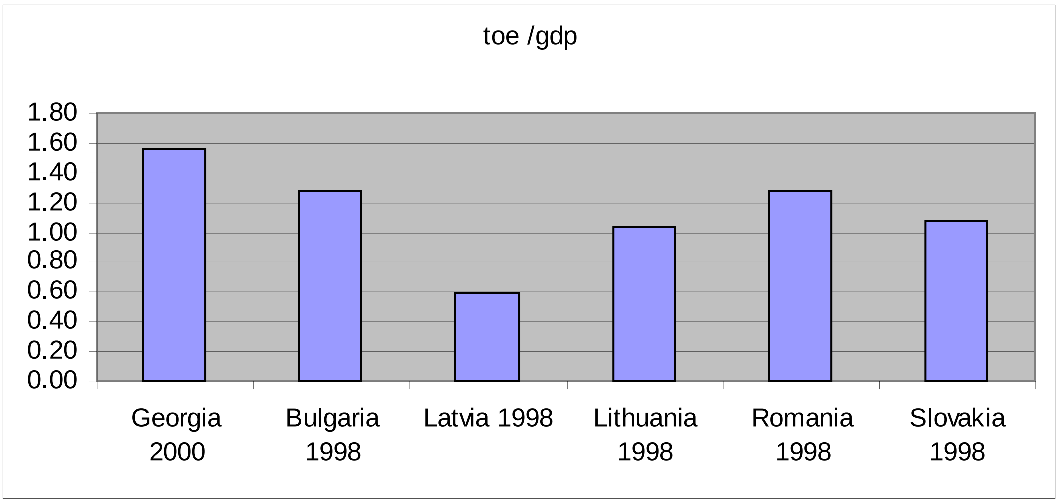
Dependence on import

According to the estimates, in 2000, the share of oil products in total energy supply was the highest – 48 per cent. The share of natural gas was 25 per cent followed by electricity - 15 per cent; while the shares of solid fuel and liquid gas were 11 and 1 per cent respectively. Most of the energy used in the country is imported: 71.7 per cent. This is a situation common to many other countries such as Japan or Italy. Anyway, Georgia's dependence on import could be reduced by a fair process of privatisation of the power generation assets of the country.

The energy sector should become more efficient

The present situation shows that Georgia uses a relatively high amount of energy to produce a dollar of GDP. This is probably due to an inefficient energy system, where there are substantial losses and electricity is produced by many inefficient generators. For instance, in Latvia with the same amount of energy is possible to produce almost three times the amount of wealth produced in Georgia.

Figure 2.4: Energy/GDP Ratio (toe/GDP)



Source: : IEA, www.iea.org and Georgian Ministry of Economy, Industry and Trade

NATIONAL DEBT

The total amount increases but decreases as a share of GDP

As of January 1st 2001, the foreign debt was GEL 3,051 million (49.3 per cent of GDP 2000) and the internal debt was of GEL 1,497.5 million (24.2 per cent of GDP) so the Georgian state debt amounted to GEL 4,548.5 million, i.e. 73.5 per cent of country's GDP in 2000;. The ratio of total debt to GDP has decreased compared with 1999 from 78.7 per cent to 73.5 per cent. This was mainly caused by a reduction of the ratio of foreign debt to GDP from 55.2 per cent to 49.3 per cent; the ratio of internal debt has increased from 23.5 to 24.2 per cent.

The present trend is positive and the government should continue this way: reduction of the debt/GDP ratio and of the foreign debt/GDP ratio; if debt is really needed, then this should be raised from national creditors.

Foreign Debt: A large debt, in need of restructuring

By January 2001, the contracted amount of Georgia's external state commitments was USD 2,038 million, but not all these commitments were transformed into disbursements: only USD 1,697 million was actually transferred. Georgia paid to creditors USD 366 million in principal and interest payments. The outstanding foreign debt in January 2001 amounted to USD 1,544 million, i. e., its ratio to GDP was 49.2 per cent and 468 per cent of registered exports.

In a country like Georgia with substantial trade and current account deficits, poor export performance, and weak tax collection, the servicing of external debts represents a difficult problem. In 2000, the Government planned to allocate GEL 172 million, but because of a lack of revenues the state budget was sequestered in July and the provision for external debt servicing was reduced to GEL 133.4 million. In reality even this task was not completely fulfilled. The arrears of payment for principal and interest on foreign debt in 2001 made up USD 180.7 million. In addition, according to the original loan terms Georgia in 2001 will have to pay USD 168.1 million. Therefore in 2001 expenditures for foreign debt service will be USD 348.2 million. According to the 2001 state budget only GEL 165 million has been allocated, that is 14.7 per cent of total budgetary expenditures and insufficient to service the accumulated debt. Therefore the question of restructuring the foreign debt of country arises; an agreement with creditors on restructuring terms is necessary. Otherwise Georgia could be declared a defaulter with all the negative consequences coming from this event (suspension of the process of official payments, also of programmes of international financial organisations, large foreign investments, etc.). The restructuring of Georgia's foreign debt is necessary not only for balancing the 2001 budget, but also for future years. According to the original loan terms the peak for payments of interests and principal on foreign debt falls in 2002 (see table 2.5). Currently most payments are due to former soviet countries, while after 2003, most payments will be to international financial organisations.

In order to achieve Russian approval for restructuring Georgian debt, in February 2001 the Parliament of Georgia ratified the so-called "zero option"; this is an agreement with Russia to settle the issue of the legal succession of Soviet foreign debts and assets.

In the beginning of March 2001, Georgia held negotiations with its main creditor countries. Significant progress was reached in postponing and alleviating payments on Georgian debts. Information about this will be published in next edition of GET.

Table 2.5: Projected external debt principal and interest payments in 2001-2012 according to original loan terms

(USD million)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
FSU countries	124	123.1	41	39.6	38	27	22.8	--	--	--	--	--
Non-FSU countries	10.6	21	22.3	23.5	20	23.5	25.8	25.3	27.1	27.4	19	15.9
International Institutions	32.9	53.1	65.5	72.2	75	64.7	51.5	42.1	54.6	44.7	41.5	40.2
Grand Total	168	197.2	128.8	135.3	133	115.2	100.3	67.4	81.7	72.2	60.5	56.2

Source: Ministry of Finance

Note: This table does not include new terms of servicing Georgia's foreign debt negotiated in March 2001.

Internal debt

Over the last four years (1997-2000) Georgia's internal debt has increased from GEL 824.8 million to GEL 1,497.5 million and its ratio to GDP from 21.3 per cent to 24.2 per cent (see table 2.6). The growth of internal debt is due to the new borrowings by MoF from NBG for financing the budget deficit (GEL 477.1 million) and to the recognition of the state obligations from the Soviet times[4] (GEL 173.3 million in 2000). However, the state internal debt does not include other budgetary arrears of about GEL 300 million accumulated over 1998-2000.

In 2000, GEL 88.7 million was allocated for servicing internal debt, that is 92.5 per cent of the target expenditure for this budget item. These funds were directed mainly to payments of interests on borrowings from NBG, for state bonds[5] and for the discounting costs of treasury bills (GEL 88.4 million in total). Other items of debt are either not serviced at all or only partly and erratically.

Table 2.6: Dynamics of Georgia's internal debt, 1996-2000

	By January 1st 1997	By January 1st 1998	By January 1st 1999	By January 1st 2000	By January 1st 2001
Internal state debt (million GEL)	824.8	944.6	1175.5	1343.4	1497.5
Share the debt to GDP (%)	21.3	20.2	23.2	23.5	24.2

Source: Ministry of Finance

[4] It includes obligations undertaken by the state related to co-operative dwellings construction, providing employees of Municipal Enterprises "TbilTrans" with apartments and etc.

[5] Bonds were issued for the recapitalization of assets of the NBG.

The internal debt shows a trend of almost continuous growth: it is bad that the state has to borrow, but it is good that at least partially it can do so from national sources, it means that future payments of principal and inteterests will remain in the economy.

BALANCE OF PAYMENTS

Export performance good, inflow of capital and the transfers to Georgia bad

Compared with 1999, exports increased by 39.4 per cent, reaching the highest level since 1995. The sharp export growth did not affected the growth of the current account deficit. The main reason for this is the reduced inflow of official transfers and also incomes from short-term and long-term Georgian workers abroad[6]. This may reflects the deterioration of the situation of Georgian emigrant. This tendency could be worsened by Russia's introduction of a visa regime with Georgia.

In 2000, the investment inflow to Georgia also dropped. FDI amounted to USD 131.2 million (18 per cent less than in 1999).

A lot of shadow operations

In the Balance of Payments 2000 there is an "errors and omissions" item of USD 196.1 million. Comparing this figure with the value of the item "current acounts" is possible to evaluate the rate of unregistered foreign operations (investments, income transfers, export). They can be considered "shadow operations". Similar evidence comes also from the so called "mirror statistics" (see Chapter 5).

Table 2.7: Balance of Payments, 1995-2000

(USD million)

	1995	1996	1997	1998	1999	2000
Current Account	-363.4	-295.3	-499.1	-416.5	-197.4	-261.9
Trade balance	-421.6	-313.2	-675.1	-760.4	-533.8	-506.1
Export	289.5	372.3	377.2	300	329.5	459.4
Import	-711.1	-685.6	-1052.3	-1060.4	-863.4	-965.5
Services	4.9	4.3	-147.8	-55.2	-3.9	-8.6
Export	110.5	98	167.9	289.9	216.7	206.1
Import	-105.6	-93.6	-315.7	-345.1	-220.6	-214.8
Income	-60.6	-70.4	127.4	190.8	146.9	117.4
Credit	4	5.5	186.6	243.3	211.4	178.5
Debit	-64.6	-76	-59.2	-52.4	-64.4	-61
Current Transfers	113.9	84.1	196.3	208.3	193.4	135.3
Credit	113.9	84.1	205.3	220.1	228.7	163.6
Debit	0	0	-9	-11.8	-35.3	-28.3
Capital and Financial Account	210.2	323.6	378.5	421.4	336.8	65.8
FDIs	---	---	242.5	265.3	158.7	131.6
Portfolio Investments	0	0	2.4	0	---	2.7
Other investments	210.2	276.9	154	120.2	154.7	-83.7
Reserve assets	-40.6	-0.5	-14	42	30.4	20
Net errors and omissions	112.5	-27.7	120.5	5	-169.8	196.1

Source: State Department for Statistics.

[6] In 2000, transfers from long-term Georgian workers abroad amounted to USD 94.9 million; they transferred USD 149.5 million in 1999; in 2000 the repatriation of remuneration by short-term workers abroad amounted to USD 178.5 million, while it was USD 211.4 million in 1999. The current transfers to general government amounted to USD 12.5 million in 2000, while they were USD 31.7 million in 1999. Source: Balances of Payment of Georgia 1999 and 2000, SDS.

CHAPTER THREE: GOVERNMENT FINANCE

In 2000, the Georgian state collected approximately 12 per cent of GDP in revenue, the same as in the previous year. Central budget revenues in GDP terms decreased. Low tax collection remains the main problem of public finance. Almost one third of the expenses of the Central budget have been used to service debt. Almost all the other items of expenditure had to be reduced.

GOVERNMENT REVENUE: NO INCREASE OR REDUCTION

Bad results of income tax and excises, good results of VAT and custom duties

The initial budget envisaged GEL 874.4 million of state revenues. GEL 684.5 million were for the central budget and GEL 190 million for the Special State Funds. During the year it was clear that revenue targets would not be met. In June, the Government undertook a sequester. As a result of the sequester and further corrections, the corrected revenue target for the state budget was set at GEL 695.1 million which itself was fulfilled at 92 per cent.

The state budget actually received GEL 639.2 million. Of this amount, GEL 437 million were tax revenues, (a 5.7 per cent improvement over the previous year) GEL 30.7 million were non-tax revenues, GEL 156.5 from special state fund levies and GEL 14 million from grants.

The most important item - tax revenues were low in terms of planned targets but they look even worse compared to GDP. The 2000 tax revenues of the central budget accounted for about 7 per cent of GDP. In the past they were about the same. Figures on local budget performance are not available at the moment, but based on the fact that in previous periods local budgets were about 3 times less than the state budget and considering actual tax revenues of special state funds, we can roughly assume that overall taxes in the economy as in previous years, comprise 12-14 per cent of GDP. The corresponding CIS average is about 21 per cent and the average of less developed Phare countries is 32 per cent.

Table 3.1: Central budget tax revenues
(GEL thousand)

Category	1999 Actual	2000 corrected budget	2000 Actual	Change (per cent)	Performance compared to corrected budget (per cent)	Share in total revenues (per cent)	Share in GDP (per cent)
Income tax	44.9	32.0	31.3	-30.2	98	7	**0.51**
Profit tax	20.2	20.3	21.0	3.8	103	5	**0.34**
VAT	212.7	265.5	254.9	19.9	96	58	**4.12**
On domestic products	*124.4*	*156.5*	*148.3*	*19.2*	*95*	*34*	2.40
On imports	*88.3*	*109.0*	*106.6*	*20.7*	*98*	*24*	1.73
Excise	110.7	97.7	86.6	-21.7	89	20	**1.40**
On domestic products	*13.5*	*11.1*	*10.4*	*-23.1*	*93*	*2*	0.17
On imports	*97.2*	*86.6*	*76.3*	*-21.5*	*88*	*17*	1.23
Customs duty	25.9	37.7	44.0	69.8	117	10	**0.71**
TOTAL CENTRAL BUDGET TAX REVENUE	**414**	**453.2**	**437.9**	**5.8**	**97**	**100**	**7.09**

Source Ministry of Finance

Structure of tax revenues

Table 3.1 highlights that the central budget depends heavily on indirect taxes; the GEL 52 million of direct taxes (income and profit taxes) represent 12 per cent of actual tax revenues and 0.8 per cent of GDP. It should be mentioned that according to law only 40 per cent of income and profit tax paid by citizens and legal entities goes to the central budget, while the rest goes to local ones. Collection of direct taxes shows relatively good performance compared to planned figures while poor collection of VAT and excise had a sizeable impact on the overall budget performance.

The Parliament Budget office estimates that in the case of 100 per cent compliance to existing tax legislation, the state could get GEL 350 million from taxation of oil products. The same source suggests that 90 per cent of diesel import is illegal.

An uneven tax burden

Data on distribution of tax burden on economic sectors for the year 2000 are not yet available but there is no evidence that they will differ much from 1999. Table 3.2 below provides information on the actual tax burden for different economic sectors derived from 1999 figures.

Table 3.2: Distribution of tax burden, 1999

(Per cent)

Sector	Representation of sector for direct taxation. (Share in direct taxes received/ Share in GDP)	Representation of sector for indirect taxation. (Share in indirect taxes received/ Share in GDP)	Representation of sector for overall taxation. (Average of first two columns weighted by share of received direct and indirect taxes)
Industry	1,5	3,2	2.64
Agriculture	0,4	0,1	0.19
Construction	0,7	1,5	1.24
Transport	1,5	1,0	1.15
Communications	2,2	5,4	4.29
Trade	1,2	1,0	1.09
Education, Health, Culture, Sports	2,6	0,3	1.11
Other	1,0	0,8	0.88

Source: 1999 annual report of the Ministry of Finance, GEPLAC calculations.

The implementation of an equally distributed tax burden will give positive structural changes to the economy as neutrality is the way to achieve an efficient allocation of resources and hence economic growth.

The Georgian Tax Legislation preserves the main taxation principles of the modern world. However, a lack of proper tax administration puts significant constraints on the economy and hampers fair competition. Some economic agents or entire economic sectors end up paying much less than others. We cannot completely believe the table above because some sectors such as constructions and trade have large shadow components, which escape measurement.

Non tax revenues

Non tax revenues of GEL 30.7 million were collected, that is 96 per cent of the planned amount. Only 39 per cent of the expected GEL 36 million in foreign grants were received. Of this an amount of EUR 9 million was a grant from European Union to cover debt repayments payments of Georgia to the EU. The grant might have been twice as much but Georgia did not manage to meet the co-financing requirements. The EUR 9 million grant was part of special financial assistance programme which includes a EUR 110 million credit and EUR 55 million grant for Georgia.

Special State Funds: small revenues

Special State funds received GEL 156 million of own revenues instead of the planned GEL 173 million. Revenues of the United State Social Safety Fund were GEL 127 million (94 per cent of target). The main source of income of this fund is social contributions paid from salaries by employees and employers. The Unemployment Fund received GEL 4.5 million instead of GEL 5 million. Revenues of the roads fund were GEL 24 million, that is 77 per cent of the planned amount. The low performance is a result of low collection of excise on oil products which are an important part of the roads fund revenues.

Reform in tax administration: fewer employees and more qualification exams

The reform programme of the tax administration was developed in accordance with a memorandum of understanding signed on March 1999 by the Georgian and US Governments. The major features of this reform are the reduction of the number of employees, the selection of personnel on a competitive basis and the provision of good salaries to combat corruption. A similar reform is planned in the Customs Department.

By the end of 2000, the first stage of reform in Tbilisi was implemented. As a result the number of tax inspection offices was reduced by half ; the structural reorganisation of the central staff of the tax department and of the large taxpayers inspection has been completed. Qualification exams for tax inspectors were held in the "Kvemo Kartli" region in October 2000. Similar exams are planned for other regions in March 2001.

SOURCES OF DEFICIT FINANCING

The major role of domestic sources

The initial budget envisaged a deficit of GEL 389.7 million; GEL 148.1 million had to come from internal sources and GEL 241.6 million from external financing. In the corrected budget, the deficit was set at GEL 297 million. Actually GEL 190 million 64 per cent of the target was received. A detailed breakdown of sources of deficit financing is provided in the table below:

Table 3.3: Sources of deficit financing
(GEL thousand)

	Initial budget law	Corrected budget	Actual	Actual as share of initial budget (per cent)	Actual as share of corrected budget (per cent)	Share in total (per cent)
Domestic sources	**142,106**	**177,952**	**151,870**	**107**	**85**	**80**
Privatisation of State Property	103,000	33,752	12,793	12	38	7
NBG loan	29,600	129,900	134,823	455	104	71
T-bills	9,500	3,700	4,244	45	115	2%
Budget brought down	6		10	167		0
Other		10,600	-		0	0
External sources	**241,600**	**119,500**	**38,052**	**16**	**32**	**20**
World Bank credit	223,600	110,200	32,683	15	30	17
Sales from various commodity credits	18,000	9,300	5,368	30	58	3
TOTAL SOURCES OF FINANCING	**389,700**	**297,452**	**189,921**	**49**	**64**	**100**

Source Ministry of Finance

Table 3.3 shows that most of the deficit (71 per cent) was funded with NBG loans, i.e. with national resources; the revenues from privatisation and World Bank credit were not received in full.

STATE BUDGET EXPENDITURES

All expenditures falling, slight increase in the support to economic activities

The initial law on the state budget envisaged GEL 1,264.1 million of expenditure. From this amount, GEL 1,074,2 was set as an expenditure target for the central budget. Following the budget sequester and further corrections, the expenditure target for the central budget was set at GEL 810 million. The actual expenses of the central budget for the year were GEL 674 million – 83 per cent of the corrected budget.

Table 3.4: Structure of Central Budget expenditures by function
(GEL thousand)

Category	Expenditure 1999	Share in GDP (per cent)	Expenditure 2000	Growth	Share in total (per cent)	Share GDP (per cent)
General Government	125,148	**2.19**	94,937	-24	**14.1**	**1.54**
Security	*111,420*	**1.95**	*92,584*	-17	**13.7**	**1.50**
Defence	*35,720*	*0.63*	*28,733*	*-20*	*4.3*	*0.46*
Law and order	*75,700*	*1.33*	*63,851*	*-16*	*9.5*	*1.03*
Welfare	250,255	**4.38**	214,401	*-14*	**31.8**	**3.47**
Education	*29,563*	*0.52*	*26,888*	*-9*	*4.0*	*0.44*
Health Care	*15,72*	*0.28*	*20,454*	*30*	*3.0*	*0.33*
Social security	*137,488*	*2.41*	*109,313*	*-20*	*16.2*	*1.77*
Housing	*5,107*	*0.09*	*4,203*	*-18*	*0.6*	*0.07*
Culture sport and religion	*25,582*	*0.45*	*21,199*	*-17*	*3.1*	*0.34*
Subsidies and current transfers (from "Other" heading of the budget)	*36,791*	*0.64*	*32,344*	*-12*	*4.8*	*0.52*
Economic Activities	32,693	**0.57**	49,316	*51*	**7.3**	**0.80**
Energy Heating	*11,521*	*0.20*	*25,306*	*120*	*3.8*	*0.41*
Agriculture forestry, fishing	*15,517*	*0.27*	*12,312*	*-21*	*1.8*	*0.20*
Construction and mining	*765*	*0.01*	*331*	*-57*	*0.0*	*0.01*
Transport and communications	*2,166*	*0.04*	*9,666*	*346*	*1.4*	*0.16*
Other economic activities	*2,724*	*0.05*	*1,701*	*-38*	*0.3*	*0.03*
Debt service	*216,131*	**3.79**	*219,051*	*1*	**32.5**	**3.54**
Interest payments	*148,608*	2.60	*169,837*	*14*	*25.2*	*2.75*
Lending	*67,523*	1.18	*49,214*	*-27*	*7.3*	*0.80*
Other	22,878	**0.40**	4,274	*-81*	**0.6**	***0.07***
Salaries		-	*41*		*0.0*	*0.00*
Social Contributions		-	*11*		*0.0*	*0.00*
Target programs		-	*16*		*0.0*	*0.00*
Other goods and services	*22,878*	0.40	*4,206*	*-82*	*0.6*	*0.07*
Total	**758,522**	13.28	**674,592**	**-11**	**100.0**	**10.92**

Source Geplac elaboration on data from the Ministry of Finance

DEBT SERVICING

The largest budget expenditure item

GEL 169 million were designated to interest payments on foreign and domestic debt. GEL 73 million was paid as interest on foreign debt and GEL 97 million on domestic debt (mainly on NBG loans and T-bills). This makes up 10.8 and 14.4 per cent of central budget expenditures respectively.

Payments of interests and principal remain the main expenditure item of the central budget with 3.54 per cent of GDP and 32.5 per cent of the total central budget expenditure dedicated to this. Even if the share of GDP slightly decreased in 2000, the decrease has been less than for almost all other items. In any case, the service of debt remains a big constraint on any political choice, limiting any other kind of social or productive expenditure. At the beginning of the year, before any other choice, the government knows already that about one third of its resources must be dedicated to debt payments.

General Government, Security and Welfare lose ground

The General Government, the Security area and Welfare area have all lost more than 20 per cent of what was their GDP share during the previous year. Only interventions in favour of productive activities have slightly increased their share of GDP.

Welfare expenditure (Education, Health, Social Security, Housing, etc.) in 1999 was 4.38 per cent of the GDP, in 2000 it was just 3.47 of the GDP, a loss of 21 per cent. Social security spent a total of GEL 109 million, 20 per cent less than in 1999

The areas of General Government and security lost a large part of their GDP share (30 and 23 per cent respectively). The GEL 95 million spent on general government is GEL 30 million lower than the 1999 amount. GEL 24 million from the above shortfall is explained by lower financing of investment projects by international financial organisations.

Table 3.5 Central budget expenditures by economic classification.
(GEL million)

Category	Actual 1999	Corrected budget 2000	Actual 2000	Growth (per cent)	Share of corrected budget (per cent)	Share in total (per cent)
Salaries	72.3	65.9	65.2	-10	99	9.7
Social contributions from employer	9.4	12.3	11.6	23	94	1.7
Business trips	10.0	6.1	5.4	-46	88	0.8
Other goods and services	180.5	93.8	90.6	-50	97	13.4
Interest payments	148.6	178.9	169.8	14	95	25.2
Subsidies and current transfers	204.0	239.5	212.7	4	89	31.5
Capital expenditures	8.2	6.1	4.7	-42	77	0.7
Programme expenses		30.5	25.8		84	3.8
Net lending	126.2	177.6	88.7	-30	50	13.2
Total	**758.5**	**810.8**	**674.6**	-11	**83**	**100.0**

Source: Ministry of Finance

Planned salary payments have been respected, but the total amount allocated to this purpose has decreased

Plans for payment of salaries of state employees have been fulfilled at a 99 per cent level. This means that the government is better able to plan what it can really afford, but also that the situation of state employment has worsened; the total amount of salaries decreased by 10 per cent.

An opposite situation can be observed in the social contributions of the state; they basically are transfers to various funds as pay-roll taxes and should be derived from paid salaries; they were financed only at 94 per cent of the planned amount, but actually there was a 23 per cent improvement in this category over the previous year. In 1999 social contributions were financed rather poorly.

The state spent less to maintain its cars, for business trips and for food for the military

"Other Goods and Services" were purchased to the total of GEL 90 million, half of 1999 spending. Under this heading office maintenance and various utility charges were financed by 85 and 82 per cent respectively. GEL 9 million was spent on vehicle maintenance, compared to GEL 12.3 million in 1999.

An important sub-heading within other goods and services is food for state (military, paramilitary, police) servants. This was GEL 15 million, 97 per cent of the plan. The figure shows a 40 per cent decrease compared to the GEL 24 million spent for the same item in 1999.

Courts condemned state payments not foreseen by the budget

Under the “Other Expenses” heading, the diplomatic corps was financed at 100 per cent of budgeted level, GEL 19 million were allocated to various diplomatic missions abroad. The same GEL 19 million was spent in 1999. Miscellaneous refugee related spending amounted to GEL 11.5 million, 83 per cent of target. It shows a 22 per cent increase over the year. Overall execution of “Other Expenses” over 100 per cent of target is conditioned by “unexpected” liabilities. These budgetary arrears accumulated in previous years against various commercial enterprises have been in large part reclaimed by through court decisions. Notwithstanding similar problems in 1999 (GEL 8 million was extracted from government accounts by court decision) all this contingent liability (about GEL 3 million) could not or had not been accounted for during the 2000 budget planning phase.

The Pension Fund received 31 per cent less than in the previous year

The United State Social Safety Fund (pension fund) received GEL 27 million, 70 per cent of due transfer of GEL 38 million. The amount was 31 per cent less than the GEL 44 million allocated in 1999. Under a separate sub-heading GEL 18 million was fully paid as pensions to former military, paramilitary and police servants. Unlike the previous item, spending on military pensions has increased by 46 per cent over the year.

Reduced transfers to local budgets

Transfers to local budgets were GEL 32 million, that is 10 per cent less compared to corresponding item for 1999. Financing of the state health insurance company increased by 27 per cent over the year. GEL 12 million was allocated to the company, 66 per cent of planned amount.

CHAPTER FOUR: MONEY AND FINANCE

In 2000, inflation was 4.6 per cent and the exchange rate did not fluctuate much, thanks to the strict monetary policy of the National Bank of Georgia (NBG). The NBG has also succeeded in reducing interest rates slightly. The economy is still using the banking system very little and most commercial credit is short term and used in tertiary sector activities. Auctions for longer term T-bills restarted.

BANKING SECTOR

The number of Georgian commercial banks is likely to decrease further, while the remaining banks should be growing. The working banks will generally concentrate on short and medium lending while the range of customers' accounts services will increase. As far as long-term lending is concerned much will depend on the level of foreign financing programmes that will be provided for Georgian banks.

The share of banking capital in GDP is 4.5 per cent, which is less than in most of the transition countries. The wide presence of the shadow economy can explain this figure: shadow transactions are often in cash.

Inflation and exchange rate

Low inflation of around 5-6 per cent will be maintained if conditions are favorable, although there are both internal and external risk factors. The main internal risk factor is the non-fulfillment of the budget. According to some estimations, the 2001 budget revenue is overestimated. Besides, in this year Georgia has to continue to service its foreign debt. Hence one can expect further either expenditure cuts or inflationary borrowing from the NBG (the latter seems to be less likely).

The central external risk factor is the trade balance. It would have some effect on the exchange rate and thus on inflation. In case of crisis in one of Georgia's large trade partners, like Russia or Turkey the GEL exchange rate could suffer.

IMF credit

In 2001, Georgia will probably receive an IMF credit for a poverty reduction programme, although the county still has to fulfill several preconditions set by the IMF. These preconditions center on the achievement of a solution with the Paris Club on external debt repayment, fiscal sector improvements, and anti-corruption measures.

DOMESTIC INFLATION

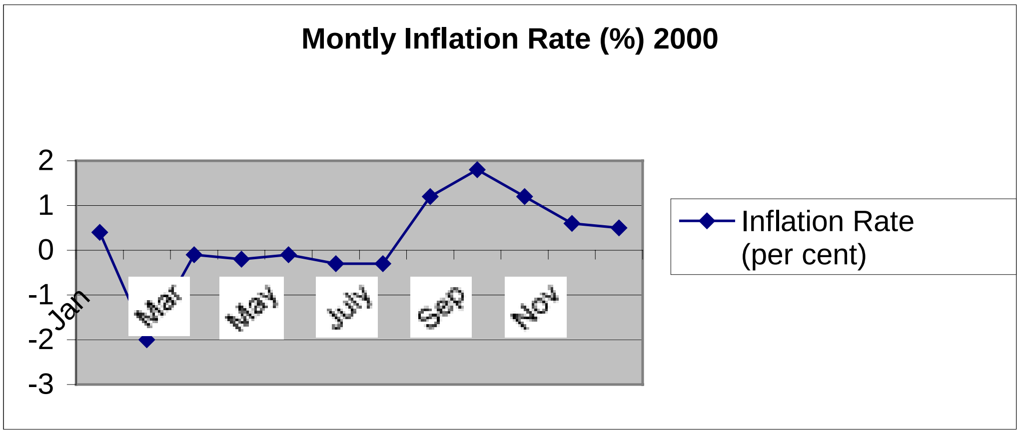
The main guarantee of economic stability in 2000 was the tight monetary policy and annual inflation target of 6 per cent, set up by the "Main Trends on Monetary and Foreign Exchange Policy for 2000". From February to July deflation took place. After the decline in February and March, the prices continued falling, though only slightly. According to the State Department for Statistics, the annual inflation in 2000 reached 4.6 per cent, which was less than the targeted 6 per cent. In 2001 the targeted inflation is also 6 per cent.

Table 4.1: Urban Consumer Price Index and Inflation, 2000*
(December 1998 = 100)

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
111.3	109.3	109.2	109	108.9	108.6	108.3	109.5	111.3	112.5	112.56	113.06

Source: GET calculations based on data provided by the State Department for Statistics
** This indicator keeps the effects of the inflation of the previous periods.*

Figure 4.1: Monthly Inflation Rate, 2000



Source: GET calculations based on data provided by the State Department for Statistics

The level of inflation in Georgia strongly depends on the GEL nominal exchange rate. If the NBG is able to maintain tight control over its net credit to the Government, it will avoid pressures on the nominal exchange rate. If the depreciation of GEL is caused by other factors, it will affect the price level.

However, one can expect some inflation pressure due to the new visa regime with Russia, the biggest trade partner of Georgia. Both large and small importers will bear the visa expenses so that we assume a rise of prices on goods imported from Russia.

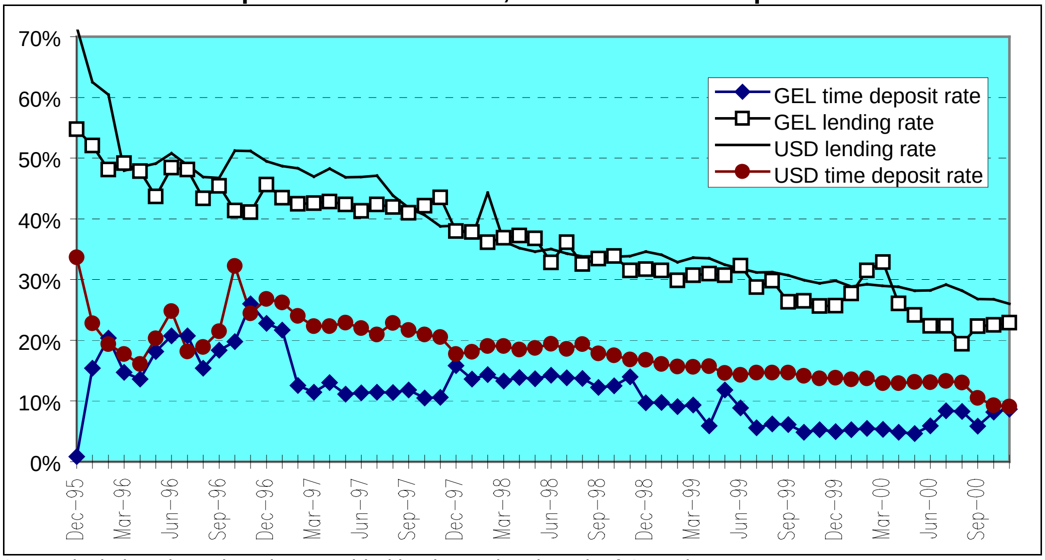
The Turkish lira crisis could negatively affect the lari
The sharp devaluation of Turkish lira (by 40 per cent within one day) in February 2001 could create an outflow of hard currency from Georgia. It could cause this by falling prices of Turkish exports. Taking into account that Turkey is the largest trade partner of Georgia, the devaluation of Turkish lira will increase the negative trade balance. The large outflow of US dollars from Georgia will cause the increasing of the US dollar price, which in its turn will provoke price growth for consumer goods.

CREDIT TO THE GOVERNMENT
In the "Law of the State Budget" for 2001 total revenue is planned to be GEL 840 million, total expenditure GEL 1,120 million, and the total deficit is GEL 278 million. GEL 20 million is to be financed by the T-Bills sales. To reduce the inflationary effect of the financing of the budget deficit and to set a tight monetary policy, the NBG will issue credits to the Central Government only for external debt service. This is a policy, which can create a bias towards foreign debt rather than towards inflation.

However, if tax revenues are scarce, the Ministry of Finance can cut expenditure on salaries, pensions and other social benefits, with all the consequent social effects.

INTEREST RATES

Figure 4.2: Loans and Deposits Interest Rates, December 1995-September 2000



Source: GET calculations based on data provided by the National Bank of Georgia

Interest rates show a positive downward trend

The interest rates of lending and deposits show a slow downward trend, for both short term and long term. The NBG affects interest rates in GEL through its monetary instruments. The central bank introduced three-day credit auctions where commercial banks can borrow from the National Bank loans with a maturity of up to tree days. However, it is doubtful whether commercial banks will follow the NBG in decreasing lending interest rates. The first factor is that the NBG instruments are in GEL while commercial banks borrow money in dollars. The other factors are: the country risk, the limited possibilities of external refinancing, the limited inflows of funds into the banking sector and a stable demand for credits from the real sector.

Table 4.2: Observation and Forecasting of Interest Rates
(Per cent)

				Forecast	
Type of Interest Rate	**Average 1998**	**Average 1999**	**Average 2000**	**March 2001**	**June 2001**
Interbank credit (USD) up to 1month	n/a	33	21	18	17
Interbank credit (USD) (1-3 months)	n/a	24	23	22	21
Banks' credit (USD) (exc. bad loans)	36	32	28	27	26
Banks' credit (USD) (6-12 months)	31	30	26	26	25
Banks' credit (USD) (>12 months)	23	23	22	22	22
Banks' time deposit (USD)	18	15	12	11	10
Banks' deposits (USD) up to 3 m	16	15	12	12	11
Banks' deposits (USD) up 3-6 m	19	14	13	10	9
Banks' deposits (USD) up 6-12 m	18	16	15	14	14

Source: GET calculation on data provided by the National Bank of Georgia

The common picture shows a tendency toward decreasing interest rates both for deposits and loans. The net interest margin between total loans and time deposits is 15 points, which is still high, but less than in previous years.

Interest rates on interbank credits and credit to customers show a downward trend especially in 2000. We expect that at the end of the first semester of 2001 interbank credits interest rates will reach 17 and 21 per cent per annum. Interest rate for long-term loans (more than 1 year) is the lowest. This is because in most cases long-term loans are refinanced from foreign donors credits, given at relatively low rates. We can assume that interest rate for long term loans will not decrease so fast as other interest rates.

Credits are usually short term and to services and trade

According to NBG data on the term structure of banking loans to the economy, short-term credits dominate in the total loan portfolio. The cause of this is the short-term nature of the sources of banks' refinancing, the high risk of long-term lending and the low capitalization of commercial banks. Short-term deposits create the assets of most of the Georgian banks.

The slow development of the structural reforms and the low profitability of enterprises are determinant factors of banks' reluctance to give credits to industry and agriculture. There is also no state policy to stimulate credit to the real sector. Facing problems with the external debt service, the State is unable to be a guarantor for foreign creditors. Within these circumstances, in the nearest future one can hardly expect an increase of credits to the real sector.

TREASURY-BILLS MARKET AND CREDIT AUCTIONS.

At the end of the year, the T-Bills market was characterised by an increase of interest rates. The NBG restarted auctions for 91-day T-Bills. This showed some regained trust in the solvency of the Government. Two 91-day auctions were held in November and December with average annual interest rates of 22 and 29.25 per cent. Such high rates are usual for the end of the year when there is a demand for GEL from the taxpayers and correspondingly there is a small demand for government securities. We may suppose that due to the recent political and social developments private borrowers charge the State with a country risk premium.

By contrast, interest rates at inter-bank credit auctions continue to fall (only 5-6 per cent annual). This is caused by a policy of the NBG aimed at achieving low interest rates; besides this at credit auctions there is an over-supply of credit resources and limited possibilities of investing in GEL due to the high dollarisation of the economy.

EXCHANGE RATE

The official exchange rate has shown small fluctuations in H2 2000. There was a seasonal demand increase for GEL before the New Year and Christmas holidays from households and taxpayers. Thus there was a seasonal appreciation of the GEL against the USD. At the very beginning of January the GEL depreciated as it usually does, since the new financial year is just starting.

The depreciation continued in February 2001. On February 22nd, 2001 it achieved GEL/USD 2.165, the lowest price of GEL since the beginning of 1999. This was caused a by seasonal outflow of foreign currency for payments of imports and by falling exports. At the same time, tax payments were expected only at the very end of the month, so commercial banks had no demand for lari.

The same situation happened at the beginning of 1999. The increasing outflow of the foreign currency for current account transactions was not compensated by an inflow through capital account transactions. The lowest official price of lari GEL/USD 2.4510 was fixed on February 22nd 1999, but then there was seasonal export growth and by August 1999 the official nominal exchange rate of lari had appreciated to USD/GEL 1.8300. In 2000, there was no seasonal sharp depreciation of lari because there was an inflow of capital in hard currency: direct investments in the energy sector.

Taking into account the 2 years history of the free-floating exchange rate of the lari, one can expect a further nominal appreciation of the lari. However, the Turkey currency crisis (see sub-chapter on domestic inflation) could negatively effect the trade balance and the lari nominal exchange rate.

CHAPTER FIVE: INTERNATIONAL TRADE AND FOREIGN ECONOMIC RELATIONS

The normalization of Georgian trade relations with the rest of the world has made some further progress, in particular with the USA. The trade deficit of Georgia keeps on reducing even if a large part is not officially registered in Georgia. CIS, EU and Turkey remain the main trade partners of Georgia. As a WTO member Georgia has to be ready for the new Millennium round and the accession of new members; the country should learn how best to use the trade tools allowed by WTO (GSP and trade defence instruments).

USA extends nondiscriminatory treatment to Georgia

On December 29th, 2000, the US President extended nondiscriminatory treatment – normal trade relations treatment – to Georgian products. Now Georgia has unconditional, normal trade relations with the USA. The extension of unconditional NTR treatment to Georgian products will permit the USA to treat Georgia according to ordinary WTO rules.

Registered trade turnover and direction of trade

During 2000, external trade turnover was USD 1,030.1 million, of which exports were USD 329.9 million and imports USD 700.2 million. Thus, Georgia's trade deficit was USD 370.3 million, that is USD 12.6 million less than in 1999. It represents 12 per cent of GDP while in the previous year it was 13.6 per cent of GDP.

Georgia had a trade deficit with 79 trade partner countries and a trade surplus with only 35 countries. Georgia's trade deficit with the CIS countries represented 23.1 per cent of the total trade deficit.

Mirror statistics show that Georgian trade statistics overestimate Georgian trade deficit

The figures of registered trade probably differ from the real picture. In order to demonstrate the differences between registered trade figures and the real situation we decided to use so-called mirror statistics analysis. This methodology consists in comparing the exports of Georgia to a given country with the imports of that country from Georgia. The same can be done for Georgian imports.

According to the USITC Trade Database Georgia's exports to the USA amounted to USD 24 million (compares with USD 6.4 million registered by SDS), and Georgia's imports from USA amounted to USD 106.1 million (compare with USD 70.9 million). The same picture can be observed in the case of the Georgia's trade with Turkey. According to the State Institute of Statistics of Turkey (SIS), during the period of January-November of 2000 Georgia's exports to Turkey were USD 145. 9 million, while SDS registered only USD 73.6 million, following the same source Georgia's imports from Turkey amounted to USD 113.8 million, which is exceptionally very close to the registered imports (USD 108.6 million). A lot of the exports to these two countries is not registered in Georgian statistics.

The main trade partners remain the same, but EU countries enlarge their share

The share of the ten main trade partners in the total registered trade turnover remains unchanged and equal to 74.3 per cent. As indicated in Table 5.1, the main partners in 2000 were Turkey, Russia, Germany and Azerbaijan. These countries together represented about 50 per cent of Georgia's registered trade turnover. The neighbouring countries of Turkey, Russia, Azerbaijan, and Armenia still remain the main markets for Georgia's exports. However, there is growth of exports to EU countries. In that respect, Germany is one of the largest importers of Georgian products.

Table 5.1: Registered International Trade Turnover and Direction of Trade, 2000

International Trade Turnover	Import		Export		Trade Turnover	
	Thousand	Per cent	Thousand	Per cent	Thousand	Per cent
Total	**700, 200**	**100**	**329, 900**	**100**	**1 030, 119**	**100**
Main partner countries (total)	**497, 244**	**71.0**	**268, 520**	**81.4**	**765, 764**	**74.3**
Turkey	*108, 634*	*15.5*	*73, 623*	*22.3*	*182, 257*	*17.7*
Russia	*90, 236*	*12.8*	*68, 072*	*20.6*	*158, 308*	*15.4*
Germany	*55, 999*	*7.9*	*30, 859*	*9.3*	*86, 857*	*8.4*
Azerbaijan	*56, 714*	*8*	*21, 093*	*6.3*	*77, 807*	*7.6*
USA	*70, 911*	*10.1*	*6, 425*	*1.9*	*77, 336*	*7.5*
Ukraine	*37, 739*	*5.3*	*19, 473*	*5.9*	*57, 212*	*5.6*
Switzerland	*22, 305*	*3.1*	*13, 522*	*4*	*35, 827*	*3.5*
UK	*23, 322*	*3.3*	*10, 398*	*3.1*	*33, 720*	*3.3*
Italy	*21, 810*	*3.1*	*11, 578*	*3.5*	*33, 388*	*3.2*
Armenia	*9, 574*	*1.3*	*13, 479*	*4*	*23, 053*	*2.2*
Others	**202, 956**	**28.9**	**61, 380**	**18.6**	**264 355**	**25.7**

Source: State Department for Statistics

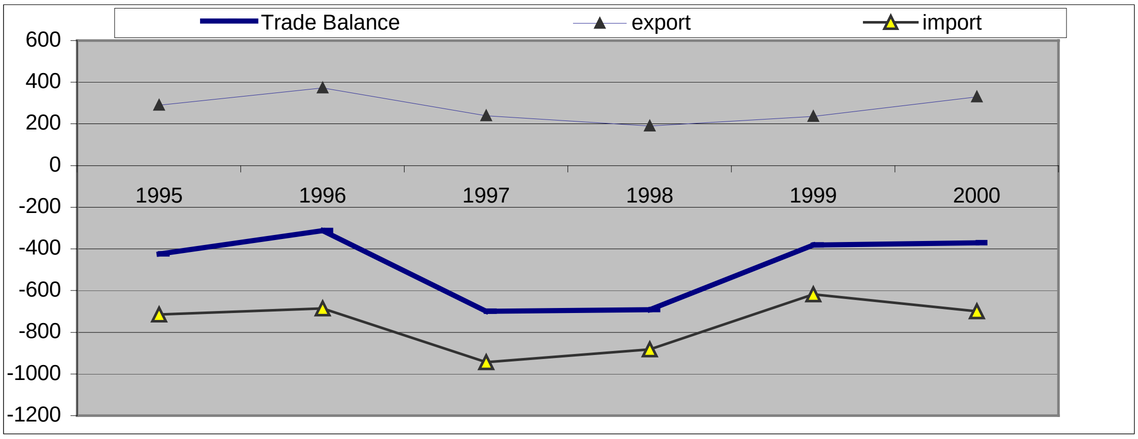
Table 5.2: Registered imports by region and country of origin, exports by destination, 2000

	Import		Export	
	Thousand	Per cent	Thousand	Per cent
CIS (including Russia)	221, 576.6	31.6	136, 203.4	41.2
EU	167, 131	23.8	68, 354.5	20.7
Turkey	108, 634	15.5	73, 623	22.3
USA	70, 911	10.1	6, 425	1.9
Others	131, 947.4	19	45, 294.1	13.9

Source: State Department for Statistics

The EU and its associated countries are the destination of at least 43 per cent of Georgia's registered exports. Georgian trade has a rationale quite similar to that of most of the market economies of the world. In most of the market economies we can observe that the main trade partners are neighbouring regional powers and the EU. This is true in Georgia as well.

Figure 5.1: Registered Exports, imports and trade balance, 1995 – 2000
(USD thousands)



Source: Data from State Department for Statistics

The ratio of export coverage of import improves

The export coverage of import ratio can be considered as the best indicator of the country's position on the world market; it also shows the trade balance of the country. Georgia needs to increase the level of this ratio significantly. Georgia's export coverage of import ratio in 2000 was 47.1 per cent. Despite the fact that this indicator is higher than it was in 1999 (39.6 per cent) Georgia needs to increase this indicator significantly. The external trade objectives should be based on the facilitation of the competitiveness of Georgia's goods and services and stimulation of export-import proportions that would be favorable to Georgia.

Structure of registered exports

The overall composition of Georgian exports shows that the share of scrap metals in 2000 was still very significant and reached about 15 per cent of Georgian exports. This item hardly can be for long time a main component of Georgian export.

"Agribusiness" (prepared foodstuffs, vegetable products, wood and wood articles) accounts for about 30 per cent of exports.

Past investments in the extractive industry positively contributed to the present result of the extraction industry: 19 per cent of the total.

In order to expand exports, Georgia has to activate economic relations with different countries, finding new markets and enlarging the market share in the traditional markets.

Table 5.3, indicates main registered export items according to the Harmonized Commodity Description and Coding System[1] (HS).

Table 5.3: Composition of registered exports according to the Harmonized Commodity System

	2000	
	USD million	**Per cent**
Total exports	**329,892,202**	**100**
Base Metals including metal scrap, iron, steel, copper, nickel, aluminium etc. (HS Chapters 72-83)	79,921,308	24.2
Mineral Products including mineral fuels, mineral oils, manganese ores etc (HS Chapters 25-27)	63,537,226	19.2
Prepared foodstuffs; beverages, spirits, sugars, tobacco etc. (HS Chapters 16-24)	57,702,813	17.4
Vegetable products, including nuts, tea etc. (HS Chapters 06-14)	38,538,388	11.7
Chemical products, including fertilizers, inorganic chemicals etc. (HS Chapters 28-38)	30,017,120	9
Machinery and mechanical appliances; television image and sound recorders and reproducers etc. (HS Chapters 84-85)	25,491,881	7.7
Vehicles, aircrafts, vessels and associated transport equipment (HS Chapters 86-89)	14,069,209	4.2
Wood and articles of wood (HS Chapter 44)	7,154,035	2.2
Other	13,460,222	4

Source: State Department for Statistics

[1] The Harmonized System is an international six-digit commodity classification developed under the auspices of the Customs Co-operation Council. Individual countries have extended it to ten digits for customs purposes, and to 8 digits for export purposes.
In the Harmonized System, goods are classified by what they are, and not according to their stage of fabrication, their use, or origin. The Harmonized System nomenclature is logically structured by economic activity or component material. For example, animals and animal products are found in one section; machinery and mechanical appliances, which are grouped by function, are found in another. The nomenclature is divided into 21 sections. Each of these sections groups together goods produced in the same sector of the economy. Each section is comprised of one or more chapters, with the entire nomenclature being composed of 97 chapters.

Structure of registered imports

Table 5.4 shows the largest imported product groups that together constituted 82.8 per cent of total imports in 2000. The share of natural gas and oil and oil products in total imports in 2000 was more than 16 per cent. Other major imported product groups are pharmaceuticals (6.5 per cent), cigarettes (4.2 per cent), food products such as, wheat (4.1 per cent), flour (3.6 per cent). Thus import substitution should be one of the main priorities of Georgia's economic policy. Some positive steps has been taken recently in this direction with the constitution of a Georgian cigarette manufacturing company.

The import of machinery, vehicles and other technological products still remains rather low.

Table 5.4: Composition of registered Imports according to the Harmonized Commodity System

	2000	
	USD million	**Per cent**
Total imports	**700, 226, 526**	**100**
Mineral Products including mineral fuels, mineral oils and products of their distillation etc. (HS Chapters 25-27)	133, 416, 422	19
Machinery and mechanical appliances; television image and sound recorders and reproducers etc. (HS Chapters 84-85)	129,193, 796	18.4
Prepared foodstuffs; beverages, spirits, sugars, tobacco and tobacco substitutes etc. (HS Chapters 16-24)	74, 543, 024	10.6
Chemical products, including pharmaceutical products, perfumery, cosmetics, soaps etc. (HS Chapters 28-38)	70, 629, 490	10
Vegetable products, including cereals, products of milling industry, grains etc. (HS Chapters 06-14)	65, 393, 597	9.3
Vehicles, aircrafts, vessels and associated transport equipment (HS Chapters 86-89)	51, 920, 048	7.4
Base Metals including iron and steel, articles of iron and steel etc. (HS Chapters 72-83)	30, 845, 601	4.4
Optical, photographic, cinematographic, medical or surgical instruments etc. (HS Chapter 90)	23, 314, 274	3.3
Other	120, 970, 274	17.2

Source: State Department for Statistics

Box 5.1

USA Extends Normal Trade Relation (NTR)[2] Treatment to Georgia

Following Georgia's accession to the WTO, in a statement issued December 29, 2000, the US President Clinton extended nondiscriminatory treatment – normal trade relations – to Georgian products.

Before this decision, Georgia was subject to the Jackson-Venik amendment to Title IV of the Trade Act of 1974, the provision of law governing the extension of NTR to non-market economy countries, those ineligible for such status as of the enactment of the Trade Act.

A country subject to this provision may gain conditional NTR including NTR tariff treatment, only by complying with the freedom-of-emigration criteria under the Trade Act and concluding a bilateral commercial agreement with the USA, providing reciprocal nondiscriminatory treatment. The extension of NTR is subject to Congressional approval. The US Trade Act authorizes the President to waive the requirements for full compliance of emigration criteria with respect to a particular country, if he determines that such a waiver will substantially promote the freedom-of-emigration provisions and if he has received assurance that the immigration practices of that country will lead to the substantial achievement of those objectives.

On May 6, 1992 the president of the United States determined that Jackson-Venik waivers for Georgia would substantially promote achievement of the freedom-of-emigration criteria. This determination was followed on June 3, 1992 by an executive order, under which Georgia's Jackson-Venik waiver entered into force. NTR was extended to Georgia effective August 13, 1993, following an exchange of diplomatic notes applying the provisions of the United States-Soviet Union agreement to Georgia in a new bilateral agreement.

NTR with Georgia (also with some FSU countries) was continued in effect under annual Presidential waivers in subsequent years. On June 3, 1997 the President of the United States determined that Georgia (together with Armenia and Moldova) was in full compliance with the Jackson-Venik freedom-of-emigration criteria.

Pursuant to section 122 of the Uruguay Round Agreements requiring Congressional consultation prior to country accessions to the World Trade Organization (WTO), the United States Trade Representative transmitted detailed materials to the Committee on Ways and Means on September 7, 1999, on the pending accession of the Georgia to the WTO. On June 14, 2000, Georgia formally became a full member of the WTO.

Georgia had conditional NTR treatment and was subject to the freedom-of-emigration provisions of the Jackson-Vanik law. Most former soviet countries are still in this category. Despite Georgia's accession to the WTO, the obligations of the WTO were not applied between the USA and Georgia. This is because Georgia's trade status was still conditioned by the Jackson-Venik amendment (Title IV of the trade Act of 1974).

Thus, Georgia has an unconditional normal trade relations treatment with the USA.

After the extension of the unconditional NTR treatment to Georgian products, USA can use all the WTO rules in its trade with Georgia.

2 Legislation was enacted in 1998 to replace in US statutes the term "most-favored-nation (MFN)" with "normal trade relations (NTR)".

TRADE POLICY / World Trade Organisation

Millennium round

Georgia's membership of the WTO should not be taken as the end goal. In the next round of WTO negotiations (the in the so-called Millennium Round) it is planned to lay the groundwork for new developments for the WTO and to reach a new level of trade liberalization. Georgia has the right to express its views in these talks.

Bilateral negotiations with WTO candidates

Bilateral negotiations with countries that are currently in the process of accession into the WTO, are also important for Georgia. Among them, Russia, Moldova and other CIS countries are the most important for Georgia. With them Georgia can substantially improve and stabilize its trade relations. The opportunities provided by a deepening of regional integration have to be used to a greater extent. The legal basis of trade relations with these and other partners has to be improved; great attention should be paid to the enforcement of laws on appellation of origin in order to protect Georgian wine and mineral water exports from imitation and falsification.

The use of the Generalized Systems of Preferences (GSP)

One of the main directions for Georgia's trade policy should be the activation of foreign economic relations, using the existing Generalized Systems of Preferences (GSP). The purpose of the GSP is to offer developing and transition countries lower customs tariffs than those applied to the developed nations. This gives their exports preferential access to the developed markets. Almost all the developed countries operate GSP schemes[3]. Despite the fact that Georgia is a beneficiary of the EU, Japan and Switzerland GSP schemes, Georgia does not use these preferences. The US GSP scheme is a widely used scheme. Unfortunately Georgia is not a beneficiary of this scheme, which provides preferential duty free entry for more than 4,650 products from approximately 140 designated beneficiary countries. Despite the fact that the overall size of the GSP relative to total US imports is small, many developing and transition countries use the US GSP scheme very effectively.[4]

Trade defence instruments in accordance with WTO

Due to the global trade liberalization the role of tariff barriers has substantially diminished. Thus the use of trade defence instruments to ensure fair competition in the internal market of countries is increasing.[5] Georgia needs to develop and adopt internal market protection legislation (antidumping, countervailing and safeguards) in accordance with WTO and EU rules.

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[3] The following developed countries have their own GSP schemes: EU, USA, Canada, Japan, Norway, Switzerland, and New Zealand. Some central European countries, not members of the EU, namely Poland, Slovak Republic, Hungary and Czech Republic also use these schemes.

[4] Among the former Soviet Union and east European countries it should be mentioned that the share of GSP free product in total export in US is quite significant for Kazakhstan (83.2 per cent), Poland (36.3 per cent), Slovenia (35.1 per cent), Czech Republic (27.2 per cent), Slovakia (25.7 per cent) and Croatia (22.7 per cent). Source: GEPLAC calculations based on the data provided by the USTR.

[5] The most widely used trade defence instrument is anti-dumping. In 1999 there were 330 antidumping cases initiated world-wide (compared to 232 cases in 1998), the number of countervailing measures has increased from 26 in 1998 to 38 in 1999. The necessity to apply safeguard measures in 1999 was considered 14 times compared to 11 in 1998. Source: The World Development Report 1999-2000

CHAPTER SIX: PRIVATISATION

In the second half of 2000 the privatisation process continued. Progress was mainly achieved in the preparation of enterprises for sale or liquidation. The objects easiest to privatise have been already transferred into private ownership, while the enterprises of special importance to the economy need more examination and time to be privatised. Some large enterprises such as the joint stock companies (JSC) Metekhi Ceramics, Saktungoeterzeti, Intelsat and Georgian State Insurance were privatised in the second half of the year. However, investors in two of the large enterprises, Chiatura Manganese and Rustavi Metallurgical Plant, failed to fulfil the conditions set by the tenders and it is likely that these enterprises will need new investors soon. Preparation work to privatise the assets of energy and telecommunication sectors, the water supply and sewage system is under way. It is important to note that bankruptcy cases have been raised against some large enterprises. The introduction of bankruptcy procedures may speed up the overall privatisation process in the country.

Energy sector

The process of privatisation of the electricity sector of Georgia continues. The Ministry of State Property Management (MSPM), the Ministry of Fuel and Energy and other related bodies have considered the recommendations of the World Bank, PA Consulting and experts of USAID and consequently, the electricity distribution companies that are still in the state ownership, are being grouped according to the territorial principle. As a result the following joint stock companies have been established: Mtskheta-Tianeti Energy, Samtskhe-Javakheti Energy, Shida Kartli Energy, Kvemo Kartli Energy, Imereti Energy, Guria Energy, and Samegrelo-Zemo Svaneti Energy. The establishment of the Racha-Lechkhumi-Kvemo Svaneti energy company is under way. These energy companies are to be privatised by international tender, which are planned to be announced in the beginning of 2001. It is also planned to announce tenders for the management of the JSC "Elektrogadatsema" (transmission), "Electrodispecherizacia" Ltd. (dispatch) and Electricity Wholesale Market. The majority shareholdings of 38 gas distribution companies are still state owned and their privatisation is planned for 2001.

Telecommunications

Privatisation of telecommunication sector assets Sakartvelos Elektrokavshiri and Georgian Telecom was not completed in 2000. The information memorandum was sent to potential investors by the consortium of companies led by Commerzbank acting as a financial adviser to the process of privatisation.

Poti Port

Two terminals of Poti port are to be offered by tender into concession for 20 years. The process of leasing of other terminals and the reorganisation of the port will continue.

Water supply-sewage system

The MSPM is working on the establishment of JSCs and Ltds on the basis of the regional assets of the water supply system. This is a preparatory activity for the future privatisation or transfer into management of the water supply-sewerage system. A working group is developing the strategy for the process and writing proposals.

SMALL ENTERPRISE PRIVATISATION

The privatisation of small enterprises successfully continues. As of 1st January 2001, 13,527 small enterprises had been approved for privatisation and 15,376 had actually been privatised[1]. In 2000, 882 small enterprises were transferred into private ownership (for details see Table A6.1 of the Statistical Appendix). This figure is smaller than in previous years (1,373 in 1999, 1,645 in 1998) because the amount of available objects is diminishing.

Most of the small enterprises are in the trade and service sectors - 34 and 44 per cent respectively. According to the regional breakdown given in the Table A6.4 of the Statistical Appendix, 31 per cent of privatised small enterprises are in Tbilisi.

The constantly growing number of both newly established and privatised small enterprises is prompted by the following. Some small enterprises are split into two or more enterprises. During the restructuring of the medium and large enterprises many parts of them are established as small enterprises. Even though the privatisation of small enterprises does not necessarily imply their efficient operation in future (the acquisition of enterprises by insiders is still widespread), the existing resale market seems to be effective enough to ensure the acquisition of assets by more efficient owners.

MEDIUM AND LARGE ENTERPRISE PRIVATISATION

As of 1st January 2001, 1,312 medium and large enterprises have been established as joint stock companies, while the number of the medium and large enterprises approved for establishment as JSCs remains the same at 1,334. Data in terms of number of employees are unfortunately not available.

During the second half of 2000 the number of JSCs established increased by 92. Eight JSCs were established in manufacturing sector, 10 in agriculture and food, 6 in architecture and construction, 2 in trade, 1 in oil products, 3 in gas, 3 in transport, 9 in social sphere, 16 in energy sector, and 34 in the healthcare system.

According to the conditions of the Structural Adjustment Credit III (SAC) the MSPM continues working on privatisation of the list of large enterprises. Some of them have been already privatised. By the end of the year, the majority shareholdings of JSCs Metekhi Ceramics, Saktungoeterzeti, Intelsat and Georgian State Insurance had been sold. As of 1st January 2001, 82 per cent of the established JSCs had been privatised[2]. Manufacturing still remains the most privatised sector followed by service and trade sectors.

However, many of the large enterprises are difficult to privatise. Many of the tenders failed to collect bids and the enterprises are left unsold. Even in the cases when the price of the majority shareholding in the enterprise was reduced no bids were made. It seems that the conditions of these tenders were too demanding and serious investors refrained from taking on heavy liabilities regardless the low price. The main obstacles to privatise these enterprises are indebtedness, poor condition of the assets of the enterprise, overstaffing, the size itself, and influential interest groups.

[1] The number of enterprises actually privatised can exceed those approved for privatisation since some are split up during corporatisation. The total number of small enterprises, including those not approved for privatisation, is not available. Small enterprises are those with a book value of less than USD 44,000 on April 1st 1993.

[2] Private enterprises are defined as those that are more than 50 per cent privately owned.

Failed privatisations

Saga Print and Metalurg-Oil-Gaz-Invest, the investors of Chiaturmanganumi and Rustavi Metallurgical plant, failed to fulfil the conditions of the tenders and were deprived of the right to own or manage the respective enterprises. The agreements with the investors have been cancelled. Such developments have a negative effect not only on the enterprise, since it will stay idle and accumulate debts until a new investor shows up, but also on the social situation. These enterprises are two of the largest in Georgia and the majority of population of the regions around the plants is economically dependent on them. As the plants are not functioning, the personnel is left without salaries, which maybe small and received with delay, but still, in many cases, are the main financial source for families. So it is important to avoid such situations and find more capable investors with sound financial standing and good knowledge of the specific conditions of the country. The changes in the tendering conditions will make the enterprises more attractive and also facilitate the process of finding investors.

New business plans

Some enterprises such as JSC Azot and Industria Ltd. are being offered for international tenders. The JSCs Elmavalmshenebeli and Georgian Airlines have prepared new business plans for future independent development and have had discussions with the relevant authorities. That means that these enterprises seem to be viable and potential investors can still be found.

Zero reserve price auctions

Zero reserve price auction is the last measure to privatise enterprises before raising a bankruptcy suit against them. The state shares in enterprises like JSCs Shenobanagebobmshenebeli and Energomsheni are being offered at a zero reserve price auction. The bidding will take place from 12th February to 13th March 2001 and the shares will be distributed among bidders in proportion to the sums paid. The previous 6 zero reserve price auctions have been successful and all shares offered at these auctions have been sold. After the failure to privatise JSC Sakabreshumi by tender it is also under consideration for sale at a zero reserve price auction.

Restructuring processes

For a number of large enterprises, MSPM has started using such mechanisms as restructuring, liquidation and bankruptcy procedures. The enterprises JSC Sakartvelos Traktori, Medea, JSC Kolkhida, have been restructured. As a result of restructuring JSC Sakartvelos Traktori was divided into three companies. One of them has a relationship with a potential investor, one is to be purchased by the management of the enterprise, and one faces bankruptcy procedures. The restructured part of the JSC Medea is also under bankruptcy procedure. In the case of JSC Kolkhida the restructured part is to be split into several companies of different type of activity. The management of the company is waiting for a proposal from a potential investor to proceed with the restructuring. These measures will have a positive effect on the process of privatisation. Restructuring enterprises will separate the viable part of the enterprise from the rest. The viable part will become more efficient and consequently more attractive to potential investors. The assets can be sold separately and used by other entrepreneurs.

Liquidations and bankruptcies

JSCs Saktseoliti, Elva, Kimbochko are in the process of liquidation. JSC Tami has a bankruptcy case in the court. JSC Kachreti Puri is also going to face bankruptcy procedures.

Implementation of the bankruptcy proceedings leads to reorganisation or liquidation of an insolvent enterprise. Reorganisation of the enterprise implies managerial, structural and financial restructuring of the enterprise. If reorganisation is successfully implemented, the enterprise will be able to service its debts and improve its overall performance. In other words the enterprises will become more efficient, increase competition and development in the relevant field, repay arrears, pay taxes and thus contribute to the economy of the country.

A well functioning bankruptcy procedure has an effect on the management of troublesome enterprises. It spurs the restructuring process in inefficient enterprises, since the management is more eager to carry out restructuring and save at least part of the enterprise than to lose it completely.

If it is impossible to carry out reorganisation, the assets of the insolvent debtor are to be sold and the claims of the creditors satisfied. In this case the economy also benefits, because some tax and other arrears will be paid. Bankruptcies have a strong positive effect on other businesses by putting new assets on to the market where they could be bought and operated by more dynamic entrepreneurs. At the same time bankruptcy can be used by insiders as a way of obtaining valuable assets cheaply and for that reason it is important to carry out the procedures properly.

CHAPTER SEVEN: EMPLOYMENT, INCOMES AND THE SOCIAL SAFETY NET

LABOUR MARKET

The unemployment rate decreases, but the general situation cannot be considered improving

Although, according to the SDS household survey figures, the unemployment rate appears to be fading: 2000 figures show a certain year-on-year decline[1], the employment situation remains largely unfavourable and unstable. While unemployment rate figures suggest optimistic conclusions, persisting underemployment and widespread hidden and disguised unemployment behind these figures blemish the overall picture, aggravated further by long-term unemployment and continuing decreases in the labour force. A vast proportion of those employed work substantially less than full-time and earn much less than a living subsistence.

Rural figures and self-employment give misleading messages

The national unemployment rate is highly biased by the rural figures, which, in accordance with the existing legislation, excludes rural unemployment per se[2]. The majority of those employed are self-employed (nearly 58 per cent), and the majority of the latter are self-employed in agriculture (nearly 86 per cent of self-employed). Many of them are hardly earning a living and yet cannot be considered unemployed. Urban unemployment, though, is almost twice the national rate. Counting long-term unemployed, who have given up looking for job long ago, i.e., "discouraged workers", would show a picture much closer to reality than that shown in the statistics.

Staff cuts in the public sector increase the number of registered unemployed

Strangely enough, the number of registered unemployed that has been kept optimistically low, is showing signs of growth (by 14 per cent against the previous year as of end of Q3 and by 18 per cent as of end of Q4 2000). It still fails to reflect the real unemployment rate: given the symbolic sum of the unemployment benefit, the short period during which it is paid and the very low chances of finding a job through registration, only very few of the unemployed bother to register. At the end of Q3 1999 the share of the registered unemployed in the total number of unemployed (by ILO "strict" standard) did not exceed 37.6 per cent, but at the end of Q3 2000 as many as 65.5 per cent considered it worth registering. This was not the result of a better organised labour market as one might suppose, since virtually nothing was changed as far as both the size of unemployment benefit or the mechanism of registration are concerned. Most probably this can be explained by staff cuts in the public sector, mostly in budgetary organisations, as a result of which those who lost their official jobs registered at the Employment Fund offices, while, at the same time engaging (or continuing with) various informal activities.

The information on unemployment, employment structure, economically active population, population outside the labour force and the labour force participation rate drawn from the State Department for Statistics Labour Force Survey (LFS)[3] and the Household Survey[4] can be considered as reflecting much more the real situation.

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[1] Since economic status data where drawn from the SDS Labour Force Survey up to the end of 1999, and starting from 2000 – from the SDS household survey, slight differences between the methodologies applied in the respective surveys could also account for the substantial fall of the unemployment rate in 2000.

[2] According to the Law on Employment, each farmer owing at least 1 ha of agricultural land, or his/her family member are considered self-employed.

[3] Labour Force Survey (LFS) started by the SDS in 1998-1999 with help from ILO and UNDP.

[4] Since Q3 1996, the SDS has been implementing the continuous Household Survey with the financial support of the World Bank and in co-operation with *Statistics Canada*.

Table 7.1: Economic Status, Q I 1999 – Q3 2000*
(Thousands)

Economic Status	Q I 1999	Q II 1999	Q III 1999	Q IV 1999	Q I 2000	Q II 2000	Q III 2000
Total population over 15 years old	**3, 032**	**3, 049**	**3, 092**	**3, 018**	**3, 123**	**3, 151**	**3, 133**
Total economically active population (labour force) (1)	**2, 018**	**2, 052**	**2, 058**	**1, 917**	**1, 951**	**2, 102**	**2, 064**
Total economically active population (labour force) (2)	**2, 058**	**2, 093**	**2, 106**	**1, 975**	**2, 087**	**2, 199**	**2, 181**
Employed	***1, 725***	***1, 784***	***1, 792***	***1, 633***	***1, 705***	***1, 890***	***1, 890***
Hired	737	743	741	710	679	695	675
Self-employed	973	1, 023	1, 030	905	912	1087	1095
Unemployed (1)	**292**	**268**	**266**	**284**	**246**	**212**	**174**
Unemployed (2)	**333**	**308**	**314**	**342**	**382**	**309**	**292**
Unemployment rate (per cent) (1)	**14.5**	**13.0**	**12.9**	**14.8**	**12.6**	**10.1**	**8.4**
Unemployment rate (per cent) (2)	16.2	**14.7**	**14.9**	**17.3**	**18.3**	**14.0**	**13.4**

Source: Data from the SDS Labour Force Survey and the SDS Household Survey
Note: (1) ILO Standard (or "strict" methodology
(2) ILO "Loose" Methodology
** For more a more detailed table and 1998 figures see Statistical Appendix Table A7.1.*

The household survey results (see Table above) suggest that although Q3 2000 saw a slight growth in the participation rate (by 2 percentage points), the annual trend is not encouraging, being characterised by the downsizing of the labour force which renders the declining unemployement rate less optimistic. However, the participation rate in Georgia is still rather high (65.9 per cent as of end of Q3 2000), the main reason being the criteria used in measuring self-employment, and, particularly, rural self-employment.

Fewer hired employees, more self-employment

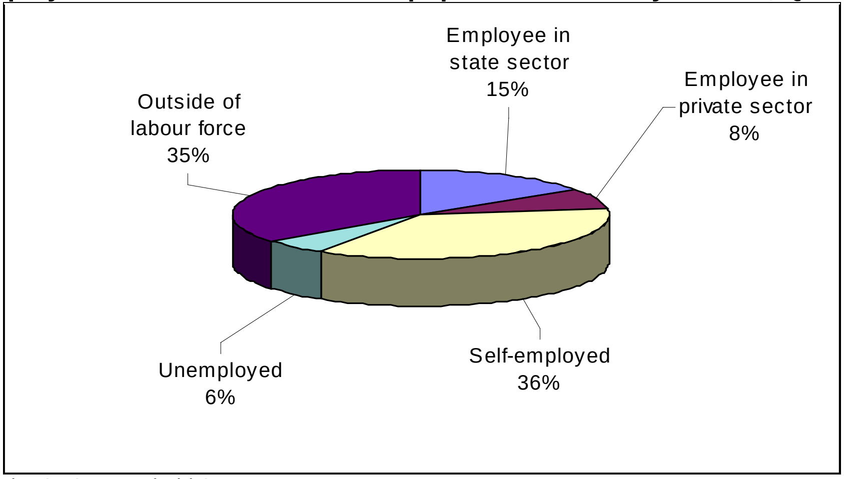
The number of hired employees is diminishing, compared to previous years, however, the number of the self-employed resumed its growth, though on a rather modest scale, reaching its 1998 level in Q3 2000. Shrinking hired employment and increasing self-employment in recent years used to be a sign of staff cuts in the state sector on the one hand, and of an unfavourable situation for the businesses on the other. As a result, former salary earners had to seek some kind of self-employment to survive. Those who failed to do so, became unemployed.

A growing number of discouraged workers

Though the unemployment rate figures were much lower in the first three quarters of 2000[5], than in 1999, the gap between the unemployment rate measured by the ILO 'strict' standard and the one measured by the ILO 'loose' methodology was much higher - the best evidence of long-term unemployment, when "discouraged workers" fall out of the labour force. The long-term unemployed's prospects of finding a job are poor the more prolonged the period of unemployment and the smaller the chances of finding a job. The "discouraged workers" run the risk of falling out of the labour force, and, in the long run, of social isolation and social exclusion.

[5] When this issue of GET was ready for publication, household survey data for Q4 2000 were not available.

Figure 7.1: Employment characteristics of the population over 15 years old, Q3 2000



Source: Data from the SDS Household Survey
Note: Share of the population outside labour force is given according to the ILO 'strict' standard of measurement, i.e., including discouraged workers.

As shown in Figure 7.1, in Q3 2000, over 70 per cent of the adult population were split almost evenly between the self-employed and those outside the labour force. The next largest group, accounting for 15 per cent of the adult population, were those employed in the state sector, and they accounted for 64.2 per cent of the total number of hired employees and 22.3 per cent of the labour force. The vast majority of state employees – 67.5 per cent – worked in budgetary organisations, and, therefore, received low and irregular salaries (possibly having to seek another secondary alternative employment – most likely in the shadow economy, either as self-employed or in private firms). Just about 8 per cent of the adult population, or 11 per cent of the labour force had so-called conventional jobs, i.e., salaried jobs in private companies. The majority of such jobs, however, are very much likely to be low paid, insecure jobs in small firms, and a proportion of them is undoubtedly in informal sector. Although, it has to be mentioned that there is a tendency for the share of the state sector employees to diminish while the share of private sector employees in the total labour force is growing. The self-employed still account for as much as 53 per cent of the labour force and almost 58 per cent of total employment (see Table 7.1 of Statistical Appendix).

Low quality of the available jobs

It is apparent from all the above that underemployment is a widespread phenomenon, hiding behind the encouragingly decreasing unemployment rate figures. The majority of the employed is engaged in low-paying and insecure segments of the labour market under poor working conditions. Most jobs are created in the informal sector that is a major provider of urban jobs, and in low-productive agriculture; many of these are part-time or temporary jobs, offering extremely low remuneration and insufficient to change the household budget situation. Informal activities, that are mostly a way of surviving, are largely unrecognized, unrecorded and unregulated small-scale activities, many of which are irregular self-employment.

SALARIES AND WAGES

Average salaries are still very low; education and healthcare are still the worst payers

As the SDS household survey figures show, the average monthly nominal salary of hired employees across the economy was GEL 91.2, and the share of the average monthly salary in the minimum subsistence level of a family of four was 42.3 per cent at the end of Q3 2000. Employees in transport and telecommunication (over GEL 150 per month on average), and construction (over GEL 132) were the highest salaries earners in Q3 2000, and those engaged in education and healthcare were earning the lowest salaries (around GEL 45 and GEL 58 respectively). The former two sectors accounted for 11.3 per cent of hired employees, while the latter two accounted for 31.2 per cent.

The salaries of budgetary organisation[6] employees range between GEL 20 and GEL 66 since the concept of a minimum salary was re-introduced after a 4-year gap by a presidential decree in June 1999. Those employed in budgetary organisations accounted for 43.3 per cent of hired employees in Q3 2000.

Many public sector employees are paid only token salaries, the cases of non-payment of salaries are widespread, arrears in the payment of budgetary employees' salaries persist and the growth in salaries is eroded by inflation.

MINIMUM SUBSISTENCE LEVEL

Though discussions on the necessity of introducing a new methodology for calculating the minimum subsistence level to replace the outdated one have been held for several years already, the methodology, introduced in early 90s, is still being used. In August 1999, a Government meeting passed a decision "On Introducing Changes into Calculation Methodology and Re-calculation of the Minimum Subsistence Level", a draft presidential decree "On Defining and Applying Subsistence Minimum" has been drawn up and a new methodology to calculate the minimum subsistence is ready at the SDS. However, no formal steps have been taken so far to formalise it. It still remains to be seen to what extent the minimum subsistence levels to be calculated based on the new methodology will better reflect reality.

The subsistence minimum levels published by the SDS, were: GEL 114.5 for a working man, GEL 100.4 for an average consumer and GEL 199.2 for a family of four – on average at the end of Q4 2000, a 3.8 per cent year-on-year growth. (As of end of Q3 2000 the levels were correspondingly GEL 113.2, GEL 99.3 and GEL 197). As usual, the minimum subsistence level in Tbilisi was higher than the national average, this time by 4 per cent, reflecting the growing gap between the national level and the level in the capital.

SOCIAL SAFETY NET

Social policy reform is among the top priorities in the country, as it is becoming apparent that the existing system is unsustainable. The current social safety net system is largely the heritage of the soviet past and in the conditions of transition economy appears to be ineffective as poverty refuses to subside. The pay-as-you-go pension system is not in a position to ensure payment of the extremely low flat rate benefits payable to all the pensioners and the tightly targeted token social benefits are unable to alleviate poverty. However, even these are too high a burden for the current government budget. The fundamental restructuring of the state social protection system is indispensable and should be aimed at creating economically viable, affordable and equitable social safety net, promoting growth.

The Government, in its interim Poverty Reduction Strategy Paper, has laid out structural reforms in five main areas to reduce poverty and stimulate economic growth: 1) social sector reforms to improve

[6] A budgetary organisation is a public organisation fully subsidised by the state budget.

allocation of benefits to better target the poor; 2) supportive macroeconomic policies, such as tax and customs administration, to raise fiscal revenues while reducing the budget deficit; 3) public administration reform based on recommendations of the anti-corruption commission; 4) private sector development to foster investment in infrastructure as well as other areas; and, 5) agricultural reform.

State Social Allowance

The State Social Allowance is targeted now at households comprised exclusively of non-working pensioners without a legal breadwinner, and/or orphans. Actually, it represents a kind of topping-up of symbolic pensions of the poorest elderly and a modest child allowance for the most destitute children. The State Social Allowance payble to recipients, in accordance with a presidential decree of 21 August 2000, was GEL 20 for a qualifying household consisting of one member, or for each orphan under guardianship, and GEL 29 for an eligible family of two or more. Another presidential decree of 10 February 2001 increased the size of the allowance to GEL 22 for a one-member recipient household and to GEL 35 for a recipient family of two or more.

Unemployment Benefit

The payment of the standard monthly Unemployment Benefit payable for the first six months of registered unemployment is fixed at GEL 14 for the first two months of unemployment, GEL 12 for the next two, and GEL 11 for the final two months of payment. To become officially eligible, a person should be registered as unemployed, therefore, should have a certain working record in the official sector. As a result, the number of the unemployed who bother to register is several times lower than the actual one and the number of the benefit recipients is insignificant (on average, hardly 2 per cent of the registered unemployed).

Pension System

Under the current pay-as-you-go pension system, pensions are financed through the United State Social Safety Fund – the only pension fund providing fixed-rate, symbolic (equivalent to about USD 7.5 per month) old-age pensions to the majority of pensioners. The revenue of the fund is formed from payroll tax proceeds[7] with budgetary transfers meant to compensate for the under-funding of pensions. The pension system has long proved to be unsustainable and insolvent continues to accumulate arrears, fighting hard in a constant attempt to fulfil an extremely challenging task of having to cope with regular payments, at the same time having the burden of old commitments, especially under the conditions of a narrow tax base, big informal economy, and constant tax under-collection and non-compliance. The tight budget is hardly in aposition to help the Fund with the transfers.

While for a pay-as-you-go pension system to be functioning relatively smoothly the *dependency ratio*[8] should be at least 3:1, the current ratio is 1:1.2 – a ratio unsustainable for a universal PAYG scheme. In addition, the number of those who should be contributing by definition (hired employees and their employers), but in reality are not due to various reasons (budgetary organisations payroll is very often late, many of the companies are not functioning, and some contributors are not paying in full) is large.
The low level of wages and no link between the future benefits and current contributions result in virtually no incentive for those employed not to evade paying taxes, and a relatively high payroll tax rate discourages tax compliance on the part of the employers. Under such circumstances it is apparent that the system cannot be fulfilling its obligations.

[7] The contributions from workers' wages, that form the United State Social Safety Fund (USSSF) revenue are 26 per cent of gross wages for budgetary organisations and 27 per cent for others paid by the employer and 1 per cent paid by employees.
[8] The number of pensioners as a per cent of the number of people employed, or contributor to beneficiary ratio.

The *replacement rate*[9] of the current pension system is low. The average pension flat rate of the majority of pensioners is 20 per cent of the average hired employees' monthly salary. Monthly pensions are now GEL 14 for the majority of elderly. As of end of December 2000, pensions accounted for just 14 per cent of the minimum subsistence level of an average consumer.

The severe crisis the current pension system is facing is painful not only economically, but also politically and socially. Neglecting the short- and long-term consequences of the current situation will place the vulnerable at serious economic risk and may result in growing poverty, social disintegration, marginalisation and social exclusion. At the same time, the elaboration and implementation of an effective social policy would offer a more solid base for long-term economic growth. Reform of the pension system is now among Government's top priorities, and a far reaching pension reform programme is being designed, aimed at establishing a financially sustainable modern pension system suited to changing demands of a transition economy and, where possible, tailored to local conditions. The Government, strongly committed to reforms in the social sector, is supported by the President and assisted by advice from external aid agencies in implementing, developing and supporting the reform programme.

A PAYG system is based on a solidarity contribution[10] principle, and is effectively an element of the social safety net, and thus, can only provide basic minimum pensions to the elderly. However, it is not in the position to provide adequate benefits to the elderly on its own. In order to provide a plurality of possibilities and availability of choice for those who can afford to make provisions for their future pensions, it is logical to introduce a *multi-pillar system*[11]. This would have the benefits of increasing personal responsibility and creating savings funds for investment. The point of pension reform is to stabilise the pension system and ultimately to increase the pension benefit through higher returns. However, as it is not likely that a big share of the population would be able to afford participation in private schemes, at least, in the short and medium term, and the PAYG pillar is going to be mandatory under the reformed pension system and still very important for the majority of the pensioners, the most imperative goal to aim at is to improve payroll tax collection and broaden the tax base.

[9] The average pension in terms of the average wage.

[10] A compulsory contribution which is not expected to earn a specific benefit for the contributor but which is required by the social security system in order for it to provide benefits to others.

[11] For detailed definitions of the pillars and some other pension system terms see GET 1999 No. 3, Chapter 7, p. 64.

CHAPTER EIGHT: THE EU-GEORGIAN RELATIONS

The EU Ministerial Troika (Mr. Javier Solana – Secretary General/high Representative of CFSP, Mrs. Anna Lindth – Minister of Foreign Affairs of Sweden, Mr. Chris Patten – EU Commissioner for External Relations) visited Georgia during the 20-21 of February 2001. The Troika visit emphasises the EU interest towards Georgia with a view to support peace, stability, prosperity and regional cooperation.

During the last year the trade relations intensified between Georgia and European Union and amounted to USD 235.4 million. This is by USD 50.9 million more than in 1999. In 2000, Georgian export amounted to USD 68.3 million and import – USD 167.1 million. The trend of the last year show the decrease of Georgian import from EU Member States and increase of Georgian export to the European market.

Georgian-Greece economic relations intensified after the restoration of Georgian independence. These relations cover economic, financial, technical assistance and other spheres.

According to state department of statistics of Georgia last year trade relations between two countries amounted to USD 18.9 million. However, official data on Greece-Georgian trade relations provided by the National Statistic Service of Greece are different.

In terms of investments the Greek businessman are cautious. They prefer to develop trade relations in Georgia than to invest in the country.

The EU Ministerial Troika visits Georgia

The EU Ministerial Troika (Javier Solana – Secretary General/high Representative of CFSP, Anna Lindth – Minister of Foreign Affairs of Sweden, Chris Patten – EU Commissioner for External Relations) visited Georgia during the 20-21 of February 2001. During the visit Troika held meetings with the Georgian President, State Minister and other High Officials. The Troika visit emphasises the EU interest towards Georgia with a view to support peace, stability, prosperity and regional cooperation. During the meetings the importance of strengthening the EU's political role in the region was underlined.

After the Troika visit, on 26th of February, the General Affairs Council adopted conclusions on the Southern Caucasus and it was stated that "The Council invited its competent bodies, with the assistance of the High Representative/Secretary General, and the Commission to make recommendation for the implementation of a reinforced EU policy, on the basis of preparatory work for and the results of the Troika visit and report back in time for the Cooperation Councils with Georgia, Armenia and Azerbaijan under the Belgian Presidency."[1]

[1] Brussels 26/02/2001 Agence Europe.

EU-GEORGIAN TRADE RELATIONS

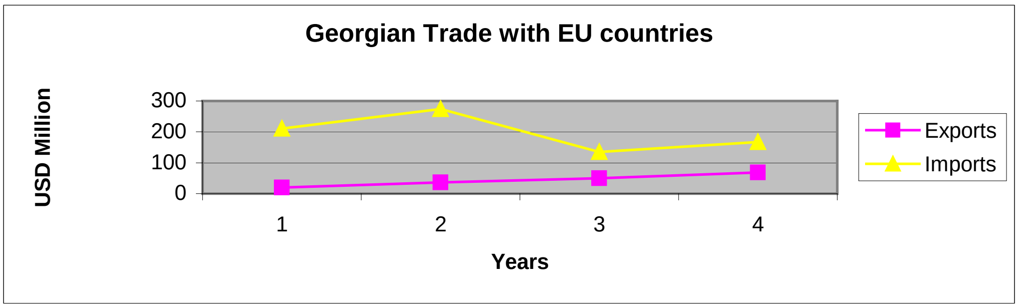
Trade between the EU and Georgia amounted to USD 235.4 million in 2000, of which exports were USD 68.3 million and imports USD 167.1 million. Compared with the previous year exports increased by USD 18.9 million and the imports by USD 32 million.

Table 8.1: Georgia's Trade with the EU Countries
(USD million)

Year	Turnover	Exports	Imports	Balance
1997	231.2	20.2	211.0	-190.8
1998	310.5	36.7	273.8	-237.1
1999	184.5	49.4	135.1	-85.7
2000	235.4	68.3	167.1	-98.8

Source: The State Department for Statistics

Figure 8.1: Georgia's Trade with the EU Countries



Source: The State Department for Statistics

The trends of the last years show a decrease of Georgian imports from Europe. On the other hand, Georgia keeps on increasing its export to the EU market, but this increase is not enough to eliminate the Georgian trade deficit.

During the last year the main trade partners for Georgia are Germany (with a turnover of USD 86.7 million), UK (USD 33.6 million) and Italy (USD 33.3 million). The trade turnover of these countries with Georgia constitutes 65.2 per cent of total amount of Georgia-EU trade.

GEORGIA'S ECONOMIC RELATIONS WITH THE EU MEMBER STATES: GREECE

Georgian-Greek relations are the oldest. Co-operation between the two countries dates back to the Argonauts. The geographic location of Georgia and trade turnover between Europe and Asia facilitated the Georgian-Greek economic relations during the centuries.

Georgian-Greek economic relations intensified after the restoration of Georgian independence and the Greek community in Georgia plays an important part in these relations. Relations include economic, financial, technical assistance and other spheres. An Agreement for a bilateral Technical Assistance Programme was signed in Athens in 1999. The agreement covers a bilateral short-term pilot technical co-operation assistance programme. The total amount of the programme is EUR 900,000. The main activities of the program are business services to small and medium sized enterprises, technical assistance to public entities, NGOs, and for privatization and private investment projects.

The Greek Development Assistance to Georgia is another important aspect of Greek-Georgian relations. The programme covers economic, financial, technical and humanitarian assistance. Through this programme Greece provided Georgia with export credits amounting to USD 15 million. The credit was granted on favourable terms with a grace period of two years, 3-5 years duration, interest at LIBOR + 1.75%[2]. The credit has already been spent but the Greek side considered that "the aims for granting this export credit have not been achieved in general terms" [3].

Greek Development Assistance also contribute USD 500,000 for the structural reform programme of Georgia, USD 2.8 million for Georgia's equity share in the Commercial and Development Black Sea Bank, USD 50,000 for the Georgian Investment Centre (GIC).

Dimension of trade

According to the State Department of Statistics of Georgia last year trade relations between the two countries amounted to USD 18.9 million, of which USD 8.1 million is Georgia's exports to Greece and USD 10.1 million Greece's export to Georgia. It represents 8 per cent of the total trade turnover of Georgia with EU Member States.

However, the Head of the Economic and Commercial Attaché office of Greek Embassy in Georgia Mr. Vassilis Skronias considered that the statistic on Georgia-Greece trade relations do not express the real picture, because of the shadow economy and corruption in the customs services of Georgia[4]. According to him, the real turnover is much higher than is registered in official data. According to him the annual turnover of Georgian-Greek trade exceeds USD 40 million. Official data, which are provided by Greek and Georgian statistical services on trade relations between two countries confirm this opinion. For example, according to National Statistic Service of Greece in 1998 the Greek exports to Georgia were USD 26.4 million and during the same period according to State Department of Statistics of Georgia the Greek imports were USD 0.4 million.

Table 8.2: Georgian-Greek Trade Relations
(USD million)

Year	Turnover	Georgian Import	Georgian Export	Balance
1997	15.5	1.2	14.4	13.2
1998	19.4	0.4	19.0	18.6
1999	13.3	3.0	10.3	7.3

Source: State Department for Statistics

[2] "The Georgian Times" 9, November, 1999.
[3] Ibid.
[4] "The Georgian Business Week". "Bilateral economic relations between Greece and Georgia are not being developed at desirable level" June 12-18, 2000.

Table 8.3: Georgian-Greek Trade Relations
(USD million)

Year	Turnover	Greek Exports	Greek Imports	Balance
1997	27.3	24.7	2.5	22.5
1998	28.4	26.4	1.9	24.4
1999 (Jan-Aug)		6.1	4.0	1.1

Source: National Statistic Service of Greece

To look into detail, Georgia exports to Greece hazel-nuts, nitrate fertilizers, timber, iron alloys, clay and Greece exports to Georgia flour, sugar, food products, oil products, freezers, tanks, and telecommunication equipment.

On the Georgian market the major competitors for Greece are Turkey, Spain, Italy and Israel. The Cheap Turkish products are dominating all levels of the Georgian market thus creating severe problems for imports from Greece. Also the exporters of above mentioned countries operate in “compliance with specially worked out price policy” [5], they participate in sectoral exhibitions, and have permanent representatives in the country. The impediments for Greek exporters are a lack of interests in the methods that are established in the internal market, unfair competition and “lack of succession in the responsibilities undertaken by Georgian partners” [6].

In terms of investments, Greek peopleman are cautious. They prefer to develop trade links in Georgia to investing in the country. This can explained by the existing energy crisis, the unfavorable investment climate, the unstable situation in neighboring countries (the war in Chechnya) and the geographical location.

Finally, we should pay attention to the Greek companies operating in Georgia. These are: International Black Sea Commercial bank[7] and EA-Bank in the banking sector: Helascom, which operates in telecommunication sector and installed the optic network of communications Poti-Tbilisi-borders of Armenia and Azerbaijan (total amount USD 21 million): Eko-Georgia which owns 12 petrol station in Georgia: Kay Investments which owns betonite mining: and Terna which specializes in repairing and exploitation of hydro electric stations.

[5] “The Georgian Business Week”. “Bilateral economic relations between Greece and Georgia are not being developed at desirable level” June 12-18, 2000.
[6] “The Georgian Business Week”. “Bilateral economic relations between Greece and Georgia are not being developed at desirable level” June 12-18, 2000.
[7] 51 per cent share of the bank belongs to the Commercial Bank of Greece.

CALENDAR OF EVENTS

2000

NOVEMBER

1 The Government presented main directions of the National Anti-Corruption Programme.

3 A well-known financier George Soros, visited Georgia on a 2-day visit. He expressed his satisfaction with the work of the authors of the draft anti-corruption programme. Soros stressed the necessity for transparency in the anti corruption process. He expressed his opinion that abolition of police stations on motor roads would raise the cargo transportation figures as well as the efficiency of highway development. According to the State Chancellery, Soros is going to finance one specific direction of the anti-corruption programme.

6-10 **WTO** regional seminar was held in Tbilisi for the BSEC countries. Representatives of eight countries attended this seminar. Participants were able to model the process of accession to the WTO, when simulating bi-and-multilateral trade negotiations.

10 **Ratification of international treaties** The Parliament ratified two international treaties – "Concerning Trade and Economic Co-operation" concluded between Georgia and Switzerland and "Concerning Joint Exploitation of Railways and Ferries" concluded between the governments of Bulgaria, Ukraine and Georgia.

15 **Foreign Assistance** The well-known economist and Adviser to the President on economic issues Leshek Balcerowicz visited Parliamentary Chairman Zurab Zhvania. Balcerowicz said that the state of the macro-economy in Georgia is much better than that of other states in the post-soviet space. The Parliament Chairman noted that the current tax legislation requires urgent changes, as it is not effecive enough, it does not promote the increase of revenue. According to the Chairman, it would be much more efficient if there was fixed tax imposed in such fields as agriculture and small business.

24 **Energy** Financing Agreement was signed between the European Commission, represented by Ambassador Elio Germano, and David Mirtskhulava, Minister of Fuel and Energy of Georgia. Through this agreement, the European Community shall provide a grant of EUR 5 million to contribute to the financing of the Enguri Arch Dam rehabilitation. The works of rehabilitation will have to be completed within 18 months. The European Commission has also committed itself to provide financial assistance for the rehabilitation of generator number 3 at the Enguri hydro-power station. This latter programme will be implemented together with the EBRD.

DECEMBER

10 **Oil** At the meeting of the vice-chairmen of "Shevron" board of directors Richard Mazke with the Georgian President Eduard Shevardnadze discussed the course of "Shevron" projects implementation in Georgia.

13 **Parliament/Budget** The Parliament of Georgia approved 2001 budget at the third reading. The state budget law provides for GEL 641,7 million in revenue and GEL 918,3 million of expenditure.

14 **Mining** Paul Willen, vice-president of a Swiss company Glencor International AG, which is the major investor in Madneuli, presented the main directions of the investment programme of the company and its point of view of the managing structure of this major mining industry of Georgia at a meeting with the Georgian President.

15 **Oil** Special adviser to the US President and Secretary of State for Caspian energy resources Elizabeth Jones started negotiations with the government of Kazakhstan for the participation of Kazakhstan in the realisation of Baku-Tbilisi-Ceyhan main export pipeline project.

29 **NTR Status with USA** In a proclamation, US President Clinton extended non-discriminatory treatment – normal trade relations treatment – to products of Georgia. The extension of unconditional NTR treatment to the products of the Georgia will permit the USA to avail itself of all rights under the WTO with respect to Georgia.

Privatization/Chemical Industry The Ministry of State Property Management announced an international tender on the right of possession of 90 per cent of the JSC Azot stocks for 1 year. The debts of the JSC amounts to GEL 72.29 million, the equity capital – to GEL 30.3 million. Generally, the investment programme envisages the maintenance of the main profile of the enterprise – the production of mineral fertilizers, caprolactam, and potassium cyanide during 10 years. At the same time, the investor is to increase production. The volume of the commercial output is to be no less than USD 50 million a year, in 2003-2006, and up to USD 72 million. Profit should be USD 2 million. The investor is to also carry out rehabilitation works and invest no less than USD 18.1 million for that purpose.

JANUARY

10 **Oil and Gas** Refusal of part of the authorised dividends from the use of Baku-Supsa pipeline and Supsa oil terminal for the benefit of the national budget for several years to come was made by the Georgian International Oil Corporation (GIOC). According to the agreement signed with the Finance Minister at the end of last year, the national budget will receive corporation dividends not according to the sum of the financial year but during all year according to the schedule agreed with the Finance Minister. The Oil Corporation refuses dividends for the whole period while the national budget has problems before the construction of Baku-Tbilisi-Ceikhan.

11 **Oil** Celebration ceremony for the opening of the new oil well by the President Eduard Shevardnadze was held on the oil-fields in Ninotsminda in eastern Georgia. In Ninotsminda oil-fields 12 wells are functioning currently. Hydromagnetic inspections are being held on 3 wells. According to official information, total daily mining is equal to 300 tonnes of oil and about 240,000 cubic metres of natural gas. This will soon increase to 500-700 tonnes of oil and 1 million cubic metres of gas. The oil mined in Ninotsminda is refined by the Georgian-American company GAOR founded by the Georgian-British oil company – 19 per cent, Canargo company – 51 per cent and GeoOil stock company.

12 **Programme of the IMF in Georgia resumed** The Executive Board of the International Monetary Fund approved a three-year loan under the Poverty Reduction and Growth Facility (PRGF) in an amount equivalent to SDR 108 million (about USD 141 million) to support the government's economic programme. The first disbursement of SDR 9 million (about USD 12 million) under the new programme will become available immediately.

18 **Government** The presentation of the National Poverty Reduction and Growth programme was held. In the programme, special attention is attached to the rehabilitation of economy in the region, and the problems of refugees. The document will be reviewed every three years. For the next three years the programme aims at forming the foundations for more rapid economic growth and reducing poverty. In parallel, the problem of external debts will be settled. In the intermediate document worked out by the Government there are structural reforms in five basic spheres along with the strategy of poverty reduction. In particular, the reforms in the social sphere - for improving the distribution of assistance to the poor; macroeconomic policy to support growing fiscal revenues; improvement of administration, taking into account recommendations of the anti-corruption commission; development of a private sector for mobilizing investment and the reform of agriculture.

30 **Industry** A meeting dedicated to the problems of “Chiaturmanganese” in Chiatura took place. It was decided to give “Saga Print” a last opportunity to improve the situation at the enterprise.
Foreign Investments The meeting of President Eduard Shevardnadze with Turkish businessmen and potential investors was held in the "Sheraton-Ankara" hotel. It was mentioned that the business circles of Turkey consider Georgia to be one of the most important partners in trade and economic spheres and are interested in expanding co-operation. There are 150 Georgia-Turkish joint ventures . Investment by Turkish companies in Georgia make up about USD 45 million. In 1997, a Georgian-Turkish business council was founded. Turkish businessmen stress that the development of beneficial co-operation would be promoted by ratification of the agreement on avoiding double taxation between the two countries.

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8 **Tbilisi natural gas network rehabilitation** The Parliamentary Committee on Sector Economy conducted a hearing aimed at considering programmes on the rehabilitation and upgrading of the Tbilisi network of natural gas. The meeting discussed issues relating to the implementation of a memorandum of mutual understanding signed by USAID, P & A Consulting, the Ministry of State Property Management, the Tbilisi Municipality, and Tbilgas in November 2000. The network requires urgent rehabilitation at a cost of nearly USD 100 million. According to the USAID P & A Consulting, the implementation of the programme was to start in February.

16 **Parliament** Parliament ratified the 1993 agreement On Regulating Assets and Liabilities of the Former Soviet Union between Georgia and Russian Federation, known as the 'zero variant' agreement. By the agreement, Georgia transfers to Russia its 1.62 per cent share in the former Soviet property. In exchange for ratification of the given agreement Russia promised to restructure USD 158 million of debt owed by Georgia.

20-21 **EU/Georgia relations** EU Ministerial Troika (Mr. Javier Solana – Secretary General/High Representative of CFSP, Mrs. Anna Lindth – Minister of Foreign Affairs of Sweden, Chris Patten – EU Commissioner for External Relations) visited Georgia. During the visit, the Troika held meetings with the Georgian President, State Minister and other High Officials. The Troika visit emphasized the EU's interest towards Georgia with a view to supporting peace, stability, prosperity and regional co-operation. The importance of strengthening the EU’s political role in the region was uderlined.

22-23 **International Relations** The third session of joint Georgian-Ukrainian intergovernmental commission on economic co-operation was held in Kiev. According to members of the commission, reported trade (in goods) turnover increased by 149 per cent to USD 57 million. The parties discussed co-operation in the transport sphere. In connection with the liberalisation of tariffs, the Georgian side approved the decision on reduction of tariffs for transit transportation by 50 per cent. The parties also look at the question of the optic-fibre cable Trans-Asia-Europe

(TAE) joining the system of Black Sea optic-fibre cable. One of the main priorities in the co-operation of the intergovernmental commission members was recognized to be joint participation of the two countries in global energy projects. To avoid penetration of counterfeited produce on the markets of both countries, the parties agreed to prepare a draft intergovernmental agreement on protecting industrial property.

26 **EU** The General Affairs Council adopted conclusions on the Southern Caucasus where it was stated that "The Council invited its competent bodies, with the assistance of the High Representative/Secretary General, and the Commission to make recommendations for the implementation of a reinforced EU policy, on the basis of preparatory work for and the results of the Troika visit and to report back in time for the Co-operation Councils with Georgia, Armenia and Azerbaijan under the Belgian Presidency."

28 **Industry** The French company Castel Group plans to expand beer production in Georgia. Pierre Castel discussed the plans of future development with President Shevardnadze. According to the presidential press-service, the talks dealt with beer export growth and the potential for internal and external markets, in particular, in Russia and Ukraine.

APPENDIX I: ECONOMIC APPROACH TO THE RESTRICTION OF CORRUPTION IN GEORGIA

By Vladimer Papava, Deputy Parliamentary Secretary of the President of Georgia, Doctor of Economic Sciences, Professor

Corruption is one of the most pressing problems of modern society. It has become a priority for consideration by International organizations and more generally among politicians and scientists. It should be mentioned that the scientific analysis of this problem is often of secondary importance and gives way to political approaches to ways of suppressing of corruption, not to mention proposals intended for populist effect.

It should be made clear from the very beginning what kind of event is the corruption from the economic point of view in Post Communist countries in general and particularly in Georgia. This will help in creation of an effective mechanism for its restriction.

The main question, which should be answered in the first place, is a very simple one: *Does corruption exist in Georgia,* as in one of the Post Communist countries*?* The answer to this, so to say, rhetorical question is simple as well: *of course, it does*. Although there should not be any doubt about the trustworthiness of such an answer, it is still necessary to underline the fact that *nothing much is said by this assertion,* because there is no place in the world where there is no corruption.

It should be mentioned that *corruption*, as such, is a *secondary phenomenon* and it will be practically impossible to elaborate an effective mechanism for its restriction without revealing the economic reasons causing it.

One terminological aspect should also be discussed. Namely, as a general rule, in respect to corruption the word combination - *"to combat corruption"* - is used, what, in our opinion *is unacceptable in principle*, because there are economic preconditions causing corruption, the fight against which, *or against economy is just nonsense.* It is true that the various manifestations of corruption could be combated, which in a short period of time will have camouflage-type pseudo-effect, but actually nothing will be changed: the "main actors" of corruption will change, but the economic reasons causing corruption will remain untouched. At the same time, if we consider, that the full disappearance of corruption is impossible in principle, then, by taking into account the above , the right approach to the problem from a terminological point of view, will be the word combination *"the restriction of corruption".*

The nature of corruption in countries in the process of Post Communist transformation differs from that of developed countries. This process itself is unique, as the corresponding economy is no longer a command one, but is not yet fully a market one either; and it is this that is directly reflected in the causes of corruption and its various manifestations.

In order to study the nature of corruption in a period of *Post Communist transformation of the economy,* it will be appropriate to remember that this process consists of two mutually complementary sub-processes. The first is *the achievement of macroeconomic stability* and the second - *the formation of the institutions appropriate to a market economy.* Unless these sub-processes reach their logical ending, both of them may (and it is generally the case) *become the cause of corruption in the Post Communist transformation of the economy*.

If the macroeconomic stability of the country has not been achieved, which can be revealed in high rate of inflation and devaluation of the national currency and /or in considerable failure to collect the tax revenues, then this first of all*, creates a possibility of "rapid" earning of dirty money.*

In this case, the management of the State banking system and persons close to them, having access to the State credits, are given "legally unlimited" opportunity to become rich through rapid currency or commodity transactions, with the help and by means of devaluation of national currency and increases in prices. Unfortunately, Georgia has a bitter experience in this respect, when in 1992-1994 the main form of corruption was "rapid" earning of dirty money.

Failure to collect revenues to finance the State budget is nothing else than directing them to the pockets of the tax collectors and their protectors and on the other hand incomplete budget creates the productive grounds for the authorities of the State Treasury, to give priority to those persons, who give a larger bribe, while financing the budgetary expenses, approved by the Law and in settlement with the budget. Low tax revenues are not able to ensure the relevant level of payment of the employees of the budgetary sector, and this is an objective reason for initiating corruption in respect of high officials.

Therefore, *Post Communist macroeconomic instability is quite a strong nourishing source for the corruption.*

As far as control of inflation, the achievement and maintenance of exchange rate stability is possible within a quite short period of time, this makes it possible not only to restrict, *but also to practically eradicate corruption* in this field. The International Monetary Fund (IMF) has a great experience of this and all those Post Communist countries, which have intensively cooperated with it, achieved the positive results in a short period of time.

Georgia is one of the best examples of this. In 1994 co-operation with IMF within the scope of the anti-crisis programme, drafted and carried out under the leadership of the Head of State Mr. Eduard Shevardnadze, resulted in the successfully implemented monetary reform of 1995.

It is far more difficult to establish perfect order in fiscal system. As proved by the international experience, there is practically no country in the world, *where concealment of revenues does not take place with the aim of evading the payment of taxes.* Such a phenomenon is known as *"shadow economy"*. Tax evasion is the main element of illegal activities in any country with a developed market economy. In order to restrict corruption in this field it is necessary to aim at: *continuous improvement to the administration of taxation and customs systems; the development of taxation and customs legislation relevant to this process; and practically continuous education of the public in taxation and customs matters.*

Georgia had the most serious problem in this field, because *the reform aiming at the improvement of the administration of the taxation and customs systems had started very late.* The Georgian government was partly responsible for this, but the IMF and the World Bank, despite the greatest international experience failed to outline this task as priority of the reform of fiscal system at a sufficiently early stage. As a result of their recommendations, a specialized foreign company was invited to carry out *pre-shipment inspection* with the view of improving customs administration, on the grounds of the international tender, which was organized with the help and under the supervision of the World Bank. Unfortunately this did not have the expected positive outcome, because there was no timely and corresponding reform in the Customs Department. The Customs Department was made to play an obviously passive part in this reform, and *instead of reducing, the smuggling and corruption have increased for certain commodity flows.*

Even more important is the *role of the IMF in respect to the Tax Code,* which in itself is not a bad one, *but it did not reflect and consequently was not appropriate for the existing level of administration in taxation and customs systems at the start of the reform.* The most evident example of such assessment is the strictest regime recommended to Georgia by the IMF for the taxation of cigarettes and tobacco products, which transferred a great part of the corresponding business to the "shadow economy" and increased the scale of corruption in this field. Another impressive example is the taxation of those agricultural products, with value added tax, the annual circulation of which is more than USD 15,000, which was also introduced under the IMF requirements and which impedes the establishment of large scale enterprises in rural areas. These kinds of mistakes made by the Fund became even graver through continuous, irregular amendment of the Tax Code by the Georgian Government, which finally made the taxation legislation of the country non-effective. Taking into consideration all of the above there should be no wonder why it has proved so difficult to overcome the *budgetary crisis* in Georgia for the last 3 years. Hence, there should not be any doubt about the *need for a new, regulated Tax Code.* Without this the restriction of the corruption in the field of taxation will be practically impossible.

With the view of establishing order in the fiscal system, apart from improvement of taxation and customs institutions, it is no less important to adopt a *realistic State budget, to improve the Treasury and introduce the institution of public procurement,* where despite the positive role of the IMF and the World Bank, *Georgia is,* unfortunately, *still not behaving itself*.

As proved by the international experience, the reformation of fiscal system requires much more than one year. A longer period is needed for the second constitutive sub-process of Post Communist transformation of the economy – the establishment of the institutions appropriate to the market economy. At the same time, *the lack or imperfection and weakness of the part of such institutions create possibilities for corruption.* It should also be stressed that *the creation of some institutions in a hasty way,* for which, as a general rule, the direct copy of Western analogues is used, does not prove right in most cases, *not to mention the obvious adverse effects revealed in some cases.* One of the relatively "harmless" examples of the above in Georgia is the *law on bankruptcy*, which is practically a copy of the German legislative model, drafted with the help of German experts and then adopted by the Georgian Government a couple of years ago. *D*espite the general approval of foreign experts the law was *stillborn* from the very beginning, inasmuch as according to this law none of the *de facto* bankrupt enterprises was *de jure* bankrupt. After the improvement of this Law *its possible enactment was halted for an undetermined period of time by the Law on Tax Arrears Restructuring*, the draft of which was prepared with the help of the World Bank experts and which expresses the nationally detrimental interests of the most anti-reformatory wing of the industrial lobby of Georgia. It tries to demonise bankruptcy. Yet, it should be stressed, that prolongation of the operation of a bankrupt undertaking is equivalent to maintenance of bad management without any changes (something which destroys the development prospects of an undertaking). *The Tax arrears restructuring procedure is of a corruptive nature for enterprises,* because the preparation of the draft of the approval on restructuring, consideration of deadlines and other conditions in this draft is dependent upon a public official. Furthermore, the above mentioned lobby has been trying for years to introduce a mechanism for writing off the tax arrears, what will obviously be a step "forward" towards corruption in this field. An already difficult situation is made even more complicated by *transferring the right of management of the state share in enterprises to sector ministries. This is not just a return to the communist system of economic management, but also intensifies the existence of corruption in this field,* under the condition of the current mechanism of national debt restructuring.

There is only one way out of this situation: *the sector ministries should be deprived of the right of management of the state share in enterprises and it should be delegated to the Ministry of State Property Management, prior to urgent privatisation. The Ministry itself should be reformed; procedures provided by the Law on Bankruptcy should be simplified and after this, the Law on Tax Arrears Restructuring should be repealed* (*in an exceptional case the Law could be maintained only with the purpose of attracting foreign investments during the privatisation of the relevant enterprise and long-term transfer of the right of its management*).

An evident example of obvious adverse effects of rapid copying of Western analogues for the purpose of establishing the institutions appropriate to the market economy in Georgia is the Tax Code, which was already discussed above.

In order to restrict corruption caused by the institutional vacuum, that is characteristic of the Post Communist economic transformation*, it is inevitable to choose that main institution*, without which the establishment of a market economy will be impossible: the *institution of private property.*

The difficult process of establishing the institution of private property in a Post Communist transformation is the main cause of corruption and thus differentiates itself from the reasons for corruption in Western Countries.

The creation of a liberal legal environment, necessary for the development of the entrepreneurship, is the basis for the reinforcement of the institution of private property. It is also necessary to place all of the entrepreneurs, both local and foreign ones, in equal conditions, in order for *fair competition* to be the only way of revealing the winner.

Primary accumulation of capital is taking place in the countries of the Post Communist transformation. This process took place a long time ago in well-developed Western countries; without it transition to a market economy is impossible.

History does not show any example of carrying out the process of primary accumulation of capital with *"clean hands" and only legally*; usually, this process was based on the phenomenon, which today is considered as corruption.

There is no (or almost no) objective economic basis for the corruption in the developed countries, because, first of all, high officials are provided with rather high wages and what is most important, they, as a general rule, already have capital accumulated by their ancestors, which other things being equal, is a guarantee for their respectable existence and secondly - practically perfect institutions are already established in these countries, which ensure the protection of ordinary citizens. Despite this, it is still "popular" to expose the governments or separate ministers of the whole EU or of any of its Member States, of USA or Japan in corruption. In these countries they usually use *administrative methods* for the restriction of the corruption, which is fully justified.

In the process of primary accumulation of capital, the use of mainly administrative methods with the purpose of restriction of the corruption will inevitably fail. The introduction of a rule that every official should prove that his property has been legally acquired (a breach of the principle of the "presumption of innocence"), and that in the absence of documentation of the origin of the property, its owner should be fined, or the property should be seized, etc. *will finally result in returning of the process of primary accumulation of capital to its point of origin.* Launching this process all over again will prolong *the " life" of corruption*. Besides, as a result of imposing the mentioned punitive measures *a renewed process of primary accumulation of capital* will be carried out in an even more disguised manner and accordingly *will develop as a more hideous event.* Today the main way of transformation of newly accumulated capital into property terms in Georgia is house-building, or creating other immovable property, from which many people are employed and get remuneration for their work, construction materials are bought, and gives employment to the workers of their enterprises etc. If punitive measures are introduced, first of all *the rate of bribery will be increased* because of the increased possibility of disclosure (or risk-factor), and secondly - *illegally gained money will not be transferred into property terms in Georgia, but it will flow out abroad.* In other words corruption will not be restricted, but its "main actors" will change and the *society will be deprived of the indirect effect of primary accumulation of capital.*

In order to restrict corruption and establish the institution of private property, it is *necessary to legalize the existing results of primary accumulation of capital,* which will let it "act" in the public interest.

Such an approach does not exclude *the punishment of all the lawbreakers according to the law, provided the constitutionally recognized, very important principle of "presumption of innocence " is not violated.*

Measures for restricting corruption *should be carried out in law enforcement agencies with particular care, and to this end institutional reforms should be carried out together with the financial stimulation of the officers*. Otherwise, the agencies intended for the defence of order, may become the initiators of an extension of corruption or in a worse case even *institutions of political settlement* (the epoch of Stalin, when because of the well known events of 1937 many persons, who had different thinking, the whole army of innocent people were subjected to repression, was a bitter experience for us).

From this point of view, special care is needed in regard to the establishment of any *anti-corruptive institution, or institution having special rights* (namely the right of criminal prosecution and investigation) *for combating corruption*. *In conditions of weakness in the institutional arrangement of the State, such an institution will become a shelter of corruption itself.* Unfortunately there are many examples of this in the world practice. *Only the creation of an institution with coordinating functions is acceptable*, which at the same time will monitor the measures to be carried out for the purpose of the restriction of the corruption.

With a view to the restriction of corruption, it is very important to comply with the *principle of publicity*, which should ensure the provision of the society with maximum information regarding the current processes, in order to increase the efficiency of the measures to be carried out. To this end, it is *appropriate to publish information on the expenditure of budget funds by the State agencies on a monthly basis,* which will be an effective possibility of public monitoring of these funds.

Corruption is a contagious disease, the whole society is more or less sick from it– the appropriator of collected taxes, the thief of the Treasury, or the ordinary citizen who does not pay for electricity consumed. Unfortunately, even *media could not avoid this disease*, when financially powerful clans (some of them of political nature) can bribe them and dictate the kind of information to be publicly spread. This first of all is caused by existence of unorganised state institutions and by grave economic conditions in the country, when the press and the television have the difficulties to survive independently. But despite this, *only the press and the television are efficient instruments, which could be used for restricting corruption, through the State promotion of competition between them.*

And finally, as corruption is a secondary phenomenon, *the overcoming of poverty by means of economic growth should be the main objective of the country. This itself will be the precondition for the restriction of the economic basis of corruption.*

APPENDIX II:
STATE BUDGET OF GEORGIA

By Demur Giorkhelidze, Chairman of Budgetary Supervision Parliamentary Sub-Committee

Challenges. Strategic Outlines

The main deficiencies and problems, which have been especially outlined on the basis of an analysis of the 1995-2000 budgets, in the author's opinion, are not being paid enough attention. This article focuses on the fundamental financial problems and their background factors. It presents options for solutions to these problems and the data obtained from a State Department of Statistics of Georgia and other official sources, together with the author's remarks.

1. General Survey

In recent years, a new tendency has developed in our country – necessity of unprecedented reduction of Georgian State Budget and the budgets of its territorial units (see Table 1). As can be seen, budget expenditures have been growing in GEL terms, but the parameters of the state budget expenditure have never been executed. The dynamics of state expenditure in USD better reveals the processes taking place in budget sphere. According to the table, since 1997 expenditures have been falling. This tendency was sure to have negative results. (If nothing changes, it will cause even worse results in the future).

The reduction of necessary expenditures results in the reduction of domestic demand (consumption), as the actual income of the population reduces as well. We are facing this situation now. GDP per capita is very low – GEL 1,340 (Table 3), which aggravates a tendency of partial financing in the whole country and its territorial units, thus resulting in financial crisis. On top of that, it undermines the possibility of building and implementing a strategy of long-term economic development, as well as stimulating directions of primary importance. Actual investment reserves in the economy of the country and its territorial units are at a zero level.

It is well known that reduction and degradation of home market is a way to permanent poverty.

All this results in the impossibility of high-level reforms. Due to the absence of financial resources in the territorial units of the country, less work is done to create private banking and financial-investment structures, to reveal informational and human reserves and use them in the economic life of the country. All this makes it impossible to stimulate production and support the social sphere etc. In such a situation the vector of executive power should be directed towards forming a new market. Authorities, especially local authorities, having proper conditions and power, should strive to expand the local market and promote the increase in the solvency of market operators. This can be achieved only by stimulating the real sector of economy, through accumulation and greater reproduction of capital.

Table 1: Execution of the Georgian State Budget Expenditure

	1996	1997	1998	1999
1. State budget expenditure				
GEL million	771.3	776.8	798.9	904.8
USD million	593.3	597.5	570.7	452.4
2. Execution of the State Budget Expenditure (per cent)	-	88.2	85.7	73.4
3. Rate of expenditure growth compared to previous year (per cent)				
GEL	-	100.7	102.9	113.3
USD	-	100.7	95.5	79.3

It is evident that achievement of this will not be possible without an appropriate economic policy and an appropriate environment – businesslike atmosphere and real professionals creating and maintaining this atmosphere. Today, mostly, anticipated foreign funds (to finance the budget deficit) are allocated for economic investments. In such circumstances attracting foreign capital is the best decision, but out of foreign funds only credits of the World Bank and the International Monetary Fund are allocated for this purpose. We have never managed to receive these credits fully, as their reception is connected with fulfillment of strict requirements of these organizations, and Georgia has never been able to do it. Up to now very little has been done to improve the climate for investments.

Fighting against inflation has not only diminished foreign currency reserves of National Bank of Georgia, but it has also excluded our main strategic economic aim – development of the Georgian economy. As to the most important thing for Georgia – " the Development Budget" – this has not been introduced in the 1996-2001 state budget, while state budget funds accumulated in the "Budget of Development" could have been allocated for crediting short-term projects and guarantees.

The main problem is that it has not been calculated what the minimum necessary finances are vitally important expenditures to ensure defence, social, industrial, energy and humanitarian security of the state. Thus it is unknown, what should remain on the market and what part of it can be centralized for pursuing active industrial and structural policy. This is caused by an existing chaos in the budget process. Hence it may be expedient to establish an administrative budgetary department within the structure of executive power, which would define and work out budgetary strategies.

In the 2001 budget, as well as in those of 1998-2000, the following fundamental financial problem remains unsolved:

State expenditures do not correspond to the actual sources. The financial system, which is a heavy burden for the population, remains a barrier to the development of the state and effective use of actual resources. Without solving this problem (like many others) it will be impossible to influence the dynamics of economic development.

Hence:

- *State budget has not become an instrument for pursuing active economic policy.*

Other most important problems are:

- Ineffective tax system,
- Ineffectiveness of budget expenditures,
- Ineffective system of directing state finances.

It should be noted, that the main reason hindering development of the country and making effective use of actual resources impossible can be divided into three big groups:

- Bad businessclimate and bad conditions for entrepreneurship;
- Unformed financial system;
- Ineffective structure of Georgian economy and absence of good strategies for its modernization.

2. Taxation and Budget Policy

In fact, we have a substitute for a discretionary fiscal policy. Changes in the tax system (by changing tax rate) and changing the expenditures (by changing programmes of budget expenditures) should have been aimed at economic growth, achieving a high rate of employment and a fixed exchange rate. In the existing situation an effective discretionary policy could have brought about positive results, the more so as today we cannot pursue automatic fiscal policy based on already developed and inserted stabilizers guaranteeing natural adaptation of economy to the changes of business conditions.

Most well known automatic stabilizers are progressive systems of taxation and social assistance. In a period of expansion, taxes are collected at a higher rate resulting in slower growth of profits of economic agents in comparison with growth of the state revenues. This usually slows growth of consumer demand and decreases state expenditure for social assistance due to increasing incomes. All this results in a slow down of the increase in aggregate demand. In a period of contraction – on the contrary – aggregate demand is stimulated.

Notably, the Georgian economy has not worked out such automatic stabilization mechanisms which would resist strong destabilising external impulses nor have the phases of business cycles so far been set up, which must be proceeding from the current situation of the Georgian economy and thus, one can only speak of the changes in business opportunities *de bene esse*.

Consequently, due to the serious structural crisis and other problems, at this stage perhaps an appropriate discretionary policy (naturally, together with other instruments) could have produced a positive impact on the Georgian economy.

In fact, in 1999 in 2000, the fiscal policy pursued by the executive authority through formation of the structure and amount of public expenditure, setting-off transfers and by means of tax system, has not had a positive effect on the stabilization of the economy. All measures were put under consideration as one or another problem occurred and have been applied to cope just with the immediate challenges, while fiscal policy should be regarded not only as proceeding from the financial targets of the current activity of the State but as important instruments for steady economic growth.

It is well known that generally economic stabilization is achieved through macro-economic policy - by means of a reasonable fiscal and monetary policy and a thoroughly regulated financial system. That is why the macro-economic policy is to be well co-ordinated on the whole. In regard to Georgia one can speak of the macro-economic policy co-ordination only conditionally, as the entire policy is being "co-ordinated" exclusively during irregular visits by IMF experts and only according to 3 or 4 parameters, without any detailed analysis of the real situation of the economy.

Since the beginning of the budgetary crisis in 1995, the main economic functions of the budget have neither been fulfilled by the State budget nor even made a subject for consideration; in particular, the role of the budget as:

Means of distribution of the national product between private and public consumption and investments;

Means to affect supply of the factors of production (such as labor and capital) and production output by various sectors of economy through direct costs and indirect tax incentives; and the Government's fiscal policy instrument aimed at attaining macro-economic targets.

In implementing financial policy, this last aspect of the fiscal policy is being completely ignored. Moreover, no study or analysis is made either in regard to this strategic function or even of such main issues of fiscal policy as:

- *Extent of the Government's impact on the economy*. In particular: what part of the national income shall be re-distributed through the State Budget. For instance, in countries with a market economy this share is 37-40 per cent while in Georgia it is about 17 per cent.
- *Extent of centralisation of the financial flows and optimum budgetary commitments by economic entities*.

It is apparent that centralisation of financial flows and budgetary commitments by economic entities are interrelated issues. Naturally, with the growth of the Government's role a particular importance is ascribed to the formation of public demand as an element of collective demand. But recently, Georgian State budgets have been planned with no regard to these most important issues, unless it concerned allocation of particular amounts for particular organisations – an unacceptable practice, in general. This situation, unfortunately, indicates ignorance or inability to keep account, which is becoming a chronic problem of the Georgian economy. For years, awareness of the real situation on the whole has been suppressed in favour of political considerations. The Georgian mentality can be characterised as a melodramatic approach to entirely rational issues, including the Budget. The country, due to its financial situation, is unable to afford the expenditure subisidies from the State budget to various organizations.

In Georgia, budgets have been planned without taking into regard such characteristic issues as the main burden and strategic targets, which accounts for the failure to provide a positive background for economic stability. Hence, this burden is laid upon the monetary policy, which has successfully fulfilled the objective of a short-term economic stabilization - the objective performed through monetary instruments alone. Though afterwards, in the medium and long-term, it appears impossible to resolve this task just by means of the monetary policy instruments. The Georgian government has for years ignored such important fiscal policy targets as the achievement of a fast economic growth with employment and steady prices through fiscal policy consistent with monetary policy.

It should be outlined that after control of inflation, a budget deficit seriously impeding growth remains the key issue of the Georgian economy. An upward trend of the budget deficit is likely to produce extremely negative effects.

3. Role of the fictitious economy in the economy of Georgia

It would be natural to inquire what could account for the cutting back of the income part of budget (and often for its further sequestration during the year as, for instance, in December 1999 and July 2000). Apparently, this means that the growth of tax incomes is possible only through various write off schemes. Yet, despite objections expressed against the practice of writing off debts, the sums recorded in the budget receipts and outlays, as "set-off payments" during 1997-1998 were still quite impressive. In 1997, GEL 94.5 million was recorded as incomes and expenses of the Central budget through 359 set-off payments and in 1998 - GEL 83,5 million through 721 set-off payments which, respectively, made up 16,6 per cent and 14,5 per cent of the total income for these years. This practice continued to be exercised through 1999 as well. The total amount reflected in the incomes and expenses as set-off operations made up GEL 86,2 million, i.e., 13.8 per cent of the total receipts. In the first half of 1999, before the practice of set-off payments had been officially cancelled, these kinds of payments amounted to GEL 50.0 million, mainly in non-pre-emptive categories.

But substitution of cash money with set-off payments schemes is in fact an economic crime, even more so as it is a privilege of a certain group of people who have access to such set-off schemes. Thus, performance of these schemes depends on the social status of a person, his position on the hierarchic ladder. Proceeding from this, set-off payment means payment of money where the value is directly related to the owner's social status. Thus, these schemes become the bearers of a social function and are “successfully” implementing the economic theory of a 14th century German scholar - Heinrich Lagenfeld, who considers that the value of goods (services) should be determined by the the social status of a buyer (it seems that this quality of money bears an unpleasant meaning for those who support set-off schemes). This mode of payment does not only distort the country's financial system but also deprives money of its main value - the value of money does not depend on social status. Along with all the other negative effects, the mode of payments by set-off is potentially a good source for corruption. Unfortunately, this approach was maintained throughout 1999 and partially even in 2000.

Quasi-monetary (money surrogates, false money and non-monetary) turnover or the system of non-payments has turned into one of the most profitable business activities, which is harmful both to the society and State. The system of set-off payments at all budget levels became a “reliable” instrument for economic management. But non-monetary payment is the basis for a non-market. No matter what declarations are made it is obvious that in practice this system is based on feudal ideals, that is on the ideals of the society where money is turned into social status instead of goods. To a certain extent, this becomes one of the impeding factors hampering the development of the country though we regard it as just “set-off payments” and non-payments. We pay attention to the destruction of the State only in case of some extraordinary escapades, while in reality these marginal escapades do not even represent any important part of the collapse.

- The entire system of set-off payments, non-payments, overdue budget arrears, their restructuring, various assignments and speculative transactions, bribery and all other fraud commitments relating to money receipts and payments – is the essence of the illegal ("shadow') economy (together with the informal and criminal economies).

4. Imbalance of the Public Liabilities

Georgia is entering the second millennium with a huge burden of external liabilities. The necessity of servicing the accumulated debt has already predetermined the present and future economic growth of the country.

The data of the Ministry of Finance of Georgia on external debt payment and servicing for 2000- 2001 is given in Table 2.

In 1999, external debt servicing - which reached a critical margin - 73 per cent of the national GDP - constituted the biggest problem of the expenditure part in the State Budget whereas, the issue of making internal debts subject to a full record or providing legal guarantees has not yet been regulated .

This provides for the inefficiency of activities related to the formation of the budget (Ministry of Finance, State Chancellery).

In 1999 the total public debt servicing made up GEL 267.5 million, that is 35.1 per cent of the Central Budget. Moreover, the impossibility of observing the repayment schedule puts on the agenda the problem of debt restructuring.

According to the Law of Georgia on the State Budget for 2000, the amount of the public debt of the Georgian Government will be GEL 5,163 million by the end of 2000. Of this external debt accounts for GEL 3,860 million, that is 85.4 per cent of GDP in 2000 (according to the forecast GEL 6,040 million). 48 per cent of the planned expenditure of the 2000 Budget shall be used only for external debt servicing.

Table 2: Schedule of external debt repayment and debt servicing, 2001-2012

Year	Repayment of principal (USD thousand)	Repayment of interest (USD thousand)	Year	Repayment of principal (USD thousand)	Repayment of interest (USD thousand)
2001	133,391.76	32,799.02	**2007**	80,630.48	15,906.26
2002	165,242.00	29,764.56	**2008**	50,270.37	13,707.48
2003	100,350.41	26,200.02	**2009**	65,266.80	12,056.45
2004	108,872.79	23,495.02	**2010**	57,873.79	10,121.55
2005	109,806.02	20,046.03	**2011**	48,819.69	8,241.21
2006	94,046.82	17,855.37	**2012**	46,147.49	6,899.81

In total, the principal of USD 1,060,717.42 and the interest of USD 217,092.78 is to be covered during the period of 2001-2012.

According to State Department for Statistics data, by the end of November 2000 the public debt was GEL 4,114.9 million with external debt accounting for GEL 2,862.2 million (i.e., 65.2 per cent of the total). GDP is about GEL 6.2 billion and grew by 1.9 per cent, which is extremely low for an economy in such state.

The slackening in the GDP growth rate could already be observed in 1999. Given the underemployment, however, this is not unexpected, as the budgetary deficit produces complex and alarming outcomes, including slowdown of the economic growth rate in the long run and reduction in savings and investments, the classical form of which we are now facing. In 1999 the GDP growth rate was 3 per cent. During six months in 2000 GDP grew by 2.8 per cent against the relevant period in 1999..

According to the forecast, by the end of the year, this indicator will be even less than the expected range of 5-6 per cent. Actually, the growth rate as mentioned above has been forecast at 1.9 per cent. If this growth rate is preserved, approximation of the level of development of the state with that of the developed countries in the medium and long run seems quite doubtful. This requires at least 6-7 per cent of annual growth of the national GDP.

Table 3: Total volume and dynamics of GDP*, 1999-2000

	1996	1997	1998	1999	2000
GDP					
GEL million	3,870.6	4,667.6	5,063.0	5,709.9	6,186.9
USD million	3,063.7	3,595.8	3,638.3	2,856.1	3,132.8
GDP deflator	-	109	105.4	109.5	106.3
GDP (in real prices) compared to previous year (per cent)	-	110.7	102.9	103.0	101.9
GDP per capita					
GEL million	839.0	1,015.8	1,099.6	1,238.7	1,340.5
USD million	664.1	782.5	790.2	619.6	678.8
Exchange rate (USD/GEL)	1.2625	1.2976	1.3923	2.0155	1.9754

** Recently revised data by the SDS*

Thus, in 2001 the GDP growthis unlikely to reach the predicted rate of 4 per cent. Due to the form in which 2001 Budget of Georgia has been adopted it is expected to produce a negative effect on the GDP growth rate - the growth rate of the GDP is likely to remain the same as in 2000.

Unless this trend is overcome, together with the other problems, it is likely to have a serious impact on the paying capacity of the country, as well. Negotiations on restructuring foreign debts may only temporarily relieve the acuteness of the existing problems but not exempt Georgia from the repayment of debts. Restructuring means either an extension of the term of repayment of existing debts with new ones for several years or a certain revision of the terms of settlement and nothing else! Provided certain benefits are achieved through negotiations on restructuring it is possible that the negative effects of the foreseeable concessions shall exceed the positive ones.

Unfortunately, at present, the Government does not have any definite strategy in regard to the arrears - in this situation, debt management requires special attention (the author intends to publish a detailed study in the nearest future). Debt management requires other strategy than focusing on the primitive form of restructuring. Even in an ideal case - if the external debts are written off - the problems shall persist. Due to the payment of internal debts and, proceeding from the current situation, the necessity of making pressing payments, new external debts are inevitable!

- The State should completely cease incurring external debts, as this kind of indebtedness has acquired the features of narcotic intoxication, which is largely hampering the development of the country.

Accrual of State debts would not present a danger if there were a sustainable financial system and a strong confidence in state institutions, when the coverage of indebtedness is ensured by its steady and accurate servicing and the State – by virtue of high confidence both inside and outside the country – has no problems concerning its relations with creditors. In this respect we do have serious problems!

In 1999 and in 2000-2005, a significant amount required for external debt service indicates that Georgia even in 1998 had to make serious changes in the financial and budgetary policy, which it has not done. This despite the fact that in December 1999, at the session of a financial and budgetary Committee of the Georgian parliament, a new financial and budgetary policy had been outlined in principle. Although it was agreed by the majority of the leaders of economic block of the executive authority it has not been supported at the end.

The new strategy was based on the concept that, proceeding from the existing situation, in 2000-2005, trade and current account inflows had to be made the focus of the country's economic policy. This is essential! It means that in the nearest future the volume of Georgian production (goods, services) and sales on both internal and external markets is to exceed that of consumption and imports. Financial, monetary and exchange policy should have been made subject to this end (and so it will be sooner or later).

It should also be mentioned that the situation with the balance of payments is extremely complicated due to the imbalance on the current account operations, low official reserves, overdue repayment of external debts and in the short run, a sharp and spasmodic growth of external debt service. In 1999, the current account deficit (excluding transfers) was 15 per cent of GDP and there was no improvement expected in 2000.

Only the growth of budget incomes can provide for and facilitate the improvement of the external debt management and lessen the high current account deficit. For this to be achieved:

- a compulsory policy should have been pursued in the sphere of finances to restrict the growth of total budget deficit and budgetary arrears and slow the growth rate of external debt;.
- budget incomes should grow faster than budget expenditure to achieve a primary budget surplus; and
- the total State budget deficit should be reduced

If this is not achieved, the authorities will have to increase internal and external arrears for funding debt servicing and hence lead to total budget deficit growth. In the initial draft budget for 2001, the budget deficit is increased to 5.47 per cent of GDP against 3.6 per cent in 2000, which was absolutely inadmissible! Finally, the share was fixed at 4 per cent by the Law on 2001 State Budget of Georgia, which is rather high and it will be hard to finance it during the year. Another evidence in support of this is that in January 2001 the State budget of Georgia appeared short of almost GEL 10.0 million and it is doubtful that it could to be covered in the next 1-2 months.

A self-supporting budget is not an end in itself. The case is that because of the huge debts and serious problems existing in the economy, a self-supporting budget must become the country's financial basis, both in the short and long run.

Given the current situation, maintenance of the budget deficit at this level (4 per cent of GDP) was absolutely inadmissible! Today, there is a real threat of a crisis in repayment of debts that may possibly lead to a loss of macro-economic stability. If this practice continues it will be necessary to establish regulation in regard to the budget which will requirea legislative norm. In addition the structure of the budget deficit is unsustainable. It is fully focused on external debts and mainly on such internal sources as proceedings from the state property privatisation and what is worse NBG credits and the sale of T-Bills. Other internal sources of lending are not used at all due to the unsustainable financial system. These are, for instance, the program providing for covering a part of the public expenditure (defense, military forces, etc.) on the basis of bills and guarantees issued by the Ministry of Finance.

Because of the low credibility of the State these programs are limited. However, not all aspects of financial activity are being regulated at the legislative level, this also includes commercial banks' participation (at this stage banks can only participate within their own liabilities which, due to the scarcity of resources, is limited). Under the legislative regulation, a such programme is unable to provide for a significant increase of the money supply and weakens state control in the financial and budgetary sphere.

In a crisis situation budgetary arrears could be used as one of the temporary sources of internal funding if such are available. For a definite period of time it is possible not to spend the loans received from abroad fully and thus increase currency reserves. Later, quite a substantial part of these could be used to relieve the budgetary crisis. If were possible to increase the balance of the foreign currency account these resources could produce a stabilizing effect on the entire budgetary system for quite a long while. The mere availability of these resources on the bank accounts should have a positive impact on the banking system itself and on the entire macro-economic situation and through this – on the budgetary process, as well.

Instead of producing a primary budget surplus of about 2-3 per cent of GDP and respectively, cutting the total deficit, - the 2001 State budget deficit is higher than in 2000 but no appropriate measures, including those aimed at relieving the tax burden on the economy, have been offered so far. Moreover, while the situation with domestic incomes is critical and the largest part of these are not covered by the Law on annual budget, avoiding both assignments and the corresponding Law on procurements.

A deterioration of the trade balance and also the growth of imports could be anticipated already at the end of 2000 (according to SDS data, in 2000 imports were USD 700.2 million, that is, 116.3 per cent of the volume of imports in 1999). Due to the rise in prices of oil and various other factors the price index could be observed to grow and since the end of the year the exchange rate of the Lari began to deteriorate. It has not yet become painful, though. On the contrary, by October 2000 the NBG had bought USD 56 million at auction, which means that an additional GEL 112 million was released into circulation. At first sight, this is beyond any logic. This could be possible only in one case – through expansion of the shadow economy!

Not only has budgetary crisis that started back in 1997 failed to be overcome in 1999, but has also acquired a more acute form. Although centralized lending from the State budget (through NBG credits) was stopped now several years ago this practice has been resumed. One week before the beginning of 2000, due to the amendments to the Law on 1999 State Budget of Georgia (adopted in 1999 in order to reflect the low external funding) the NBG had to allocate a bigger credit to the government than it had been provided for by the end of the year. In 1999 the sum assigned by the NBG to the Government as a loan totaled GEL 146.7 million, while GEL 49.2 million had been paid during the year. Thus, in 1999 alone the growth of the government's net indebtedness to the NBG was GEL 97.5 million, while the external sources of financing went down to GEL 189 million and pension and salaries arrears have increased.

By the end of 1999, the government's net indebtedness to the NBG amounted to GEL 638.9 million. Although the budget, as a rule, should be financed not through borrowing from the NBG crediting and various set-off schemes but through tax collection. This is a common practice all over the world! Budget settlement through currency reserves means a devaluation (and that is what has happened). An organic process following-up devaluation is inflation. Nobody could benefit from the depreciation of the Lari, but commercial banks. In fact, evading bankruptcy on the part of commercial banks turned out to be the only justification for the devaluation of the Lari. This is quite a dubious benefit!

Winding down the financing of the budget deficit was a result of a quite tough economic policy pursued by the Government since 1995 in order to achieve a substantial reduction of the money supply so as to ensure a due restriction of the budget deficit. Proceeding from this, inflation had been successfully controlled through delaying budget payments, which led to a significant growth of pension, salaries, and other arrears. However, this gives only a short-term effect and on a whole is just an illusion.

This is one of the main reasons for the accrual of budget indebtedness.

Other reasons causing budget arrears are:

- In 1999 the budget had to bear the heavy burden of unexpected expenses (due to the payment of both previous and unexpected current budget expenses) which were ascribed to the budget expenditure by the Law of 24 December 1999.
- The accuracy of the revenue estimates proved insufficiently reliable
- Spending of the resources assigned for funding secured expenditure items for the payment of accrued arrears (for communal services, electric power consumption and etc.) that is to cover the expenses the absence of which also makes impossible the normal functioning of the organizations and institutions of the budgetary sphere. This shall result in the failure to ensure funding of the so-called “secured items” of the budget (salaries, pensions, etc.).

The amount defined by the Law on State Budget for financing secured items was GEL 475 million in 1998 and GEL 704 in 1999. Notwithstanding that actual expenses for those years by far exceeded that on secured items (in 1998 – GEL 798.9 million and in 1999 – GEL 904.8 million), the arrears accrued with regard to these items made up almost GEL 250 million. The definition of the secured items has turned into a fiction and is hampering budgetary process. Instead of the secured items, it would be much better to establish top, high and low priority expenses specified by the Law on State Budget on a year-on-year basis.

In 1998, pension arrears accounted for the biggest share in the structure of indebtedness on secured items (GEL 126.6 million) - 41.9 per cent, salaries – for 18.9 per cent and food expenses – for 13.2 per cent. In 1999, the indebtedness on secured items was GEL 119.7 million, of which the largest share was due to salaries – 24.3 per cent, pensions accounted for 20.6 per cent and food expenses – for 13.2 per cent.

As mentioned in the report of the budgetary office of the Georgian Parliament (“on the execution of 1999 State Budget”) there is an indebtedness in regard to the other types of budget expenses. A large amount of expenses has been carried out in advance by the budgetary organizations which means a further growth of the total amount of budget arrears. The arrears incurred during these two years exceed by half the volume of the central budget income per year. This has completely distorted the budgetary process and the biggest part of the next year assignments are being used to cover arrears for the previous year ”.

Considering that anecdotal evidence suggests the 2000 budget deficit was GEL 150.16 million, it is easy to imagine how much more difficult the situation is to be expected by 2001.

As of July 1, 2000 the budgetary arrears only in regard to secured items was GEL 246.3 million. A complete information on all budget liabilities is unavailable due to the irregularity of accounting (it is necessary to keep a full and accurate record of these liabilities and current indebtedness).

- Numerous facts pointing to the misuse of budget resources could be accounted for by an insufficient control both in the center and regions and also by the absence of a legislative and regulative framework (first of all, of the Law on Exchequer) that would enable a firm and proper regulation of the whole process of budget execution.

Therefore, today this main issue remains an urgent and unsettled problem as in 1999:

How to overcome the budgetary crisis and how to minimize the costs incurred during this difficult process? The monetary and exchange policy pursued by the NBG (while the budgetary crisis has not coped with) has actually lost its regulatory function and is entirely dependent on the terms of settlement of the budgetary problems.

This problem is becoming even more painful because no changes have been made in the financial policy up to now, the same as in 1999. (In the classical context, a financial policy as such does not actually even exist).

A chronic budget deficit shall lead us, and it should have already done so, to basic changes in the financial and budgetary policy!

It is impossible to carry out any essential changes in the financial policy without deciding fundamental problems of the Georgian economy, which is a separate topic for discussion. Proceeding from this, it is necessary to elaborate a long-term policy and to work more actively with foreign creditors. However, here, these issues shall be covered only partially.

5. Anticipated changes in the tax system

5.1. State budget revenues.

Notwithstanding numerous recently adopted laws, which in the opinion of their authors should have facilitated the growth of the income of the State budget as referred in the Government's 1999 budget report, this has not been achieved since 1995State budget execution ha only been observed to deteriorate. State budget incomes were 92 per cent (GEL 518.1 million), in 1997 - 87.2 per cent (GEL 593.2 million) and in 1998 - 82.7 per cent (GEL 621.9 million) of their respective targets. In 1999, the amount of the planned incomes and grants of the State budget was at GEL 922.5 million.

In fact, the budget received only 70.5 per cent (GEL 650.2 million) of envisaged revenues – GEL 272.3 million less than anticipated. Budgets of all levels mobilized 78 per cent of revenue expectations. According to the Ministry of Finance, in 2000 central budget revenues (including grants) made up GEL 483.514 million instead of GEL 521.916 million. Devaluation of GEL resulted in reduction of actual revenues.

It is not strangethat changes were made in the tax and custom codes as well as in legislative acts, without any substantiation, which resulted in existing financial situation. These changes substantially reduced the tax base, which partially hindered revenue mobilization. By January 2000 overdue budget debts amounted to nearly GEL 400 million. By November 2000 it had increased to GEL 549 million. The amount of overdue and deferred debts has not reduced, and debt arrears increase annually. Arrears growth substantially reduced tax collection, but the executive power has not been able to respond.

The low financing of budget expenditures was partly caused by non-activation of debt repayment and an insignificant reduction of GEL balance on budget account. Until recently, we did not analyze revenues from oil import and sale, wine and spirits production, production and realization of mineral and soft drinks, tea, etc. Without such analysis the effectiveness of measures and the situation in the field cannot become clear. For example, in 1999 the state budget was expected to receive GEL 90 million from tax on oil. Actually, only 52.9 per cent of envisaged amount was received, which does not correspond to actual amount of imported oil-products.

In 1999 registered imports amounted to USD 551.558 million. USD 521.784 million of goods were put into free circulation, USD 505 thousand were reexported, and USD 1.399 million delivered to duty-free shops. Out of the registered imports, USD 202 707 million (36.75 per cent) were fully taxed, USD 126.846 million (34.85 per cent) were partially taxed, and USD 192. 234 million were tax-exempt. USD44.221 million (8.02 per cent) was foreign investment, USD 47.514 million was humanitarian aid, USD 98.619 million (17.88 per cent) were tax exempt imports and USD 11.880 million finance by grants.

In 1999, actual State revenues amounted to 11.6 per cent of GNP, which is 0.4 per cent less then in 1998. It is worth noting, that the revenue side of the budget was not determined on the basis of the taxation code. In fact, the greatest part of the tax base (approximately 50 per cent) is officially placed in the “shadow”, in the other words, the “shadow” economy is legalized. The draft of state budget of 2001 and an explanatory letter recognize above mentioned situation as a fact.

According to the Georgian Chamber of Control and Budgetary Office of the Parliamentbudget execution was quite possible.

The present situation is caused, first of all, by an incorrect attitude towards tax payment, disrespect for law, impunity, writing off of balances, absence of effective legislation base for eradicating overdue debts, unsatisfactory work of the custom and tax services, and irresponsibility.

In 1999, tax-exempt revenues could have become a better source of financing. Revenues from allowances, licenses etc., could have been reflected as tax-exempt revenues, but they were not.

One of the main causes of this situation is the imperfection of budget laws, the absence of an accounting system, and bad treasury service laws. In fact, the state budget is considered to be a general orienting point, execution of which is not at all obligatory. Budget laws are often violated, which is also a serious problem, as there are no penalties against non-execution of budget. It is evident, that existing taxation law is ineffective. Thus most entrepreneurs raise the question of tax reduction. This question must be solved optimally; otherwise it may bring even worse results. If the proposal of mechanical tax reduction is accepted, than measures against tax evasion must become stricter with heavy fines, and civil or criminal responsibility.

In the nearest future, taxation policy must be directed towards stimulating tax paying. It is necessary to pursue a liberal taxation policy and cancel, or minimize all tax allowances. Entrepreneurs must see that paying taxes is preferable to tax evasion. But, it cannot be achieved only by improving taxation laws.

The most important shortcoming of our taxation system is absence of a differential approach to production. This is why taxes do not provide state expenditure with resources, do not restrict part of enterprises, and do not promote development of other important ones.

Today the attitude towards taxation policy is quite superficial, which can lead to mistakes in economic policy. The main reason is the absence of single global policy in modernization of economy. The mistake is intensive concentration on tax reform. The widespread idea that mechanical reduction of taxes can stop reduction of revenues, save the economy and stimulate economic activities is false, because of a number of problems in Georgia.

Though making changes in tax laws by adoption of new laws is not difficult due to the parliamentary majority, taxation will always remain a painful issue. It is well known that today “shadow” economy in Georgia exists thanks to tax evasions.

Temporary tax reduction does not always bring anticipated results. Due to lack of trust in the State, citizens do not believe that it will permanently pursue any economic policy, so even if it does, reaction of citizens and businessmen will be weak and positive results of such policy will be very poor.

A good example of this is a zero effect of unsystematic changes in tax code, mainly serving private interests. No work is done in the direction of correcting systematic mistakes in legislation, and if it is done, then it is without any visible effect. So while working on taxation policy, special attention must be paid to rationality, stability, justice, possibility of easy forecasting. As the structure of the state expenditure greatly effects the territorial distribution of the population, there is a very important question to be solved – redistribution of taxation authority among different levels of power, which will facilitate eradicating inequality in revenue distribution.

It is absolutely necessary to cancel all tax allowances. Today most important goods and quite a large number of taxpayers are granted exemption. It will be profitable for the country to set same tax rates for everyone and allocate necessary sums for exemption from the budget. Mechanism of controlling taxpayers requires serious perfection.

APPENDIX III: TRANSFORMATION OF CURRENCY CRISIS AMONG DIFFERENT COUNTRIES

By Natalia Kakabadze (GEPLAC)

The 1990s crises had a common feature that was their occurrence across several countries. The glaring example of the crisis transformation was the Russian crisis in 1998. The affect of the crisis was obvious in Georgia and Ukraine, Kazakhstan, Azerbaijan and Baltic countries as well. Also the obvious pattern of currency crisis transformation was 1998 Asia crisis. In recent economic publications, the phenomenon of regional spread of a crisis is usually referred to as contagion.

There are a lot of research papers and publication covering this subject. The goal of this article is to focus on factors, which can cause transformation of currency crisis from one country to another. Today, an issue of crisis transformation becomes urgent again because of the Turkish currency crisis in February 2001 and its possible effect on Georgian national currency.

Transmission of a crisis across countries can be clarified by various explanations. First, the number of countries can be affected by a common shock (though a crisis can spread even in the absence of such a shock). Trade links can transmit a crisis, as currency depreciation in one country deteriorates other countries' economies by reducing the competitiveness of their exports. Financial interdependence can also lead to the transmission of a crisis since initial disorder in one country can stimulate foreign creditors to call back their loans, thereby creating a credit crisis in other debtor countries. Finally, a currency crisis in one country can worsen investor confidence in countries with similar economic performance.

Explanations of the international transmission of crises contain both the fundamental and the self-fulfilling approaches. Common shocks, transmission through trade channels and common creditors, can be classified as fundamentals-driven crises. On the contrary, information about markets is the self-fulfilling approach. The first explanation for the simultaneous happening of a crisis in different countries holds that the countries are beat by common shocks. The happening of a crisis across several countries can be seen as an initial case being replicated in other places, rather than as the transmission of a shock from one country to another. In the absence of common shocks, a currency crisis can be transmitted from one country to another through structural links of those countries.

If the currency devaluation by country X has a negative impact on country Y's economy, it will push country Y's currency devaluation. The best pattern of such spillover is international trade. The devaluation in country X reduces the price of its goods in foreign markets, leading consumers to purchase more goods produced in country X and less goods produced in other countries, including country X, as they became more expensive. The reduction of export earnings can significantly hinder the ability of country Y to maintain a current account deficit, which can leave that country's currency open to pressure. In 1998, the devaluation of Russian ruble caused inflow of cheaper Russian products into CIS countries markets and outflow of hard currency from those markets. It resulted in worsening of their trade balances with Russia. Besides, country international transmission of a currency crisis through the trade channel does not depend on large trade flows between the two countries. The transmission can happen even if countries X and country Y have no trade links with each other. The key factor is that their exports compete in other countries markets. In other words, the trade channel is exceptionally relevant in the transmission of currency crises when countries X and Y sell their goods in the same markets.

Different countries are interdependent if they borrow from the same creditors. A currency crisis in country X reduces the ability of domestic borrowers to repay their loans to foreign creditors. Faced with a larger share of bad loans, foreign creditors recall some of their loans, including loans issued in other countries. Borrowers in country Y suffer from a credit crunch in country X. Such a recall of loans can generate a regional credit crisis even if foreign creditors recall their loans evenly across all countries in their portfolio. The credit crunch is sharper in the countries that depend on those creditors, which faced heavy losses due to the initial crisis.

In conclusion it could be noted that, despite the spillover effects resulting from trade linkages or common creditors, a crisis could move from one country to another as a result of information analising of markets. New information concerning one country can then be extrapolated and applied to the entire group. Specific events such as devaluation of currency may be described as a signal towards review of investment prospects in the region.

STATISTICAL APPENDIX

CONTENTS *

* Note: First digit in the number of an appendix table indicates the number of the chapter to which it belongs.

Table A 3.1: Central Budget Expenditures by economic breakdown
(GEL million)

Category	Corrected budget 2000	Actual 2000	Per cent of Corrected budget	Per cent in total
Salaries	65,9	65,2	99%	9,7%
Social contributions from employer	12,3	11,6	94%	1,7%
Business trips	6,1	5,4	88%	0,8%
Other goods and services	93,8	90,6	97%	13,4%
Office expences	7,4	6,3	85%	0,9%
Municipal charges	8,3	6,8	82%	1,0%
Transportation	9,6	8,9	93%	1,3%
Food	15,1	14,6	97%	2,2%
Medical supplies	0,3	0,1	42%	0,0%
Furniture and uniforms	3,2	2,8	89%	0,4%
Other expences	49,9	51,1	102%	7,6%
Diplomatic Corps of Georgia	19,4	19,4	100%	2,9%
IDPs	14,0	11,6	83%	1,7%
Funds extracted from government accounts by court decision	0,0	3,2		0,5%
Interest payments	178,9	169,8	95%	25,2%
Foreign debt	*84,0*	*72,7*	*87%*	*10,8%*
Domestic debt	*94,9*	*97,1*	*102%*	*14,4%*
Subsidies and current transfers	239,5	212,7	89%	31,5%
Pension fund	38,7	27,1	70%	4,0%
Military pentions	17,9	17,9	100%	2,7%
IDP benefits	43,2	42,5	98%	6,3%
Social benefits	10,6	5,9	55%	0,9%
Transfers to local budgets	39,3	32,0	82%	4,8%
Susidie to state health insurance company	18,7	12,4	66%	1,8%
Subsidies to ministry of culture	4,5	4,4	97%	0,6%
Subsidy to TV corporation	8,9	8,9	100%	1,3%
Transfer to energy sector	24,7	24,6	99%	3,6%
Capital expenditures	6,1	4,7	77%	0,7%
Program expences	30,5	25,8	84%	3,8%
Educational programs	1,1	1,1	100%	0,2%
Health care programs	8,7	5,5	63%	0,8%
Disability programs	3,5	3,1	89%	0,5%
Sport programs	1,8	1,7	97%	0,3%
Organizations of disabled and war veterans	0,9	0,9	100%	0,1%
Net lending	177,6	88,7	50%	13,2%
Total	**810,8**	**674,6**	**83%**	100,0%

Source: Ministry of Finance

Table A4.1: Accounts of the National Bank of Georgia
(GEL thousands)

	1999	2000											
	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Net International Reserves	**-369 439**	**-375 362**	**-373 289**	**-430 742**	**-442 275**	**-446 427**	**-446 326**	**-423 796**	**-390 663**	**-388 804**	**-374 583**	**-367 666**	**-409 388**
Net Foreign Assets (convertible) (1)	-368 422	-374 346	-372 273	-353 805	-367 800	-370 564	-368 014	-347 282	-316 782	-315 880	-304 747	-296 401	-332 773
Use of IMF resources	*-617 372*	*-611 215*	*-605 131*	*-592 154*	*-585 951*	*-589 290*	*-584 572*	*-564 023*	*-556 556*	*-554 731*	*-546 054*	*-545 606*	*-549 832*
Net Foreign Assets (nonconvertible)	-1 016	-1 016	-1 016	-76 937	-74 475	-75 864	-78 312	-76 515	-73 881	-72 924	-69 836	-71 264	-76 614
Net Domestic Assets	**677 879**	**672 878**	**661 920**	**731 914**	**740 980**	**740 775**	**741 232**	**743 916**	**726 755**	**726 342**	**715 920**	**708 672**	**800 559**
Net Claims on General Government	695 047	701 645	699 400	660 129	680 883	683 964	683 831	689 883	694 562	702 691	700 055	698 088	782 198
Net Claims on Banks	1 861	962	-618	-998	1 732	-1 664	931	-252	1 520	395	2 184	1 329	4 000
Claims on the rest of Economy				77 274	75 833	77 199	79 617	77 847	75 199	74 206	71 142	72 560	77 878
Other assets net	-19 029	-29 729	-36 862	-4 491	-17 469	-18 724	-23 146	-23 562	-44 527	-50 950	-57 460	-63 305	-63 517
Reserve Money (M1)	**308 472**	**297 516**	**288 631**	**301 172**	**298 705**	**294 348**	**294 907**	**320 120**	**336 092**	**337 539**	**341 337**	**341 006**	**391 172**
Currency in circulation	259 772	245 431	237 761	249 168	254 188	246 571	249 040	270 072	280 189	287 524	284 696	284 568	329 157
Banks' deposits	48 700	52 085	50 870	52 005	44 518	47 777	45 867	50 048	55 903	50 015	56 641	56 438	62 015
Required reserves	*29 691*	*31 451*	*32 670*	*33 521*	*33 932*	*33 658*	*32 737*	*33 401*	*37 257*	*38 708*	*38 577*	*40 149*	*38 943*

Source: National Bank of Georgia

Notes: (1) Since September 2000 NFA (convertible) includes gold, SDR holdings, foreign exchange, Duch account and use of IMF resources.

Table A4.2: Consolidated Accounts of Commercial Banks
(GEL thousands)

	1999	2000											
	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Net Foreign Assets	**-6 335**	**-25 192**	**-10 758**	**-15 368**	**-24 397**	**-10 465**	**-229**	**11 309**	**15 742**	**20 600**	**7 089**	**6 414**	**-12 766**
Foreign exchange	93 134	75 748	90 123	84 823	78 089	93 948	105 655	119 258	122 748	130 280	119 359	114 407	104 819
Foreign currency liabilities	-100 049	-101 532	-101 477	-100 365	-102 644	-104 571	-106 041	-108 097	-107 154	-109 702	-112 289	-108 011	-117 625
Other foreign assets (net) (1)	580	593	595	174	158	158	157	149	149	21	19	18	39
Net Domestic Assets	**206 901**	**232 883**	**224 134**	**230 316**	**242 956**	**254 609**	**246 208**	**258 284**	**276 758**	**284 041**	**309 498**	**315 324**	**316 014**
Domestic Credit	**312 587**	**320 420**	**318 794**	**311 670**	**338 639**	**339 896**	**356 332**	**374 024**	**386 954**	**394 110**	**413 869**	**426 161**	**422 732**
Net Claims on General Government	-14 594	-16 515	-15 404	-20 148	-16 610	-16 599	-18 591	-15 915	-16 198	-15 904	-17 162	-17 123	-15 980
Claims on the Rest of the Economy	327 181	336 935	334 198	331 818	355 249	356 495	374 923	389 939	403 151	410 014	431 031	443 284	438 712
Claims on Enterprises (GEL)	*62 480*	*61 238*	*58 334*	*55 632*	*53 212*	*52 188*	*53 653*	*65 236*	*56 645*	*55 363*	*57 843*	*58 211*	*57 130*
Claims on Individuals (GEL)	*29 840*	*24 987*	*25 525*	*27 259*	*28 117*	*27 577*	*28 707*	*30 181*	*29 427*	*27 918*	*28 031*	*30 306*	*33 463*
Foreign Currency Loans	*234 861*	*250 710*	*250 339*	*248 927*	*273 920*	*276 730*	*292 563*	*303 522*	*317 080*	*326 733*	*345 158*	*354 767*	*348 119*
Other Assets Net	**-105 686**	**-87 537**	**-94 660**	**-81 354**	**-95 683**	**-85 287**	**-110 124**	**-115 739**	**-110 196**	**-110 068**	**-104 372**	**-110 837**	**-106 718**
Deposit Liabilities	**200 566**	**207 691**	**213 376**	**214 948**	**218 559**	**244 144**	**245 979**	**269 594**	**292 500**	**304 641**	**316 586**	**321 739**	**303 248**
GEL Deposits	42 139	44 503	49 769	50 418	41 819	48 800	46 341	56 323	62 157	57 872	69 772	69 473	67 088
Of which: Enterprises' Current A/Cs	*30 355*	*33 119*	*38 522*	*39 155*	*30 182*	*37 987*	*34 994*	*41 891*	*46 054*	*43 297*	*55 920*	*55 400*	*51 098*
Foreign Currency Deposits	158 427	163 188	163 607	164 530	176 740	195 344	199 638	213 270	230 343	246 769	246 815	252 266	236 160

Source: National Bank of Georgia
Note: (1) Includes Gold and NFA in soft currencies

Table A4.3: Monetary Survey
(GEL thousands)

	1999	2000											
	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Net Foreign Assets	**-375 742**	**-400 554**	**-384 048**	**-446 110**	**-466 672**	**-456 892**	**-446 555**	**-412 547**	**-374 921**	**-368 204**	**-367 494**	**-361 251**	**-422 154**
Foreign exchange	341 077	311 579	321 943	322 183	295 252	311 686	321 161	334 947	361 469	368 132	359 667	362 613	320 871
Foreign liabilities	-718 437	-713 765	-707 624	-769 455	-763 070	-769 724	-768 925	-748 695	-737 591	-737 356	-728 179	-724 881	-744 071
Other foreign assets (net) (1)	1 618	1 632	1 634	1 162	1 146	1 146	1 209	1 201	1 201	1 020	1 018	1 017	1 046
Net Domestic Assets	**820 306**	**835 777**	**822 535**	**894 703**	**926 464**	**932 104**	**926 871**	**938 903**	**930 329**	**941 961**	**950 748**	**950 851**	**1 040 382**
Domestic Credit	**1 007 634**	**1 022 065**	**1 018 194**	**1 049 073**	**1 095 355**	**1 101 059**	**1 119 780**	**1 141 754**	**1 156 715**	**1 171 007**	**1 185 066**	**1 196 808**	**1 282 808**
Net Claims on General Government	680 453	685 130	683 997	639 981	664 273	667 365	665 240	673 968	678 365	686 787	682 893	680 965	766 218
Net Claims on Republican Government	*688 709*	*692 944*	*693 263*	*650 117*	*674 256*	*676 876*	*675 941*	*685 725*	*691 601*	*700 474*	*697 467*	*696 353*	*780 280*
Net Claims on Local Government	*-3 876*	*-4 537*	*-4 885*	*-5 916*	*-4 313*	*-4 866*	*-4 788*	*-4 481*	*-4 977*	*-5 709*	*6 044*	*5 329*	*-4 459*
Net Claims on Pension Fund	*-1 907*	*-1 616*	*-970*	*-1 608*	*-1 849*	*-1 415*	*-1 962*	*-1 688*	*-1 229*	*-932*	*-1 773*	*-2 408*	*-2 965*
Other Extra-Budgetary Funds	*-2 473*	*-1 660*	*-3 411*	*-2 612*	*-3 822*	*-3 230*	*-3 951*	*-5 588*	*-7 031*	*-7 046*	*-6 757*	*-7 651*	*-6 638*
Claims on the Rest of the Economy	327 181	336 935	334 198	409 092	431 082	433 694	454 540	467 786	478 350	484 220	502 173	515 844	516 590
Other items, net	**-187 328**	**-186 288**	**-195 660**	**-154 370**	**-168 892**	**-168 955**	**-192 908**	**-202 851**	**-226 386**	**-229 046**	**-234 318**	**-245 957**	**-242 426**
Broad Money (M3)	**444 562**	**435 223**	**438 487**	**448 593**	**459 791**	**475 212**	**480 316**	**526 416**	**555 408**	**573 757**	**583 254**	**589 600**	**618 229**
Broad Money, excl. foreign currency deposits (M2)	286 135	272 035	274 880	284 063	283 051	279 868	280 678	313 145	325 066	326 988	336 439	337 334	382 069
Currency in circulation	259 772	245 431	237 761	249 168	254 188	246 571	249 040	270 072	280 189	287 524	284 696	284 568	329 157
Currency outside banks (MO)	*243 997*	*227 532*	*225 112*	*233 645*	*241 233*	*231 068*	*234 337*	*256 822*	*262 908*	*269 116*	*266 667*	*267 862*	*314 981*
Cash in commercial banks	*15 774*	*17 898*	*12 650*	*15 523*	*12 955*	*15 503*	*14 703*	*13 250*	*17 281*	*18 408*	*18 029*	*16 707*	*14 177*
Deposit Liabilities (GEL)	42 139	44 503	49 769	50 418	41 819	48 800	46 341	56 323	62 157	57 872	69 772	69 473	67 088
Foreign Currency Deposits	158 427	163 188	163 607	164 530	176 740	195 344	199 638	213 270	230 343	246 769	246 815	252 266	236 160

Source: National Bank of Georgia

Notes: (1) Includes Gold and NFA in soft currencies

Table A5.1.1: Registred Foreign Trade Balance, 2000

(USD thousand)

Countries	Export	Import	Balance
Total foreign trade (USD million)	329892,2	700226,5	-370334,3
CIS			
Armenia	13479,1	9574	3905,1
Azerbaijan	21092,6	56714	-35621,4
Belarus	642,5	869,2	-226,7
Kazakhstan	4453,5	9460	-5006,5
Kyirgizstan	64	275,7	-211,7
Moldova	162,4	174,6	-12,2
Russia	68071,9	90235,8	-22163,9
Tajikistan	119,8	152,9	-33,1
Turkmenistan	7904,1	9716,8	-1812,7
Ukraine	19473	37738,9	-18265,8
Uzbekistan	740,5	6664,7	-5924,2

Source: State Department for Statistics

Table A5.1.2: Registred Foreign Trade Balance, 2000

(USD thousand)

Countries	Export	Import	Balance
EU			
Austria	103,2	9171,8	-9068,6
Belgium	799,2	5493,4	-4694,2
Denmark	503	2976,1	-2473,1
Finland	5,8	1765,4	-1759,6
France	1325,9	11557	-10231,1
Germany	30858,7	55998,7	-25140
Greece	8163,4	10840,5	-2677,1
Ireland	356,7	2417,4	-2060,7
Italy	11577,9	21809,9	-10232
Luxembourg	0	64	-64
Netherlands	1903,2	8516	-6612,8
Portugal	80,6	1333,9	-1253,4
Spain	2201,2	2442	-240,8
Sweden	78,1	9423	-9344,9
UK	10397,6	23321,9	-12924,3
USA	6424,7	70911,2	-64486,6

Source: State Department for Statistics

Table A5.1.3: Registred Foreign Trade Balance, 2000
(USD thousand)

Countries	Export	Imort	Balance
Other countries			
Albania	0	5	-5
Anguila	11,3	0	11,3
Argentina	0	432,6	-432,6
Australia	4,2	1198,7	-1194,5
Bahamas	696,1	178,1	518
Bangladesh	4,3	0	4,3
Butan	24,1	4	20,1
Bosnia	0,5	0	0,5
Brazil	187,1	5308,3	-5121,2
Botsvana	1,8	0	1,8
Bulgaria	2420,6	15310,9	-12890,3
Canada	0,2	1050	-1049,8
Sri-Lanka	1,5	223,1	-221,6
China	915	2916,4	-2001,4
Columbia	0	332,9	-332,9
Congo	3736,1	0	3736,1
Costa-Rika	0	21,7	-21,7
Cote d'Ivoire	0	28,7	-28,7
Croatia	0	1106	-1106
8508	-7454,3		
2944,1	-2195,2		

Table A5.1.4: Registred Foreign Trade Balance, 2000

(USD thousand)

Countries	Export	Import	Balance
Other countries			
Ecuador	0	438,8	-438,8
Egypt	46,5	115,5	-69
Estonia	86,4	61,2	25,1
Gibraltar	0	621,4	-621,4
Honduras	35	0	35
Hungary	547,6	4599,8	-4052,2
Island	548,1	2100,7	-1552,6
India	1303,2	1249	54,2
Indonesia	28,8	5038	-5009,2
Iran	6679,9	5865,4	814,6
Israel	548,1	2100,7	-1552,6
Jamaica	0	13,8	-13,8
Japan	380,7	7111,8	-6731,2
Korea PDR	0	1201	-1201
Korea Rep.	0	332,8	-332,8
Lebanon	0	3438,6	-3438,6
Latvia	1066	2427,27	-1361,7
Luxemburg	0	64	-64
Liechtenstein	8,8	67,9	-59,1
1212,3	1870		

Table A5.1.5: Registred Foreign Trade Balance, 2000
(USD thousand)

Countries	Export	Import	Balance
Other countries			
Macedonia	69	43,7	25,4
Mongolia	341,5	0	341,5
New Zealand	3,8	260	-256,2
Newer	0	2950,4	-6612,8
Norway	1,9	114,3	-112,4
Virjinia	293,2	338,7	-45,4
Pakistan	13,4	8,4	4,9
Panama	899,1	0	899,1
Poland	531,4	3454,7	-2923,3
Romania	60,6	10203,2	-10142,5
San-Marino	0	17,6	-17,6
Singapore	2,5	138,5	-136
Slovakia	37,6	338,1	-300,5
Slovenia	0	3688,6	-3688,6
Switzerland	13521,5	22305,4	-8783,9
Syria	3383,8	368,3	3015,6
Taiwan	32	274	-242
Thailand	18,2	6,1	12
Turkey	73623,1	108633,8	-35010,7
8,8	-8,8		
10310,7	-9718,4		

Table 6.1: Small Enterprise Privatisation by Sector as of 1st January, 2001

	Sector	Approved	Privatised	% of total privatised	Privatised in 2000
1	**Manufacturing**	392	301	2,0	12
2	**Energy**	56	44	0,3	7
3	**Bread products**	142	116	0,8	5
4	**Agriculture & food**	757	796	5,2	141
5	**Construction**	436	337	2,2	22
6	**Trade**	4 664	5 291	34,4	159
7	**Services**	5 518	6 847	44,5	420
8	**Oil products**	172	173	1,1	2
9	**Health**	785	606	3,9	15
10	**Social sphere**	415	655	4,3	61
11	**Transport**	190	210	1,4	38
	Total	13 527	15 376	100,0	882

Source: Ministry of State Property Management

Table A6.2: Establishment of JSCs by sector as of 1st January, 2001

Sector	Approved	Established	Established in 2000
Manufacturing	196	195	10
Mining and chemicals	31	25	0
Bread products	61	24	0
Agriculture and food	388	348	15
Architecture and construction	226	227	6
Retail and Wholesale Trade	86	73	3
Oil products	49	28	2
Gas	58	49	4
Transport	118	117	4
Social sphere	57	67	22
Healthcare		34	34
Energy sector	64	125	26
Total	1 334	1 312	126

Source: Ministry of State Property Management

Table A6.3: Establishment of JSCs by Region, as of 1st January, 2001

(Number of enterprises)

Region	Approved for privatisation	Total number of established and registered JSCs
Abkhazia	**34**	**0**
Achara	**86**	**35**
Tbilisi	**392**	**452**
Guria	**55**	**52**
Lanchkhuti	12	11
Ozurgeti	34	33
Chokhatauri	9	8
Racha-Lechkhumi and lower Svaneti	**12**	**8**
Ambrolauri	6	3
Lentekhi	2	2
Oni	1	1
Tsageri	3	2
Samegrelo and upper Svaneti	**168**	**184**
Abasha	9	10
Zugdidi	49	51
Martvili	12	14
Mestia	1	0
Senaki	25	31
Chkhorotsku	14	18
Tsalenjikha	21	22
Khobi	12	14
Poti	25	24
Imereti	**224**	**218**
Kutaisi	75	71
Tkibuli	16	16
Tskaltubo	18	13
Chiatura	15	16
Bagdati	10	11
Vani	11	11
Zestafoni	24	24
Terjola	16	16
Samtredia	17	18
Sachkhere	4	4
Kharagauli	7	6
Khoni	11	12
Kakheti	**112**	**107**
Akhmeta	11	15
Gurjaani	22	20
Dedoplistskaro	8	8
Telavi	26	23
Lagodekhi	10	10
Sagarejo	13	13
Signagi	13	11
Kvareli	9	7
Mtsketa-Tianeti	**41**	**41**
Akhalgori	1	1
Dusheti	12	12
Tianeti	2	2
Mtslheta	23	23
Kazbegi	3	3
Samtskhe-Javakheti	**47**	**51**
Adigeni	2	2
Aspindza	3	1
Akhalkalaki	8	9
Akhaltsikhe	13	16
Borjomi	20	22
Ninotsminda	1	1
0	**97**	
4	34	
1	7	
1	25	
3	2	
	10	
	17	
	2	
	67	
	0	
Gori	30	31
Kaspi	14	14
Kareli	9	9
Khashuri	13	13
Java	0	0
Total	**1 334**	**1 312**

Source: Ministry of State Property Management

Note: This table represents in the first column enterprises approved for privatisation, and in the second those that have actually been valued and established as joint-stock companies. It does not represent enterprises actually privatised. The numbers in the second column can exceed those in the first since some enterprises are split up when being corporatised.

Table A6.4: Small Privatisation by Region, as of 1st January, 2001
(Number of enterprises)

Region	Approved for privatisation	Total privatised	Privatised in 2000	Merged with medium or large enterprises	Liquidated
Abkhazia	8	-	-	-	-
Achara	324	171	10	21	-
Tbilisi	4 578	4 799	296	412	-
Guria	312	430	16	3	71
Lanchkhuti	60	94	9	-	17
Ozurgeti	195	241	7	3	40
Chokhatauri	57	95	-	-	14
Racha-Lechkhumi and lower Svaneti	168	253	8	2	50
Ambrolauri	58	93	7	1	18
Lentekhi	32	47	-	-	23
Oni	47	55	-	1	9
Tsageri	31	58	1	-	-
Samegrelo and upper Svaneti	1 103	1 470	21	184	278
Abasha	86	91	-	3	13
Zugdidi	211	269	4	7	-
Martvili	53	51	-	2	19
Mestia	12	23	-	3	3
Senaki	249	430	3	140	104
Chkhorotsku	39	56	1	-	23
Tsalenjikha	51	63	3	15	15
Khobi	145	136	6	2	59
Poti	257	351	4	12	42
Imereti	2 669	2 974	161	185	582
Kutaisi	608	774	41	71	211
Tkibuli	223	192	8	-	49
Tskaltubo	268	300	16	10	29
Chiatura	239	297	21	68	44
Bagdati	69	109	4	-	36
Vani	68	102	12	1	17
Zestafoni	410	378	27	12	52
Terjola	132	148	-	-	20
Samtredia	429	430	22	19	59
Sachkhere	94	78	-	-	16
Kharagauli	65	67	7	3	14
Khoni	64	99	3	1	35
Kakheti	1 076	1 243	44	71	182
Akhmeta	178	176	3	18	28
Gurjaani	136	153	5	13	19
Dedoplistskaro	87	105	6	34	3
Telavi	215	256	14	3	36
Lagodekhi	71	72	6	-	15
Sagarejo	128	124	1	3	10
Signagi	137	214	-	-	34
Kvareli	124	143	9	-	37
Mtsketa-Tianeti	315	364	25	21	71
Akhalgori	17	18	-	-	5
Dusheti	87	111	8	1	12
Tianeti	57	58	2	8	12
Mtslheta	128	149	5	12	42
Kazbegi	26	28	10	-	-
Samtskhe-Javakheti	582	869	78	9	95
Adigeni	80	95	20	-	5
Aspindza	30	47	10	1	-
Akhalkalaki	56	80	2	1	10
Akhaltsikhe	242	362	16	7	56
Borjomi	148	250	21	-	20
Ninotsminda	26	35	9	-	4
1 470	159	20	154	252,6	10
445	27	4	60	556,3	12
130	14	6	-	433,3	5
265	13	-	36	473,2	6
70	6	-	7		
217	53	4	17	146,6	11
306	43	6	10	1176,9	
37	3	-	24	3,3	6
951	49	50	169	268,6	6
5	-	5	-	8,2	8
Gori	310	355	8	19	52
Kaspi	197	159	24	-	15
Kareli	139	171	6	-	62
Khashuri	232	261	11	23	32
Java	-	-	-	-	-
MSPM	382	382	15	-	-
Total	**13 527**	**15 376**	**882**	**978**	**1 652**

Source: Ministry of State Property Management

Note: Number of enterprises actually privatised can exceed those approved for privatisation since some are split up during corporatisation.

Table A7.1: Economic Status, Q 1 1998 - Q3 2000

(Thousend)

	Q I 1998	Q II 1998	Q III 1998	Q IV 1998	Q I 1999	Q II 1999	Q III 1999	Q IV 1999	Q I 2000	Q II 2000	Q III 2000
Total population over 15 years old	**3, 099**	**3, 136**	**3, 194**	**3, 008**	**3, 032**	**3, 049**	**3, 092**	**3, 018**	**3, 123**	**3, 151**	**3, 133**
Total economically active population (labour force) (1)	**2 ,332**	**2, 462**	**2,146**	**1,990**	**2, 018**	**2, 052**	**2, 058**	**1, 917**	**1, 951**	**2, 102**	**2, 064**
Total economically active population (labour force) (2)	**2 ,457**	**2 ,555**	**2,195**	**2,042**	**2, 058**	**2, 093**	**2, 106**	**1, 975**	**2, 087**	**2, 199**	**2, 181**
Employed	***2, 101***	***2 ,283***	***1,887***	***1,741***	***1, 725***	***1, 784***	***1, 792***	***1, 633***	***1, 705***	***1, 890***	***1, 890***
Hired	714	737	786	741	737	743	741	710	679	695	675
Self-employed	1, 387	1 ,546	1,092	990	973	1, 023	1, 030	905	912	1087	1095
Unemployed (1)	***231***	***179***	***260***	***249***	**292**	**268**	**266**	**284**	**246**	**212**	**174**
Unemployed (2)	***356***	***272***	***309***	***301***	**333**	**308**	**314**	**342**	**382**	**309**	**292**
Unemployment rate (per cent) (1)	**9,9**	**7,3**	**12,1**	**12,5**	**14.5**	**13,0**	**12,9**	**14,8**	**12,6**	**10,1**	**8,4**
Unemployment rate (per cent) (2)	**14,5**	**10,6**	**14,1**	**14,7**	16.2	**14,7**	**14,9**	**17,3**	**18,3**	**14,0**	**13,4**
Labour force participation rate	***75,3***	***78,5***	***67,2***	***66,2***	***66,6***	***67,3***	***66,6***	***63,5***	***62,5***	***63,9***	***65,9***
Self-employment share in total labour force	*59.5*	*62.8*	*50.9*	*49,7*	*48,2*	*49,8*	*50,1*	*47,2*	*46,7*	*51,7*	*53,0*
Self-employment share in total employment	*66.0*	*67.7*	*57.8*	*56,9*	*56,4*	*57,3*	*57,5*	*55,4*	*53,5*	*57,5*	*57,9*

Source: The State Department for Statistics, Labour Force Survey

ABBREVIATIONS

ACDI	Agricultural Co-operative Development International
BSEC	Black Sea Economic Co-operation
CASE	Centre for Social and Economic Research
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
DMB	Deposit Money Bank (Commercial Bank)
EBRD	European Bank for Reconstruction and Development
ECU	European Currency Unit
ESAF	IMF Enhanced Structural Adjustment Facility
EU	European Union
EUR	Euro
FAO	Food and Agricultural Organisation
FDI	Foreign Direct Investment
FSU	Former Soviet Union
FXB	Foreign Exchange Bureau (x)
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GCT	General Customs Tariff
GDP	Gross Domestic Product
GEL	Georgian Lari
GEPA	Georgian Export Promotion Agency
GEPLAC	Georgian-European Policy and Legal Advice Centre
GET	Georgian Economic Trends
GNP	Gross National Product
GSP	General System of Preferences
H	Half year
ha	hectares
HS	Harmonised Commodity Description
IDP	Internally Displaced Person
ILO	International Labour Organisation
IMF	International Monetary Fund
IFAD	International Fund for Agricultural Development
ISIC	International Standard Industrial Classification
JPY	Japanese Yen
JSC	Joint Stock Company
KWh	Kilowatt hour
LFS	Labour Force Survey
MFA	Multi-fiber Agreement
MFN	Most Favoured Nations status
MoF	Ministry of Finance
MoHSS	Ministry of Healthcare and Social Safety
MoLSA	Ministry of Labour and Social Affairs
MSPM	Ministry of State Property Management
MWh	Megawatt hour
NBG	National Bank of Georgia
NDA	Net Domestic Assets
NFA	Net Foreign Assets
NMP	Net Material Product
NTR	Normal Trade Relations

OECD	Organisation for Economic Co-operation and Development
PAYG	Pay-as-you-go pension system
PCA	Partnership and Co-operation Agreement
PPI	Producer Price Index
PSI	Pre-shipment inspection
Q	Quarter year
RM	Reserve Money
RUR	Russian Ruble
SAC	World Bank Structural Adjustment Credit
SCD	State Customs Department
SDR	Special Drawing Rights
SDS	State Department for Statistics
SIS	State Institute of Statistics of Turkey
STI	State Tax Inspectorate
TBT	Technical Barriers on Trade agreement
TICEX	Tbilisi Interbank Currency Exchange
TRACECA	Transport Corridor Europe-Caucasia-Asia
TRIMs	Trade-Related Investment Measures
TRIPS	Intellectual Property Rights
TRL	Turkish Lira
UNDP	United Nations Development Program
USAID	United States Agency for International Development
USD	United States Dollar
USITC	United States International Trade Commission
USSSF	United State Social Safety Fund
USTR	United States Trade Representative
VAT	Value Added Tax
WTO	World Trade Organisation