GEORGIAN ECONOMIC TRENDS

Contents

About Tacis and GEPLAC

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

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

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

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

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

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

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

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 Foreign Affairs, the Ministry of Economy, Industry and Trade, the Ministry of State Property Management, the Ministry of Health 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.

GET also publishes articles by outside contributors: academicians, government officials, members of parliament, independent scholars and researchers, etc. The ideas and opinions contained in those articles represent the view of the authors only, which do not necessarily coincide with those of GET editorial team, neither do they represent any official view of the European Commission, the Georgian-European Policy and Legal Advice Centre or the Government of Georgia.

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FOREWORD

Dear Reader

We are pleased to introduce the June 2002 edition of Georgian Economic Trends and also the 3rd Phase of the Georgian–European Policy and Legal Advice Centre – GEPLAC, the project to which GET belongs.

We include two articles in this edition by external authors. The first is a concept of a new Tax Code elaborated by a working group based at the Georgian Economic Development Institute (GEDI), with which other experts have collaborated. This is being published in order to promote debate on an issue of great importance for the future economic development of Georgia, and we plan to present further contributions as they become available.

The second (by Prof. Vladimer Papava) draws in part on analysis by Russian academics, and paints a potentially dramatic picture of the apparent end of US dollar supremacy. This is timely since, whatever our interpretation of events over the last year or so, it seems that, as they say, "something may be happening out there".

The Euro has recently approached parity with the US dollar, which was almost unthinkable at the start of the year. This arises mainly from perceptions of the American economy, markets and government policy, rather than any new events or change of strategy in Europe.

Nevertheless, certain developments may be afoot in Europe. While there is a fairly general agreement in the industrialised world nowadays on <u>macroeconomic</u> management (e.g. the Europe Union's well-known "Maastricht criteria"), there has been less of a European consensus in the area of <u>microeconomic</u> and industrial policy. However, a clearer picture may now be emerging, with the election in June of a centre-right government in France and a possibility of the same in Germany later in the year. This would then mean that similar thinking governments were in a very obvious majority in the EU and certain long-postponed projects, such as major privatisations in France, may take place. This does not imply our endorsement of either "left or right" in Europe – it simply appears that political mandates have changed and become somewhat clearer.

This comes against the background of a well-executed and successful launch of the Euro in full replacement of 12 national currencies earlier this year. Consider also that the Single European Market has already existed for some time, and that a number of countries of Central and Southern Europe are actively seeking EU membership by 2004, and we may expect interesting developments in the next 2 – 3 years. The current strength of the Euro may be politically welcome in Europe, though if it is prolonged it will set certain challenges for policy makers who must consider how to maintain economic growth as EU companies become less competitive on world markets.

All of this is also of interest to Georgia, on the eastern borders of Europe, but increasingly involved through a close association with European institutions, including the Partnership and Cooperation Agreement with the EU (PCA), membership of the Council of Europe and other initiatives. One of the major tasks of "GEPLAC III" is the elaboration of the "National Programme of Harmonisation of Georgian Legislation with that of the European Union", pursuant to the PCA. When recommending legislation, GEPLAC will apply important tests, in particular:

- How well does it define and explain relevant economic terms and business situations to which it applies?
- Will it clearly support an improved economic and business environment in Georgia?
- Will it also contribute to export-led growth?

In order to make these judgements, GEPLAC experts will aim to analyse current conditions and concrete cases in Georgia, as well as the experience of candidate countries for EU membership. This research and the development of these ideas will be included in future editions of Georgian Economic Trends.

Mark Hudson
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GEPLAC

CHAPTER ONE: SUMMARY

NATIONAL ACCOUNTS AND MAIN TRENDS

GDP growth rate in Q1 2002 was 3.7 percent. Distiguished trend of this year is the growth in all sectors of real economy. The growth has been led by increase in construction, also trade, financial and also restraunt and hotel services. In industry and transport the growth was moderate, respectively 3.6 and 4.1 percent, while in agriculture the growth rate was lowest at only 0.3 percent. Improvement in electricity supply in Q1 allowed large industrial enterprises to increase the output, that conditioned the industrial growth. "Ocean Shipping Company" has signed contract with "Hyundai Mipo Dockyard Co." on construction of two new tankers. In Q1 2002, the outstanding foreign debt increased by USD 11 million only and amounted to USD 1,602 million.

The current account strengthened in 2001. The share of current account deficit in GDP fell from 8.8 per cent in 2000 to 6.7 per cent in 2001. Strong increase in export contributed to the reduction of current account deficit in 2001. Export of services reached the highest level since 1995. Situation with the capital and financial account was weak. Under the small foreign investments and high debt servicing obligations, new loans and grants to public sector, trade credits and accumulation of external arrears remain the main sources of financing the current account deficit.

GOVERNMENT FINANCE

According to the 2002 State Budget, total revenues in Q1 were expected to reach GEL 216.7million, that is 23 per cent of revenue expectations for the whole year. Actual state revenues (including foreign grants) were received at GEL 200.1 million level, (92 per cent of target). Nevertheless, the figure shows 20 per cent improvement over the year. Actual state budget expenditures of GEL 229.4 million were 47 per cent higher compared to the previous year. Main spending were on social security, debt servicing and general government.

MONEY AND FINANCE

MONETARY POLICY

According to the macroeconomic strategy for 2002, in the framework of PREGP, the National Bank should maintain its international reserves at the level of 1.05 months' import and keep M1 reserve money indicator at the level of 12.5 per cent of GDP. M3 growth should not exceed 19 per cent of GDP.

According to 2002 Budget, annual targets for Budget deficit financing from domestic sources related to the monetary policy are the following: GEL 30 million – NBG's net lending, and GEL 20 million – net financing to be received from T-Bills issuance and placement.

The main aim for T-Bills' policy in 2002 is to create an active secondary market and continue to diversify the structure of investors. A crucial change occurred toward the diversification of the primary market. In May 2002, the share of non-banking investors on the primary market increased to 73 per cent against 8 per cent in 2001.

DOMESTIC INFLATION

In April 2002, the accumulated indicator of monthly inflation reached 5.4 per cent. The annual targeted inflation for 2002 was 4-6 per cent, i.e., 0.42 per cent average monthly inflation. According to the State

Department for Statistics calculations, the average monthly inflation for the first four months of 2002 was 0.55 per cent.

EXCHANGE RATE

The average monthly nominal exchange rate of Lari continued to depreciate slightly vis-à-vis the USD. It was caused by increasing of the domestic foreign exchange market's demand due to the deterioration of the trade balance with the main trade partners of Georgia –Turkey, Azerbaijan and Russia.

INTERNATIONAL TRADE AND FOREIGN ECONOMIC RELATIONS

Despite the fact that in Q1 2002, the SDS recorded a 3.7 per cent GDP growth, export development, a major factor for acceleration of economic growth, remains one of the most urgent problems. The export-import balance for most goods was negative. Comparing the results of Q1 2002 for foreign trade with those of the preceding years, a certain deterioration is evident. Total exports of goods decreased, as well as export volumes of goods of Georgian origin. Exports to the CIS countries decreased from last year. Georgian exporters, who started developing their markets in Russia and other CIS countries in 2001, were not able to maintain their market shares and expand the volumes of exported products because of trade barriers. Recorded external trade turnover equaled to USD 219.6 million, of which exports were USD 58.2 million and imports - USD 161.4 million. Trade deficit of USD 103.2 million was about USD 12 million more than in Q1 2001.

PRIVATISATION

There was little progress in privatisation in the first quarter of 2002. Two management contracts have been signed with ESB International and Terna. The former is to manage JSC "Elektrogadatsema" (transmission) and "Electrodispecherizacia" Ltd. (dispatch), and the latter JSC Vartsikhehesi Cascade (Hydro Power Plant). A tender to identify the future management company of Tbilisi Water Utility is under way. Privatisation of the medium and large enterprises (MLE) had almost no results. Privatisation of the telecommunication assets is stalled. It seems that stronger political will is needed to push the process forward.

EMPLOYMENT, INCOMES AND THE SOCIAL SAFETY NET

LABOUR MARKET

The labour market situation remains largely unfavourable and unstable. Whilst unemployment rate figures are generally in line with those for transition economies (10.3 per cent by the ILO "strict" methodology and 15.1 per cent by the ILO "loose" methodology at the end of Q4 2001[1]), and, if taken alone, may even suggest optimistic conclusions, the overall picture is flawed by persistent underemployment, widespread hidden and disguised unemployment and salaries falling way below the minimum subsistence level (average monthly nominal salary of hired employees across the economy was GEL 98 in Q4 2001 – 45 per cent of the minimum subsistence level for a family of four). The situation is aggravated further by continuing decreases in the labour force caused by long-term unemployment. All the above-mentioned long-term labour market problems adversely effect the poverty situation that is continuously reflected in painful declines in living standards experienced by increasingly larger numbers of households. The unemployment rate figures are distorted by the rural ones that are always extremely low due to the existing legislation rather than to the real situation in the villages. The labour market is largely dominated by self-employment, and the latter – by self-

[1] When this issue of GET was being written, Q1 2002 results of the household survey were not yet available.

employment in agriculture. Just around 20 per cent of the working age population have waged or salaried jobs, over 40 per cent of which are jobs at budgetary organisations paying extremely low salaries.

SOCIAL SAFETY NET

The vast majority of the population, including informal sector employees, the self-employed and the unemployed, as well as their family members, have no social protection whatsoever, and the assistance for those covered by the social safety net is symbolic rather than minimal. The system of social protection provided by the state requires a fundamental restructuring, and an economically viable, affordable and equitable social safety net is to be created. The problem of poverty in old age is particularly acute, as the currently existing pension system, has long proven to be insolvent. Social policy reform aimed at introducing a sustainable pension system is among the top priorities in the country. Social reforms are acknowledged by the Government to be a long-term strategic objective and are among the main goals of its Poverty Reduction and Economic Growth Programme (PREGP).

EU-GEORGIAN RELATIONS

The figures from Q1 2002 show decrease in EU-Georgian trade, compared to the same period of the previous year. In Q1 2002 turnover amounted to USD 44.7 million. This is by 28.6 per cent less than in Q1 2001. Germany, the UK and Italy remain the largest trade partners for Georgia. Turnover of these countries with Georgia constituted about 67.2 per cent of the total amount of Georgia-EU trade in Q1 2002.

Georgia's exports to the EU market still remains quite low, despite the fact that Georgia has been a recipient of Generalized System of Preferences (GSP) scheme from the European Union since 1995.

The INOGATE is European Union's interstate project, which runs through TACIS programme. INOGATE launched in 1996 and at the moment participants of the project are twenty-one countries from Caucasus, Central Asia, Eastern Europe and the European Union.

During the period 1996-2001, INOGATE conducted various projects in energy sector in the Caucasus and Central Asia, which were funded by TACIS. Georgia is a member of the INOGATE from the beginning and actively participates in the projects. During this five-year period Georgia was a recipient of several programmes to a total value of EUR 10.6 million.

CHAPTER TWO: NATIONAL ACCOUNTS AND MAIN TRENDS

GDP AND MAIN TRENDS

The first quarter of 2002 saw an acceleration of the growth rate. This has come from a revival in industry and the stable development of services sector. Improvements in electricity supply allowed the large industrial enterprises to increase their production in the beginning of the year. Services remains the most reliable growth sector of economy. Under weak tax and custom administration the shadow economy is still increasing in Georgia. Investment flows are reducing. Taxes, regulations, corruption and political instability are the main constraints to business operation and growth in Georgia. Agreement with the main bilateral creditors alleviated the debt burden in 2001-2002, however, the depreciation of the national currency in Q1 this year has increased the price that the country pays for debt servicing.

Table 2.1: Dynamics and Structure of GDP, Q1 2002

	Q1 2002 versus Q1 2001 (Q1 2001=100)	Share in GDP Q1 2002 (per cent)
Agriculture, forestry and fishing	**100.3**	**22.2**
Industry	**108.1**	**19.7**
Industry without food industry and construction	103.6	12.8
Domestic processing of agricultural products	110.3	3.7
Construction	123.8	3.2
Services	**104.5**	**52.7**
Trade	110.5	13.3
Hotel and restaurant	108.6	2.9
Transport	104.7	8.9
Telecommunication	104.1	3.7
Financial intermediation	121.7	1.9
Operation with real estate, commercial activities	100.3	6.4
State management, Defence	101.8	3.4
Education	100.1	4.8
Health care and communal service	104.9	4.2
Other services	83.4	3.2
Amendments	129.2	-1.5
Net taxes	107.4	6.7
GDP	**103.7**	**100**

Source: State Department for Statistics

According to preliminary estimates of SDS, GDP in Q1 2002 was GEL 1 637 million (USD 742.7 million), that is 3.7 per cent more in real terms than in the corresponding period of last year. Growth has been led by increases in construction, trade, financial services and also restaurant and hotel services. In industry and transport the growth was moderate, respectively 3.6 and 4.7 per cent and in agriculture even lower only 0.3 per cent. An important development of Q1 2002 compared with the previous years was the growth in all sectors of the real economy. Usually the growth rate in Q1 is slower than in the rest of year, thus there could be an acceleration of growth in 2002.

The financial sector has also expanded rapidly. However, financial intermediation relative to GDP in Georgia is small. The lack of a credit culture, weak corporate governance, the scarcity of bankable projects and the absence of reliable financial statements for companies all hinder the development of the banking system in Georgia. As for the securities market, it is small and illiquid, the Georgian Stock Exchange lists securities of only a few dozen companies and turnover is quite limited. Poor investment performance indicates that serious industrial restructuring has not yet occurred.

The education and health care sectors suffer from poor financing by the public sector and the private sector is now taking over. Today over 50 percent of education and about 80 per cent of health care services are rendered by private entities.

According to the IMF, the shadow economy ranges from 21 to 30 per cent of GDP in the transition economies (Central European and Former Soviet countries). Among them, Georgia's shadow economy is the largest. According to the SDS, non-recorded production covers one third of total output, while according to the IMF's assessment the shadow economy is 64 percent of GDP[1]. The larger the shadow economy the fewer state revenues that can be collected. The share of collected tax to GDP in Georgia is 13.7 percent; that is among the lowest in the CIS countries. Lower revenues and public spending leads to a fall in the economic growth rate. As international experience shows, lower tax rates, fewer laws and a strong law enforcement system are most appropriate ways to reduce the shadow economy.

The inflation rate in Q1 was 3.6 per cent, on average 1.2 per cent per month. A high inflation rate in the winter-spring season (except May) is common in Georgia. Prices of energy products did not change much this year (taking into account that at the end of 2001 there were substantial increases in electricity and gas tariffs), but there have been increases of 5.6 per cent in the price of a basket comprising food, beverages and tobacco.

SECTORS OF THE ECONOMY

Agriculture

Last year the western regions of the country suffered from drought. EU, Turkey, USA, Italy, Greece, Sweden and Germany rendered financial assistance to Georgia of about USD 2.3 million to overcome the results of the drought. These funds were used to purchase and then distribute to about 150 thousand local farmers maize seeds and fertilizers for carrying out seasonal works this spring.

Since 1996, the Japanese government has assigned several grants to Georgia under the 2KR programme. Georgia imported 112 combine harvesters and 229 tractors, 8 thousand tonnes of fertilizers and also hundreds of agricultural implements. They were distributed among local farmers through installment sale with 4 years credit. In 2002, under the 2KR-V programme 147 new Italian tractors and other equipment were supplied to Georgia. In total, since the start of the 2KR project agricultural machinery worth GEL 24 million has been imported. However, there is a serious problem related to the non-fulfillment of commitments by the farmers, with the result that some of the machines were withdrawn and are to be resold. According to the agreement between the Georgian and Japanese governments, the funds received from this sale should be accumulated into a partnership fund and directed to new projects in the agricultural sector.

[1] Hiding in the shadows: The growth of underground economy. Economic issue N-30, IMF, 2002.

Nowadays in the western regions of Georgia land is becoming swamped while in the eastern part of the country it is in some places becoming desert. Last year 240 thousand hectares of agricultural land were irrigated and 70 thousand hectares were drained, while irrigation infrastructure exists on 469 thousand hectares and drainage system on 160 thousand hectares. The current irrigation and drainage system was built in Soviet times and adjusted to the needs of large state and collective farms. The process of privatization of agricultural land and the breaking up of land holdings into small plots raises the problem of structural and also institutional changes in the management of irrigation and drainage systems. In March this year a World Bank Irrigation and Drainage Community Development Project started. The aim of this programme is the establishment of water consumer communities, and the rehabilitation of the main and internal network of water supply. The first phase is scheduled for five years and involves the allocation of USD 32 million; of which USD 27 million is a credit from IDA (International Development Association) and the rest from Georgia.

The European Commission decided to prolong its Food Security Programme in Georgia for 2002-2003. The project allocates of EURO 25 million; of which EURO 12 million is intended to secure budgetary allocations for the needs of the agricultural sector, including EURO 6 million in 2002.

Industry

In Q1 2002, registered industrial output increased by 2.8 per cent and total output (including estimations of informal sectors) by 1.2 per cent compared with the corresponding period of last year. The share of large industrial enterprises in total production exceeds 75 per cent. Improvements in electricity supply in Q1 enabled large enterprises to increase output and this promoted industrial growth this year. In January-March there were increases in the production of non-alcoholic beverages, tobacco, edible oils, brandy, tea, milk products, oil products, concrete, gold, fertilizers and copper ore. Electricity output volume increased by 15.2 per cent. However, expensive electricity production in thermoelectric power stations was partially replaced by cheap hydro power electricity, that caused a decline in electricity production in value terms. Gold became one of the main exports of Georgia. Quarterly gold production continues to increase, up to 21, 962 ounces, that is about three times more than in Q1 2001. The production of oil and gas in Q1 2002 has substantially declined. The resources of oilfields exploited now in Georgia are quite limited, thus it is necessary to explore new deposits, which will require significant investment. As for the processing of oil, GAOR (Georgian-American Oil Refinery) has worked only for a few weeks in this year. The capacity of other oil-refineries is insignificant. The smuggling of oil products and the unsophisticated taxation system are main constraints on development the oil refining industry in Georgia.

Transport

In Q1 2002, the transportation of cargo by railway and motorway was 7.3 per cent in tonnage terms more than in the same period of 2001. The introduction of new flights to Russia and the gradual adjustment of problems related to granting Russian visas to Georgian citizens contributed to rise in the number of passengers on Georgian air carriers in this year.

In Q1 2002, Supsa sea port exported 1.5 million tonnes of oil, while in the corresponding period of last year exports had been 1.2 million tonnes. Poti and Batumi processed 2.7 million tonnes of cargoes, 8.6 per cent more than last year. However, serious problems appeared with the timely processing of oil tanks in Batumi sea port. This is why some tanker-cars full of oil stand idle, at great cost in fines. Poti is carrying out the construction of an oil shipment terminal by the Georgian company Potitransenergy. Its capacity is the processing of 4 million tonnes of oil and oil products. The terminal will be launched at the end of this year.

The Georgian "Ocean Shipping Company" together with a German company "Columbia Ship Management" is carrying out the management of the Georgian merchant fleet. After the collapse of USSR, Georgia retained 56 ships, thereafter the number of ships reduced to 26; of which 13 ships had been sold according to the credit agreement with main creditor "Hamburgische Landesbank". The rest of the ships were released from debt arrest and repaired. Since the end of 2000 the fleet has started to make an operating profit, which is directed to paying off debt. In this year "Ocean Shipping Company" has signed an agreement with Korean "Hyundai Mipo Dockyard Co., Ltd." for the construction of two new tankers with a capacity of 35 thousand tonnes of oil. According to the requirements of the international convention for the prevention of pollution from ships, single-hull oil tankers should be eliminated by 2015 or earlier. Double-hull tankers offer greater protection of the environment from pollution in certain types of accidents. The ships of "Ocean Shipping Company" do not meet new requirements, therefore they need replacement. New tankers will be launched in 2004.

BALANCE OF PAYMENTS

The current account strengthened in 2001. Compared with 2000, the current account deficit has declined from 8.8 per cent of GDP to 6.6 per cent. Lower industrial production in Q1 and the Turkish financial crisis had some adverse impact on the balance of payments in the beginning of year. However the strong increase in exports contributed to reduction of the current account deficit in 2001. Exports of services reached the highest level since 1995. Export revenues from transport and telecommunication services have substantially increased. The tourism industry generated income of GEL 667 million (10 percent of GDP), though its potential is still insufficiently utilised. Last year 91 new hotels with 1151 rooms were opened or re-opened, however the number of foreign tourists and visitors has reduced mainly to the crime situation and political instability in Georgia and in the whole Caucasus region.

Table 2.2: Balance of Payments, 1995-2001
(USD million)

	1995	1996	1997	1998	1999	2000	2001
Current Account	-363.4	-295.3	-499.1	-416.5	-197.4	-268.9	-211.4
Trade balance	-421.6	-313.2	-675.1	-760.4	-533.8	-511.5	-549.4
Export	289.5	372.3	377.2	300	329.5	459	496.1
Import	-711.1	-685.6	-1052	-1060	-863.4	-970.4	-1.045
Services	4.9	4.3	-147.8	-55.2	-3.9	-9.8	77.1
Export	110.5	98	167.9	289.9	216.7	206.2	313.9
Import	-105.6	-93.6	-315.7	-345.1	-220.6	-216	-236.8
Income	-60.6	-70.4	127.4	190.8	146.9	117.5	32.4
Credit	4	5.5	186.6	243.3	211.4	178.5	97.8
Debit	-64.6	-76	-59.2	-52.4	-64.4	-61.1	-65.4
Current Transfers	113.9	84.1	196.3	208.3	193.4	134.9	228.5
Credit	113.9	84.1	205.3	220.1	228.7	163.6	246.5
Debit	0	0	-9	-11.8	-35.3	-28.3	-18
Capital and Financial Account	210.2	323.6	378.5	421.4	336.8	66.5	237.7
FDIs	---	---	242.5	265.3	158.7	131.7	109.9
Portfolio Investments	0	0	2.4	0	0	2.7	---
Other investments	210.2	276.9	154	120.2	154.7	-83.2	179.9
Reserve assets	-40.6	-0.5	-14	42	30.4	20	-46.9
Net errors and omissions	112.5	-27.7	120.5	5	-169.8	202.4	-26.3

Source: State Department for Statistics.
Note: The above data includes the estimation of non-registered trade.

Foreign investment in Georgia is still on a downward trend. In 2001, it amounted to only USD 109.8 million, the lowest figure since 1997. Main targets of investments are: energy sector, transport and telecommunications, hotels and restaurants. With FDI as a percent of GDP at 3.4 per cent, Georgia lags significantly behind countries in Central Europe and the Baltic. Portfolio investments in Georgia are insignificant. This situation of weak FDI performance requires urgent measures to remedy the problem, though it is essentially a reflection of a generally unfavorable economic environment.

The situation with the capital and financial account is also very weak. A permanent current account deficit makes Georgia a net debtor country. With such small foreign investments and the high cost of debt service obligations, new loans and grants to the public sector, also trade credits remain the main sources of financing of the current account deficit. Against this background a positive trend observed in 2001 was the increase in gross international reserves that amounted to USD 159.3 million compared with USD 109 million at the end of 2000.

The current economic troubles induce many Georgians to leave the country. Russia remains the main recipient of Georgian migrants. Most Georgians emigrate with their families and some of them even become citizens of foreign countries. The introduction of a visa regime by Russia at the end of 2000 made the contacts of Georgians with their families more difficult, limited the movement of citizens and reduced the amount of transfers sent by migrants from abroad. This trend is shown below.

Table 2.3: Transfers of Georgian Workers from Abroad 1999, 2000, 2001
(USD million)

	1999	2000	2001
Transfers of short-term workers	211.4	178.5	94.3
Transfers of long-term workers	149.5	94.9	87.1

Source: State Department for Statistics

FOREIGN DEBT

As of 31 March 2002, Georgia's outstanding foreign debt amounted to USD 1,602 million (GEL 3,548 million), while the contracted debt amounted to USD 2,156 million. Compared with the end of 2001 the outstanding debt of the country has increased by USD 11 million. However, because of depreciation the Georgian Lari against US dollar, the foreign debt in national currency has increased by GEL 269 million. Depreciation of national currency obviously increases the costs of servicing the external debt in GEL; however, it remains to be seen whether an extended period of USD weakness against major currencies (6 per cent depreciation against the EURO since April 2002) will also lead to a strengthening of the Lari.

Georgia has already concluded agreements on re-scheduling foreign debt with all official creditor countries of the "Paris Club". However, relations with some other creditors, particularly Uzbekistan and Turkmenistan are not yet clarified. Especially problematic is the rescheduling of debt to the largest creditor, Turkmenistan arising from long-standing energy debts. Despite the Turkmen side’s refusal to accept conditions agreed in the "Paris Club", Georgia is continuing the servicing of debt to Turkmenistan. For this purpose, this year the Ministry of Finance plans to finance the repair and building of new fighter planes Su-25 costing USD 26 million and also the delivery of other goods in payment of debt and interest.

CHAPTER THREE: GOVERNMENT FINANCE

According to the 2002 State Budget, total revenues in Q1 were expected to reach GEL 216.7million, that is 23 per cent of revenue expectations for the whole year. Actual state revenues (including foreign grants) were GEL 200.1 million level, (92 per cent of target). Nevertheless this figure is a 20 per cent improvement over the year. Actual State budget expenditures of GEL 229.4 million were 47 per cent higher compared to the previous year. The main spending was on social security, debt servicing and general government.

STATE BUDGET REVENUES

State Budget incorporates a GEL 928 million revenue target for the year 2002. 23.3 per cent of yearly target was expected to be received in Q1. However Government expectations were only 92 per cent realised. The State received GEL 200.1 million instead of GEL 216.8 million. The shortfall of GEL 16 million was in tax revenues and a grants that were not fully disbursed. An outline of State Budget revenues is presented in Table 3.1 below.

Table 3.1: State Budget Revenues, Q1 2002
(GEL million)

	Target for the year	Target for Q1	Target share of Q1	Actual Q1 revenues	Actual compared to Target	Q1 revenues compared to Year target
Total Revenues and Grants	928.6	216.8	23.3	200.1	92.3	21.5
Total Revenues	851.1	205.8	24.2	198.8	96.6	23.4
Tax Revenues	771.3	163.9	21.2	156.6	95.5	20.3
Nontax Revenue	79.1	41.7	52.7	42.1	101.0	53.2
Revenues of Special State funds (excluding transfers from Central budget)	198.3	43.6	22.0	41.4	95.0	20.9
Grants	77.5	11.0	14.2	1.4	12.5	1.8

Source: GET calculations based on Ministry of Finance data.

Of GEL 200.1 million in total Sate budget revenues 78 per cent comes from tax revenues. The target for tax revenues was 96 per cent achieved. Non-tax revenues of GEL 42.1 million made up 21 per cent of the total figure while grants of GEL 1.4 million were 0.7 per cent of state revenues. Revenues of Special State Funds (basically included in tax revenues above) formed 20 per cent of total state receipts. The target here was 95 per cent achieved.

Table 3.2: Central Budget Tax Revenues. Q1 2002
(GEL million)

	Target for the year	Target for Q1	Target share of Q1 (per cent)	Actual Q1 revenues	Actual compared to target (per cent)	Q1 actual revenues compared to annual target (per cent)
Central Budget tax revenues	573.7	120.461	21.0	115.3	95.7	20.1
Income Tax	19.9	4.3	21.4	3.7	86.8	18.6
Corporate income tax	9.6	2.1	21.9	1.6	76.2	16.7
VAT	374.8	78.3	20.9	77.3	98.7	20.6
domestic	*203.5*	*43.1*	*21.2*	*44.1*	*102.3*	*21.7*
imports	*171.3*	*35.2*	*20.5*	*33.2*	*94.3*	*19.4*
Excise	104.7	21.9	20.9	20.8	95.0	19.9
domestic	*27.1*	*5.8*	*21.4*	*5.5*	*94.8*	*20.3*
Imports	*77.6*	*16.1*	*20.7*	*15.3*	*95.0*	*19.7*
Customs duty	59.2	12.7	21.5	10.5	82.7	17.7
Other taxes	5.5	1.2	21.8	1.4	116.7	25.5
1%social tax	*5.5*	*1.2*	*21.8*	*1.4*	*116.7*	*25.5*

Source: GET calculations based on Ministry of Finance data.

Tax revenues of central budget were 10 percent higher compared to the previous year. The figure is not fully comparable with that of the previous year as a 1 per cent social tax, previously a source for the Unemployment Fund[1], is now a source for the central budget. However amounts received from this source are not material as growth adjusted for changes is 9 per cent. **Direct taxes** collected were significantly lower than expected. GEL 1.6 million received under **corporate income tax** was short of target by 24 per cent while GEL 3.7 million of **income tax** for physical persons was only 86 per cent of the planned amount. However, a poor performance compared to planned figures does not necessarily indicate adverse changes in the economy. Comparisons with previous year figures show that collection of income tax remained unchanged and collection of corporate income tax had improved by 4 per cent.

Collection of **indirect** taxes has improved considerably compared to the previous year. **VAT** receipts were 9,3 per cent higher, while collection of **excise** duty improved by 13.7 per cent. Improvement in VAT collection is much higher for imported goods compared to domestic production 16.5 and 4.5 per cent respectively. Targets set by government for indirect taxes were met at much higher level compared to direct taxes. GEL 77 million of total VAT receipts were short of target only by 1.3 per cent. From this amount GEL 44 million comes from VAT on domestic products (102 per cent of plan) and GEL 33.2 million on imports (94 per cent of plan). GEL 20.8 million was collected under excise duty. Performance compared to target here was 95 per cent for both domestic and imported goods. Collection of Customs duty does not fit in the whole picture of tax collection. Collections of duty remained the same over the year while current targets were only 83 per cent achieved. As indicated above, both VAT and excise on imported goods are better administered than a year ago and targets achievement is higher. Such a discrepancy indicates significant imperfections in budget planning and/or mismanagement of customs operations.

In 2001, USD 701 million worth of imports were registered at customs. Goods amounting to USD 269 million were exempt from taxes while reduced rates were applied to USD 197 million of imports. Finally only 34.2 per cent of total imports were subjected to full rate import taxes. The scale of law enforcement activities against customs violations seems Inadequate. As a result of 427 revealed

[1] Unemployment fund was abolished in 2002.

cases of violation of customs law the State received only GEL 301 thousand. It is believed that there is much more potential for law enforcement activities in the customs sphere but the State is unable to undertake these activities efficiently or effectively.

Non tax revenues were collected in excess of budget. The GEL 42.1 million received under this category was 101 per cent of the planned amount. The Q1 target for this item was set at 52 per cent of expectations for the year. The reason for such a high share is the fact that usually by the end of Q1 the profit of National Bank is transferred to the budget. The detailed composition of non-tax revenues is provided in table below.

Table 3.3: Non-tax Revenues, Q1 2002
(GEL million)

	Target for the year	Target for Q1	Target share of Q1 (per cent)	Actual Q1 revenues	Actual compared to target (per cent)	Q1 actual revenues compared to annual target
Non-tax Revenue	79.1	41.7	52.7	42.1	101.0	53.2
Repayment of state credit	*9*	*1.5*	*16.7*	*2.7*	*180.0*	*30.0*
Revenue form Economic activities	*2*	*0.5*	*25.0*	*0.1*	*21.8*	*5.5*
Administrative fines	*2*	*0.5*	*25.0*	*0.2*	*46.2*	*11.6*
Other non-tax revenues	*66.1*	*39.176*	*59.3*	*38.995*	*99.5*	*59.0*

Source: GET calculations based on Ministry of Finance data.

NBG profit is included in the Other Non-tax Revenue heading. The target for the second largest item of non-tax revenues, repayment of state debt (issued in previous years), was 180 per cent achieved. At the beginning of 2002, the total amount of government credit issued to Georgian companies (65 companies) in previous years was GEL 155 million. With accrued interest and penalties, the total amount due was GEL 208 million. From this amount only GEL 16.5 million (7.9 per cent) was returned to the State.

The main development in special state funds was that from the beginning of the year the Unemployment Fund was abolished. Own revenues of existing special state funds of GEL 41.4 million were collected, that is 95 per cent of the planned level. Details on sources of Special State Funds are provided in table below.

Table 3.4: Revenues of Special State Funds, Q1 2002
(GEL million)

	Target for the year	Target for Q1	Target share of Q1 (per cent)	Actual Q1 revenues	Actual compared to target (per cent)	Q1 actual revenues compared to annual target (per cent)
Revenues of Special State Funds (excluding transfers from Central budget)	198.3	43.6	22.0	41.4	95.0	20.9
United State Social Safety Fund	156	34.5	22.1	33.6	97.5	21.5
Social tax (Employer contribution)	*150.6*	*33.5*	*22.2*	*32.2*	*96.2*	*21.4*
Social tax (Employee contribution)	*5.4*	*1.0*	*17.6*	*1.3*	*141.4*	*24.9*
Roads Fund	42.3	9.1	21.6	7.8	85.4	18.4
Excise on oil products	*15.1*	*3.3*	*22.0*	*3.0*	*90.8*	*20.0*
Cross border tax	*10*	*1.8*	*18.5*	*1.0*	*52.1*	*9.6*
Other taxes	*16.5*	*3.8*	*23.2*	*3.7*	*96.5*	*22.4*
Other revenue	*0.7*	*0.1*	*20.0*	*0.1*	*90.4*	*18.1*

Source: GET calculations based on Ministry of Finance data.

Employer contributions to the social security fund were 96 per cent of target, better than collection of income tax which has a similar tax base. However collections of employee contributions which has a tax base exactly proportionate to that of employer, were 41 per cent in excess of the planned amount. Revenues of the Roads Fund were GEL 7.8 million, that is 85 per cent of planned amount. Revenues of cross-border tax were extremely low (52 per cent of target) while revenues from other sources were short of target by less than 10 per cent. Cross-border tax is charged for transit road transport passing through Georgia's borders. Low revenues under this category indicates that Georgia's transit potential is not utilised as much as was expected by government.

Only 12 per cent of expected foreign **grants** were received in Q1. The shortfall here was GEL 10 million. Only 39 per cent of a World Bank grant was paid. Other expected grants were GEL 8.3 million of which only 3.9 per cent were paid. Grants from the largest donor, the European Union, are expected later in the year. In past ten years European Union has granted Georgia EUR 342 million.

Table 3.5: Foreign Grants, Q1 2002
(GEL million)

	Target for the year	Target for Q1	Target share of Q1 (per cent)	Actual Q1 revenues	Actual compared to target (per cent)	Q1 actual revenues compared to annual target (per cent)
Grants	77.5	11.0	14.2	1.4	12.5	1.8
European Communities food program	*23.4*	*0.0*	*0.0*	*0.0*		*0.0*
European Communities special financial aid programme	*22.3*	*0.0*	*0.0*	*0.0*		*0.0*
World Bank Investment Projects	*10.8*	*2.7*	*25.0*	*1.0*	*38.7*	*9.7*
Other grants	*21*	*8.3*	*39.5*	*0.3*	*3.9*	*1.6*

Source: GET calculations based on Ministry of Finance data.

The **deficit** of State budget was GEL 29.2 million. From this amount GEL 25.8 million came from external sources.

STATE BUDGET EXPENDITURES

State budget expenditures in Q1 2002 amounted to GEL 229 million. The figure shows a 48 per cent increase over government spending of the corresponding period of 2001. However actual Q1 spending covers only 20 per cent of budgeted spending for the year. Thus government hopes that expenditures in following quarters will be higher. The same situation, where Q1 expenditures are considerably lower compared to others, was observed in three previous years. A breakdown of State Budget expenditures by function is provided in table below:

Table 3.6: State Budget Expenditures by Function, Q1 2002
(GEL million)

	Q1 2002	Q1 2001	Per cent in total	Growth over the year
General Government	42.8	11.1	18.7	385.7
Defence	7.9	3.9	3.4	203.7
Law and Order	18.0	11.9	7.9	151.7
Education	7.2	4.7	3.1	153.1
Health Care	8.3	3.1	3.6	264.1
Social Security	58.2	54.0	25.4	107.8
Housing and Heating	1.0	0.6	0.4	170.2
Culture Sports Religion	5.6	3.4	2.4	163.2
Energy-Heating	11.4	6.1	5.0	188.9
Agriculture	1.2	1.3	0.5	92.6
Construction and Mining	0.1	0.1	0.0	153.1
Transport and Communications	8.5	6.7	3.7	127.2
Other Economic Activities	0.5	0.3	0.2	152.2
Other	58.7	47.9	25.6	122.4
Total	229.4	155.1	100.0	147.9

Source: GET calculations based on Ministry of Finance data

The largest item of government spending is under the category Other. GEL 58 million was spent under this heading; a 22.4 per cent (lower than average) growth over the year. The amount is mainly comprised of interest payments on state debt of GEL 31.5 million, subsidies and current transfers to lower level budgets of GEL 11.9 million and goods and services purchased of GEL11.3 million. The second largest expenditure item was social security. Growth here was only 7.8 per cent compared to an average growth of 47 per cent. The main items under social security spending were goods and services purchased of GEL 30.9 million and subsidies and current transfers of GEL 26.7 million. Spending on General government amounted to 18 per cent of total state budget expenditures. Growth over the year is considerable here; GEL 42.8 million in Q1 2002 against GEL 18 million in Q1 2001. Available information does not allow to make meaningful conclusions on the reasons for this growth based on Q1 figures. Other functional categories were each less than 10 per cent of total expenditures.. Growth for all categories except agriculture and housing was higher than average.

Breakdown of state budget expenditures by economic category is provided in the table below.

Table 3.7: State Budget Expenditures by Economic Category
(GEL million)

	Q1 2002	Per cent in total	Q1 2001	Growth over the year
Total Expenditures	229.4	100.0	155.1	147.9
Salaries	19.2	8.4	11.6	165.0
Business trips	1.4	0.6	2.9	47.7
Social Contributions	4.4	1.9	0.8	518.4
Other goods and services	56.9	24.8	46.0	123.6
Interest payments	31.5	13.7	31.1	101.4
Subsidies and current transfers	68.1	29.7	46.9	145.3
Capital expenditures	9.5	4.1	7.1	134.6
Programme Expenditures	6.5	2.8	1.9	349.4
Net Lending	31.9	13.9	6.8	470.6

Source: GET calculations based on Ministry of Finance data

29.7 per cent of state budget expenditures were subsidies and current transfers. The figure is 45 per cent higher compared to corresponding period of previous year. Transfers ware mainly of social nature (transfers to local budgets and social security fund) however GEL 11 million was a subsidy to energy sector. Other goods and services were purchased for GEL 56.9 million. Half of the amount was spent for social security needs. Growth under this category was lower than average (23.6 per cent). 13.9 per cent of state budget expenditures under Net Lending category were programs financed by international financial institutions. Interest payments were 13.7 per cent of total state budget exenditures of which GEL 13.8 million was paid for external debt servicing while GEL 17.7 million on domestic debt. Salaries of state employees wee paid at GEL 19.2 million 65 per cent higher compared to previous year, however growth rate of social contributions paid by state as an employer was 518 per cent. This reflects the fact that the state was not always paying social contributions corresponding to paid salaries.

CHAPTER FOUR: MONEY AND FINANCE

MONETARY INSTRUMENTS

According to 2002 Budget, the annual targets for Budget deficit financing from domestic sources related to the monetary policy are the following: GEL 30 million – NBG's net lending, and GEL 20 million – net financing to be received from T-Bills issuance and placement. One of the main common goals for the National Bank of Georgia and the Ministry of Finance is a gradual move from direct lending to the Central Budget toward financing through issuing Government Treasury Bills. More precisely this measure includes changing of the domestic debt's structure. Also in 2002, the Ministry of Finance intends to increase issuance volume and introduce T-Bills with 237 days' maturity.

The main aim for T-Bills' policy in 2002 is to create an active secondary market and continue to diversify the structure of investors. The NBG and the Ministry of Finance targeted policy to increase investors' interest in T-Bills has been successful so far. A crucial change occurred toward the diversification of the primary market. In May 2002, the share of non-banking investors on the primary market increased to 73 per cent against 8 per cent in 2001. However, the T-Bills market faces some problems, which require a gradual resolution.

The existing high investment risk also affects investors' behaviour on the primary market. The recent period's practice shows that investors prefer short-term liquidity instruments. There are T-Bills of 28 to 182 days' maturity issued by the MoF, however 140 and 182 days maturities are characterised by low demand. The demand was almost insignificantly more or even less than the volume of issuance.

Table 4.1: Issue and Demand for 140 and 182 Days Maturity T-Bills

Maturity	Date of issue	Volume of issue	Demand	Average annual weighted interest rate (per cent)
140	12.12.01	3,000,000	3,137,400	36.40
140	19.12.01	1,000,000	1,131,000	32.00
140	27.02.02	1,000,000	819,000	81.40
182	19.09.01	500,000	500,000	57.99
182	03.10.01	1,200,000	1,413,000	44.00
182	17.10.01	1,200,000	603,700	53.99
182	31.10.01	1,300,000	298,500	59.96
182	14.11.01	1,500,000	1,550,800	36.00
182	21.11.01	4,200,000	4,126,600	38.22
182	28.11.01	1,500,000	1,253,000	37.58
182	05.12.01	3,000,000	3,349,700	36.00
		Total 19,400,000	**Total 18,182,700**	

Source: National Bank of Georgia

Solving of this problem is linked with measures on improvement of economic and political environment, confidence in the Government, as well as popularisation of this instrument among all groups of potential investors. The population could be a very significant segment of the T-Bills investors. The main task to accumulate individuals' savings is to build the population's trust in this instrument.

The notorious problem of absence of a realistic approach during the Budget process creates a large impediment in defining the volume and a schedule of forthcoming issuance. Due to the spasmodic character of tax revenues inflow the bulk amount of tax revenues is accumulated on the Treasury's accounts during the last days of the month. All these are the reasons why the MoF faces difficulties with forecasting possible budget revenues and determine the necessary size of domestic borrowing during a period of time. Under these circumstances potential investors are unable to create their long-term investment strategy, which in its turn hampers the progress of the market's development. To calculate an amount of domestic borrowing through T-Bills and work out an issuance schedule a realistic forecast of budget revenues and expenditures and borrowing is required. To achieve that goal the MoF should make every effort to set up a unified methodology of budget planning and forecasting.

In Q1 2002, there were only two Lombard credits issued amounting to GEL 1.3 million. However, it was more than in all 2001. It indicates that commercial banks try to use disposable T-Bills as an instrument opportunity to settle short-term liquidity problems. It would be rather premature to recognise it as a trend. However, it gives an opportunity to believe in the further development of the instrument.

Table 4.2: Lombard Credits Issued in 2002

Date	Amount (GEL)	Maturity (days)	Annual interest rate (per cent)
29.03.2002	650,058	7	57.40
05.04.2002	654,504	7	45.35

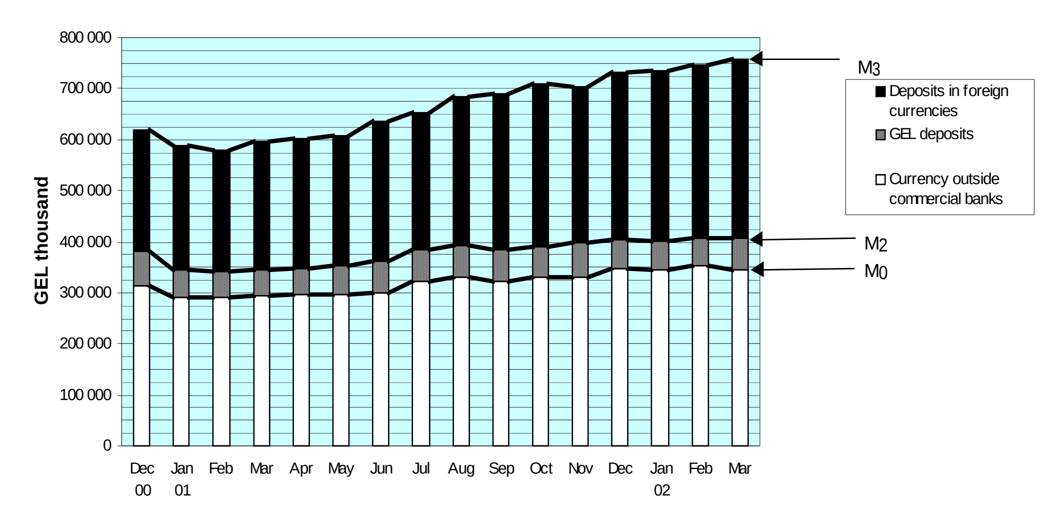
Source: National Bank of Georgia

MONEY SUPPLY

The current trend in the money supply is determined by the strict monetary policy which is an essential source of macroeconomic stability in Georgia. The monetary policy in 2002 is oriented on maintaining the annual inflation within the 4-6 per cent through rigorous control over money creation. Within the conditions of fiscal and budget difficulties, the slow development of the production sector and an import- oriented economy, the only way to avoid inflationary creation of money is the strict control over the money supply. The direct Government borrowing should be gradually substituted by the issuance and management of domestic debt instruments. The Budget Law on 2002 sets up GEL 30 million annual targets for the net lending to the Government. In 2001, annual indicators for the NBG's international reserves achieved 1.25 months of imports. Following that the National Bank should maintain its international reserves on the level of 1.05 months' import in 2002 and keep M1 reserve money indicator on the level of 12.5 per cent of GDP. M3 growth should be no more than 19 per cent of GDP.

By the end of March 2002, the NBG international reserves' indicator was kept within the target and consisted of 6.2 weeks of imports of goods and services (the SDS calculations). Actual increasing of net international reserves was faster than it was targeted and was attributed to relatively fast growth of M1 (by 7 per cent for Q1 2002) while usually this indicator falls or grows insignificantly in Q1 of the year. As the figure above shows, M3 broad money increased in Q1 2002 mainly at the expense of foreign currency deposits' growth. Compared with March 2001, the volume of foreign currency denominated deposits increased dramatically (by 40.5 per cent). One could say that during one year's period some cash in circulation moved from the informal into the banking sector. At the same time, limited issue of the legal tender regulated by a strict monetary policy has resulted in relatively modest growth of the national currency denominated deposits (19 per cent since March 2001).

Figure 4.1: Money Supply, December 2000 – March 2002



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

Within the existing policy toward small Lari emissions and unregistered inflow of cash foreign exchange through the informal sector the abovementioned tendency of dollarisation of deposits and the whole economy is very likely to be continued. The level of the national currency credibility is still low that is one of the biggest problems for the Georgian banking system and for the economy as a whole. Political, economic and historical reasons have transformed this problem into a permanent one, and the prospect of reversing this process in the near future is very weak. However, current inflow of foreign exchange through both official and unregistered sectors is less that it could be. The reason is a deterioration of the trade balance with Georgia's biggest partners caused by the stagnation of the world economy and relatively weaker demand for Georgian goods and services in Turkey.

Table 4.3: Monetary Ratios

	2001							2002		
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Dollarisation Ratio %	81.5	81.5	82.6	82.9	83.9	82.0	85.7	85.6	86.0	85.5
Money Multiplier (M2)	0.95	0.95	0.94	0.95	0.95	0.95	0.94	0.93	0.94	0.94
Money Multiplier (M3)	1.66	1.57	1.65	1.70	1.71	1.68	1.70	1.70	1.71	1.75

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

The process of dollarisation of the economy caused the increase of commercial banks' loans dollarisation. In 1997, the share of lari-denominated loans issued to NGOs and private companies was 60.9 per cent, while in Q1 2002 it fell to 27 per cent (the SDS information). Such a tendency makes banks open for injury in the case of Lari exchange rate crisis, and deepens the problems of bad loans and liquidity shortage. (See Banking sub-chapter below).

DOMESTIC INFLATION

Table 4.4: Monthly Consumer Price Index and Inflation, 2001
(December 2000 = 100)

		Price Index	Inflation from previous month
2001	**Jan**	100.70	0.70
	Feb	101.30	0.60
	Mar	101.30	0.00
	Apr	102.32	1.00
	May	101.29	-1.00
	June	100.89	-0.40
	Jul	100.18	-0.70
	Aug	100.48	0.30
	Sep	99.88	-0.60
	Oct	100.58	0.70
	Nov	101.99	1.40
	Dec	103.42	1.40
2002	**Jan**	135.44	2.0
	Feb	137,02	1.2
	Mar	137,53	0.4
	Apr	140,00	1.8

Source: State Department for Statistics

Maintaining a low level of inflation is one of the main directions of monetary policy in 2002 under the IMF Poverty Reduction and Economic Growth Facility (PREGF). The actual inflation rate for January-April 2002 was likely to exceed programme targets. In April 2002, the accumulated indicator of monthly inflation reached 5.4 per cent. The annual targeted inflation for 2002 was 4-6 per cent, that means 0.42 per cent average monthly inflation. According to the State Department for Statistics calculations, the average monthly inflation for the first four months of 2002 was 0.55 per cent. Lari devaluation at the end of 2001 and the beginning of 2002 is one of the explanations of the higher inflation rate, because the level of inflation in Georgia strongly depends on the GEL nominal exchange rate. Meanwhile, the SDS reports that growth of prices on agricultural products (mainly the seasonal growth of prices on fruit and vegetables) was, at the same time, a reason for the high accumulated inflation rate since the beginning of the year. The consumer basket consists of 269 items, however the level of consumer prices in Georgia generally depends on changing prices for agricultural producs (especially tobacco), and energy resources.

BANKING

The recent year's experience shows a substantial progress in the banking sector of Georgia. The number of banks decreased from 228 by the end of 1994 to 28 by the end of May 2002[1], mostly at the expense of insolvent banks and those that could not meet the NBG's special requirements. The 10 largest commercial banks control about 85 per cent of total assets, 88 per cent of gross loans and 64 per cent of total capital within the banking system. They also control 93 per cent of the system's liabilities and 63 per cent of total profit.

Notwithstanding all those positive changes that have taken place in the banking sector, there are problems having long-term character and requiring structural changes in the sector and improvement

1 This figure includes two existing branches of foreign banks.

of the political and economic situation in a broader sense as well. Confidence in the banking system in Georgia is low; loan portfolio management is weak; and intermediation costs are high. Most transactions are made in cash reflecting the high level of the informal economy (about 60 per cent of the taxable sector in 2001, according to the SDS information). The payment and settlement system are at an initial stage of development. Banks have very limited access to market sources of liquidity.

The main direction of current reforms in the banking sector is to create stable and capitalized banks with a wide range of services, diversified investment portfolio, adequate risk management and high confidence among institutional investors and population. The problem of risk is very topical since successful banking activity means prompt risk management that is extremely important for Georgian banks having the biggest share of income from loans. In 2001, 92 per cent of interest income of commercial banks was from issued loans. In Q1 2002, this indicator was 52 per cent. Substantial steps toward developing the banking system were made in 2001 by improvement of the supervising process over problematic banks, issuing new criteria of banking assets' classification and implementation of International Accounting Standards in commercial banks. In 2002, significant steps are planned to be made to improve the level of top managers and shareholders in commercial banks, as well as to enforce legislative measures against money laundering.

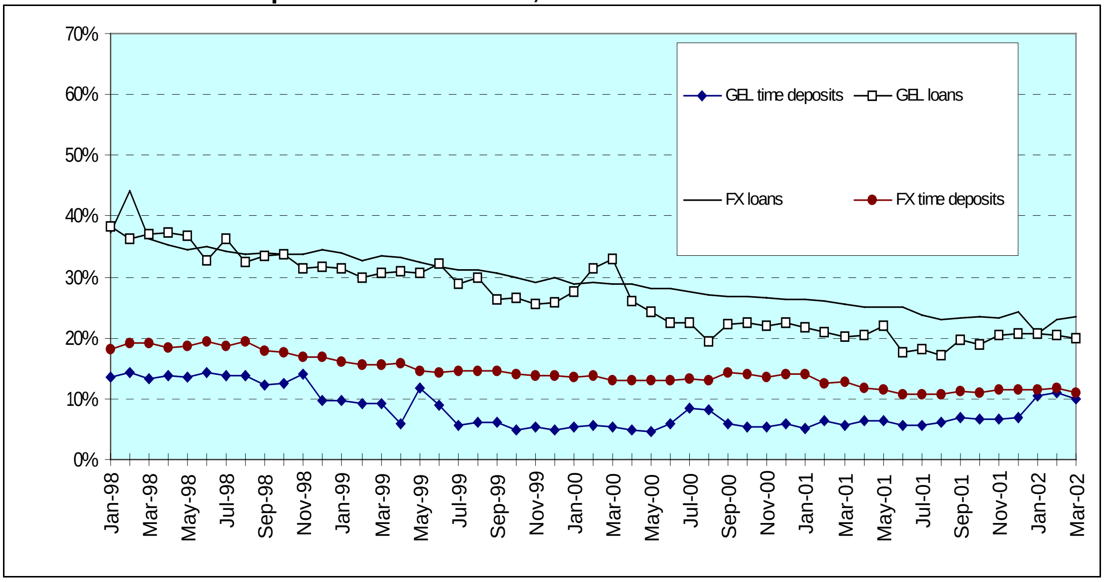
Commercial banks' largest share of loans is still issued to finance trade, while industry and agriculture sectors' possibilities to obtain bank loans remain limited. According to the National Bank's data, in March 2001, 70 per cent of total loans were allocated to trade, while by March 2002 that indicator achieved 77 per cent. Commercial banks finance mainly importers, which leads them to create foreign exchange denominated assets that in its turn increases exchange rate risk. At the same time, lending to the industrial sector shows a downward trend. In March 2001, the share of industry in total loans issued to private sector was 20 per cent, however in March 2002 it fell to about 16 per cent. The shares of trade and industry (excluding construction) in total GDP were almost the same (12.8 and 13.3 per cent correspondently), while trade absorbed almost four times more money than industry. Almost all industrial fixed assets have to be renewed, however the banking sector is undercapitalized to finance that. High credit and exchange rate risks and financial insolvency of potential borrowers are serious barriers. Banks bear high credit risks due to their dollar-denominated lending to borrowers with no regular source of foreign exchange earnings. Those banks that receive foreign credit lines have to issue dollar-denominated loans to their borrowers. Those credit lines are intended for enterprises, many of which do not have income in foreign exchange. One of the important steps to increase the banks' role in lending of industry and agriculture is to provide all necessary measures to move cash from the non-registered sector into banking one, though, it is a very difficult task within the high level of unregistered economy and corruption in the country. At the same time, increasing of accumulated long-term savings of the population in commercial banks would be crucial in solving the problem. One of the possible ways to do that is the development of a pension funds system that would accumulate and then place individual savings in banks. However, this is linked with necessity to increase credibility of banks and pension funds among the population. It will be a difficult task due to previous 8-10 years history, when there was a number of “pyramids” that gathered peoples' money and later either disappeared or became insolvent.

One may say that the development of the whole Georgian banking system in the near future will depend on factors such as: investments and economic growth and development of private sector. Strong clients of commercial banks will increase the level of deposits in the banks and this, in their turn, will positively affect the level of savings and confidence in the banking system.

The main source of Georgian commercial banks' income remains income from loans while universalised banks in developed countries receive the bulk of their income from commission fees from various services and operations. In Q1 2002, the share of fees and commissions in total income was 11 per cent of the total income and 6 per cent – of conversion operations. The structure of interest income changed slightly during the year toward increased share from loans to individuals from 17 per cent to 22 per cent in Q1 2002.

Notwithstanding the fact that net interest margin between deposits and loans is high (about 13 per cent as of 1st April, 2002) the basic business of commercial banks, such as lending, is not profitable enough because of the high rate of loan loss provisions that should be maintained by commercial banks within the weakness of collateral and insurance mechanism. In its turn, this fact is a serious obstacle to decreasing the net interest margin. Interest rates on foreign currency denominated loans and deposits are generally higher than those denominated in the national currency (see Figure 4.2).

Figure 4.2: Loans and Deposits Interest Rates, December 1998 – March 2002



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

This can be explained by banks striving to improve their foreign exchange liquidity position by dollarisatin of their balance sheets. Another reason is the fact that almost all lending of commercial banks is foreign currency denominated, while the lari lending is not available for all clients and interest rates reported by the commercial banks do not reflect the actual business done.

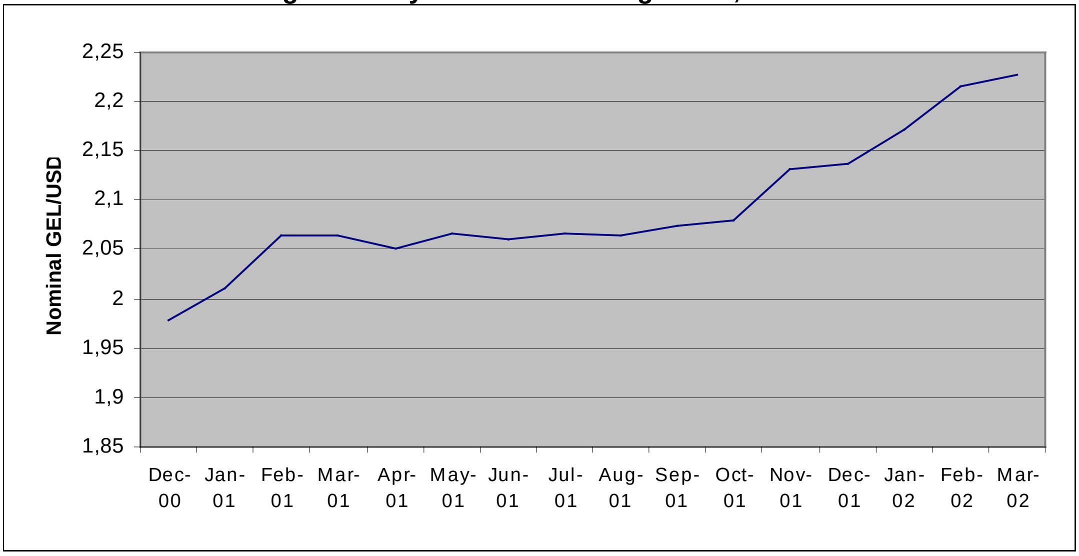
In Q1 2002, the interest rates for foreign currency denominated time deposits and those in Lari became almost the same, though it is difficult to see any trend there. One possible explanation of that is that banks started to express more interest in Lari denominated assets due to their increased willingness to create liquidity portfolio in national currency and then make investments in the domestic debt instruments.

EXCHANGE RATE AND DOMESTIC FOREIGN EXCHANGE MARKET

The targets for year 2002 foresee purchasing of USD 23 million to keep international reserves equal to about 1.5 months of imports of goods and services. The NBG has to maintain free float exchange rate and continue its policy of non-intervention in support of the Lari nominal exchange rate.

The average monthly nominal exchange rate of the Lari continued to depreciate slightly vis-à-vis the USD. It was caused by increasing of the domestic foreign exchange market's demand due to the deterioration of the trade balance with the main trade partners of Georgia –Turkey, Azerbaijan, Russia. (See Statistical Appendix Tables A 5.1.1 and A 5.1.2). At the same time, the depreciation of the nominal exchange rate of the Lari against the US dollar was followed by gradual appreciation of the Lari in real terms. This gives an opportunity to improve the trade balance in future. Turkish economy's future developments may also have a significant effect on Georgian exports.

Figure 4.3: GEL/USD Average Monthly Nominal Exchange Rate, 2000 - 2002



Source: National Bank of Georgia

CHAPTER FIVE: INTERNATIONAL TRADE AND FOREIGN ECONOMIC RELATIONS

Despite the fact that in Q1 2002, the SDS recorded a 3.7 per cent GDP growth, export development, a major factor for acceleration of economic growth, remains one of the most urgent problems. The export-import balance for most goods was negative. Comparing the results of Q1 2002 for foreign trade with those of the preceding years, a certain deterioration is evident. Total exports of goods decreased, as well as export volumes of goods of Georgian origin. Exports to the CIS countries decreased from last year. Georgian exporters, who started developing their markets in Russia and other CIS countries in 2001, were not able to maintain their market shares and expand the volumes of exported products because of trade barriers.

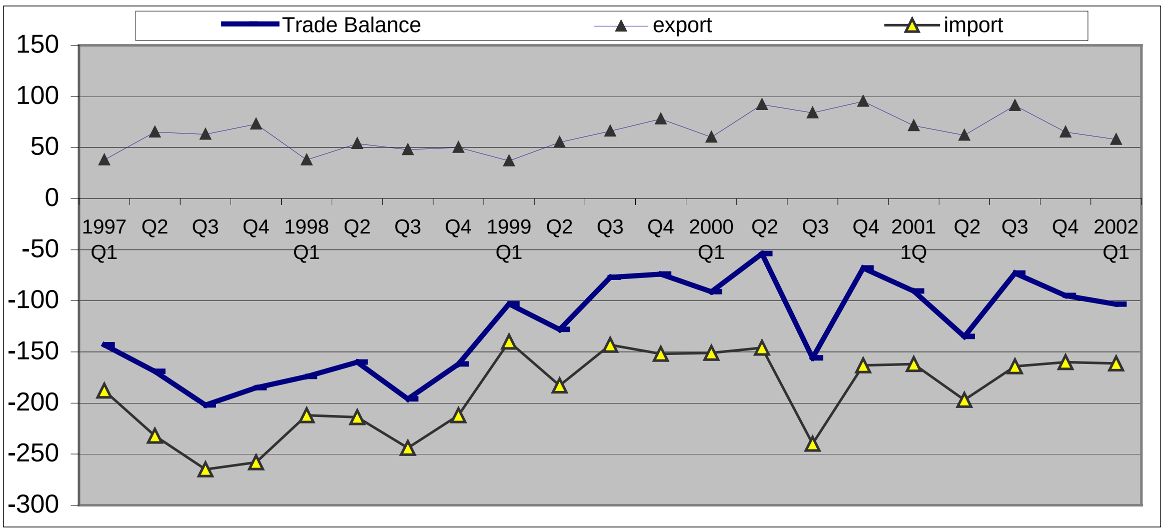
TRADE TURNOVER, TRADE BALANCE AND DIRECTION OF TRADE

The figures below suggest that the growing negative trade balance trend continued during Q1 2002. Recorded external trade turnover was equal to USD 219.6 million, of which exports were USD 58.2 million and imports USD 161.4 million. The trade deficit of USD 103.2 million is about USD 12 million more than in Q1 2001.

During the recorded period, Georgia had a trade deficit with 77 countries. Exports declined by USD 14 million, reflecting a decrease of exports of non-ferrous scrap metal, following the introduction by Parliament of a temporary ban on the export of non-ferrous scrap metals until the end of 2003. The analysis of the structure of trade by countries shows that during Q1 2002 Georgia's export to Russia fell by 50 per cent year on year. This could be explained by growing non-tariff (NTB) and administrative barriers in Russia against Georgian goods.

The export coverage of import ratio decreased during Q1 2002 to 35.5 per cent, while in the first quarter 2001 the ratio was 44.1 per cent.

Figure 5.1: Registered Exports, Imports and Trade Balance, Q1 1997 –Q1 2002
(USD thousands)



Source: Data from the State Department for Statistics

The share of the ten main trade partners in the total registered trade turnover was 75.4 per cent. As indicated in Table 5.1, the main partners in the first quarter of 2002 were Russia, Turkey, Azerbaijan and Ukraine. These countries together represented about 50 per cent of Georgia's registered trade turnover.

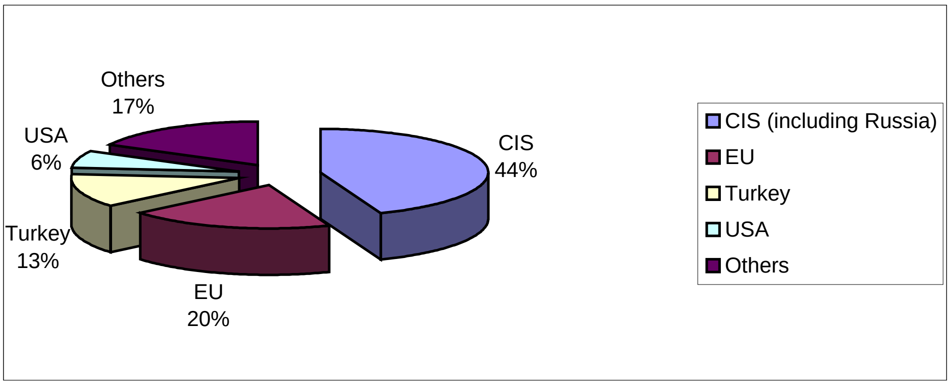
Table 5.1: Registered International Trade Turnover and Direction of Trade, Q1 2002
(USD thousands)

International Trade Turnover	Import (CIF)		Export (FOB)		Trade Turnover	
	USD	Per cent	USD	Per cent	USD	Per cent
Total	**161,426**	**100**	**58,190**	**100**	**219,616**	**100**
Main partner countries (total)	119,013	73.7	46,670	80.2	165,683	75.4
Russia	37,342	23.1	10,253	17.6	47,595	21.7
Turkey	20,262	12.6	12,657	21.8	32,919	15.0
Azerbaijan	14,587	9.0	2,145	3.7	16,732	7.6
Ukraine	10,380	6.4	1,999	3.4	12,379	5.6
USA	10,297	6.4	1,942	3.3	12,239	5.6
Germany	10,767	6.7	1,033	1.8	11,800	5.4
UK	4,085	2.5	7,649	13.1	11,734	5.3
Armenia	3,807	2.4	3,478	6.0	7,285	3.3
Switzerland	2,118	1.3	4,390	7.5	6,508	3.0
Italy	5,368	3.3	1,124	1.9	6,492	3.0
Others	**42,413**	**26.3**	**11,520**	**19.8**	**53,933**	**24.6**

Source: State Department for Statistics

During Q1 2002, CIS and EU accounted for 64 per cent of Georgia's registered imports. Turkey accounted for another 13 per cent. Imports from USA were relatively small.

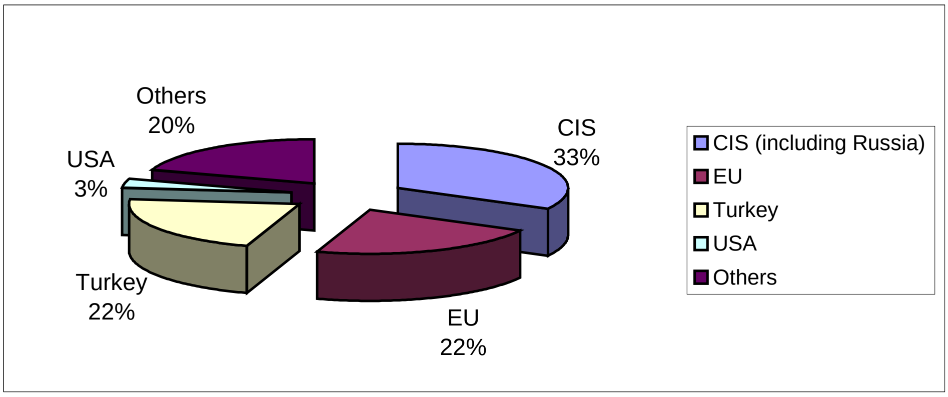
Figure 5.2: Georgia's Registered Imports by Regions, Q1 2002



Source: Data from the State Department for Statistics

Q1 2002 was characterized by a sharp decrease of exports to Russia. This is an indication of increasing use of NTB's against Georgia's exports to this country. That is why the share of CIS in recorded exports decreased from 40 per cent in Q1 2001 to 33 per cent in Q1 2002. While the share of EU and the neighboring country Turkey remains unchanged.

Figure 5.3: Georgia's Registered Exports by Region, Q1 2002



Source: Data from the State Department for Statistics

COMPOSITION OF REGISTERED EXPORTS

10 product groups represented about 67 per cent of all registered exports during Q1 2002. Ferrous scrap (HTS chapter 7204) and ferroalloys (HTS chapter 7202) together accounted for 19 per cent of all exports in the recorded period. Together with the traditional markets in Turkey and Russia the countries of destination for this product category were Greece and USA.

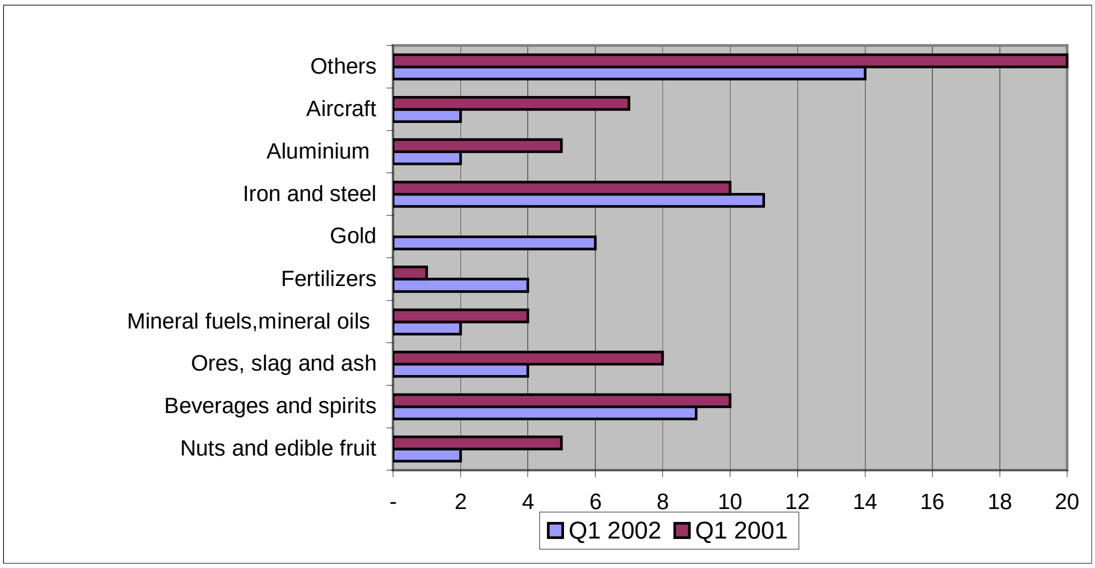
Gold (HTS chapter 7108) in semi-manufactured forms has become an important export item valued at USD 6.4million, which was about 11.1 per cent of all exports. The destination for this export item was the UK.

The trend, which has been observed in the previous years, continued in Q1 2002. Russia is still the traditional importer of Georgian wines. The destinations of the exports of wine from fresh grapes (HTS chapter 2204) during Q1 2002 were Russia (75.5 per cent), Ukraine (10 per cent), USA (7 per cent) and Latvia (2.7 per cent). These figures are a reflection of the heavy dependence of Georgian wine industry on the Russian consumption market, which puts this industry at risk. In this respect, access to new markets should be priority for Georgian wine exporters. It is worth mentioning that in order to popularize the Georgian wine industry the Union of Wine-makers and Viticulturists of Georgia, with a grant specially allotted by Eurasia Foundation and financed by USAID, is jointly implementing a Web-portal project. The web-portal is based on the first comprehensive electronic information-searching system about Winemaking and Viticulture of Georgia, developing within the project, which together with interactive components of the portal will be a helpful gateway to the Georgian wine business and the industry in general.

Chemical fertilizers (HTS chapter 3102) represented 7.5 per cent of registered exports. The destinations of this category of exports were Turkey (30 per cent), Gibraltar (30 per cent), Azerbaijan (14 per cent) and Greece (13 per cent).

Other main export items are: copper ores and concentrates (HTS chapter 2603), natural and mineral waters (HTS chapters 2201 and 2202), aluminum waste and scrap (HTS chapter 7602), aluminum, unwrought (HTS chapter 7601). These together represented 3.3 per cent of all exports in the recorded period.

Figure 5.4: Georgia's Registered Exports by Product Categories, Q1 2001 –Q1 2002
(USD million)



Source: Data from the State Department for Statistics

Turkey, Japan, Iran and India were the main markets for this product category. Despite the fact that there was significant growth of export of military aircraft during 2001, in Q1 2002 the export of this item took seventh place at USD 2.3 million (4 per cent of all exports). The destination of these exports instead of traditional partner countries Turkmenistan and Russia was the Gambia.

Most attention should be paid to market investigations, promotion of new market search and penetration, formation of a positive image of Georgian goods and services abroad, establishment of commercial representations, and provision of support for the enhancement of competitiveness of Georgian goods and services.

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

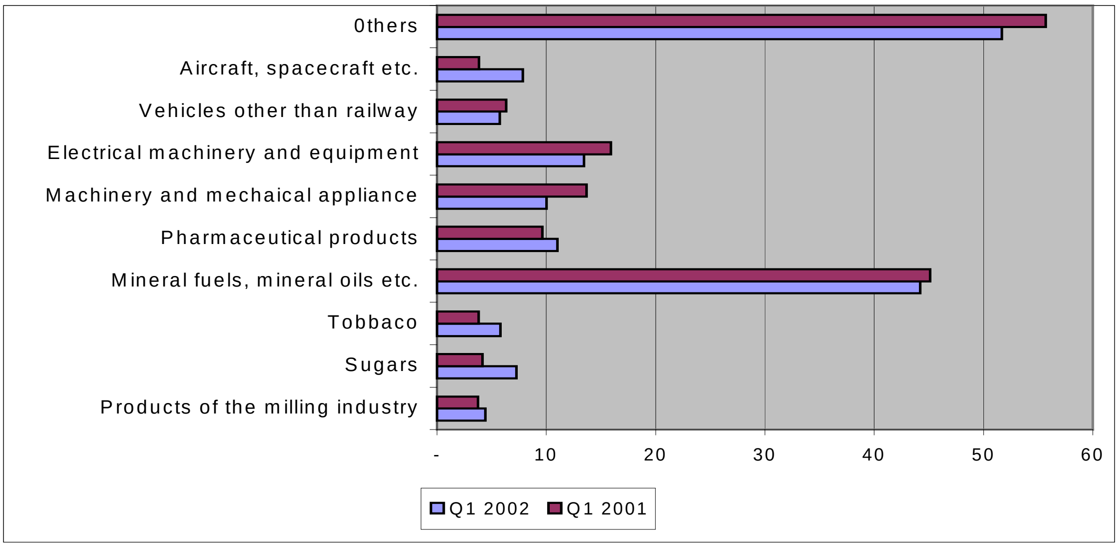
Table 5.2: Composition of Registered Exports According to the Harmonized Commodity System by HTS 4-digit Categories, Q1 2002

	Q1 2002	
	USD thousands	Per cent
Total exports	**57,667**	**100**
Ferrous waste and scrap: ingots of iron or steel-7204	8,854	15.4
Gold, unwrought or in semi manufactured forms, or in powder form -7108	6,413	11.1
Wine of fresh grapes, including fortified wines -2204;	4,886	8.5
Mineral or chemical fertilizers, nitrogenous –3102.	4,313	7.5
Copper ores and concentrates –2603	3,334	5.8
Waters, including natural or artificial mineral waters- 2201, 2202;	3,287	5.7
Aircrafts, spacecraft, and parts thereof – 8802	2,321	4.0
Ferroalloys -7202	2,006	3.5
Aluminum waste and scrap-7602; aluminum, unwrought – 7601	1,895	3.3
Nuts, fresh or dried – 0802;	1,536	2.7
Other	18,822	32.6

Source: State Department for Statistics

COMPOSITION OF REGISTERED IMPORTS

Figure 5.5: Georgia's Registered Imports by Product Categories, Q1 2001 –Q1 2002
(USD million)



Source: Data from the State Department for Statistics

Despite the fact that a significant share of Georgian imports was not recorded at all, the figures suggest that Georgia's dependence on foreign energy continues. As in 2001 imports were dominated by mineral products in Q1 2002. The import of petroleum gases, oils, and electrical energy together represented about 28 per cent of total recorded imports. Imports of medicines (HTS chapter 3004) accounted for 6.5 per cent of recorded imports. The share of food (milling industry, wheat) is slowly decreasing. Table 5.4 shows the largest imported product groups that together constituted about 55 per cent of total imports in Q1 2002. Other major imported products are airplanes (4.9 per cent), sugar (4.3 per cent) tobacco (3.6 per cent), and others (see Table 5.4).

Table 5.3: Composition of Registered Imports According to the Harmonized Commodity System by HTS 4-digit Categories, Q1 2002

	Q1 2002	
	USD thousands	Per cent
Total imports	**161,414**	**100**
Petroleum gases and other gaseous hydrocarbons -2711	17,731	11.0
Petroleum oils and oils from bituminous minerals (other than crude) – 2710	16,185	11.0
Medicaments –3004	10,416	6.5
Electrical energy – 2716	9,410	5.8
Airplanes, other aircraft, spacecraft and spacecraft launch vehicles– 8803	7,854	4.9
Cane or beet sugar -1701	6,944	4.3
Tobacco and manufactured tobacco substitutes –2402, 2401,2403	5,795	3.6
Milling industry products; malt; starches; wheat gluten – 1101	3,849	2.4
Railway or tramway freight cars, not self-propelled- 8606	3,601	2.2
Wheat -1001	3,509	2.2
Motorcars and other motor vehicles designed to transport people – 8703;	3,186	2.0
Other	88,480	45.2

Source: State Department for Statistics

WTO MINISTERIAL TRADE CONFERENCE FOR CENTRAL ASIAN AND CAUCASUS COUNTRIES IN TBILISI

Future challenges and opportunities for Central Asian and Caucasus countries[1] in integrating into the multilateral trading system were the main subjects of a two day Ministerial level Trade Conference held in Tbilisi on 21 and 22 May 2001.This was a first ever WTO-related Conference at the Ministerial-level in the region. The first aim of the Conference was to assist countries, which are either in the process of joining or have recently joined, to participate successfully in the multilateral trading system. A second aim was to help identify ways to support countries preparations for, and participation in, the current negotiating process.

Most countries in the Central Asia and Caucasus region are either members of WTO or have observer status. However, the level of integration into the multilateral trade system varies significantly from country to country. Countries such as Georgia, Kyrgyzstan and Armenia have liberal trade regimes, while much work remains to be done in some Central Asian countries.

This Conference was an opportunity to learn about the priorities and the problems and challenges that countries of this region face in integrating into the multilateral trading system. During the conference also were discussed some of the most critical issues facing the WTO, from national, regional and multilateral perspectives. At the Doha Ministerial Conference, held last November, WTO Members adopted the Doha Development Agenda, launched a comprehensive round of trade negotiations and set a deadline of January 2005 for the completion of these negotiations. Since Doha, Ministerial Conference Members have established a Trade Negotiations Committee to oversee the negotiations. They have appointed the Director-General ex-officio to chair this body. The structure of the negotiations has been determined and chairpersons of all the individual negotiating bodies decided upon. As well, Members have agreed on Cancun, Mexico, 10-14 September 2002, as the venue and date for the next Ministerial Conference.

[1] Trade Ministers and high-level officials from Afghanistan, Armenia, Azerbaijan, Georgia, Iran, Kazakhstan, Kyrgyz Republic, Russian Federation, Tajikistan, Turkey, Turkmenistan, Ukraine and Uzbekistan, and international organizations and agencies working in the region participated in the conference.

Box 5.1

DISCOVERING COMMON GROUNDS OF ECONOMIC COOPERATION
REGIONAL ECONOMIC WORKING GROUP
ARMENIA - AZERBAIJAN - GEORGIA – TURKEY

A group of 28 economists and businessmen from Armenia, Azerbaijan, Georgia and Turkey met in Istanbul over the weekend of June 21-23.

The group included academicians, representatives of business and NGO sectors. The meeting was sponsored by the American University - Center For Global Peace and Hosted by the Turkish Armenian Business Council (TABDC) and Istanbul Policy Center (IPC). During the meeting, the Group considered the current situation in economic and trade relations among the 4 countries and the possible economic benefits of expanding these relations. Of particular interest to the Group was the issue of improving the economic potential of small and Mmdium size enterprises in the region. It was proposed to exchange information on business conditions and business formation via Internet. The Group also discussed the importance of supporting current and future infrastructure projects in the region, and the need for further development of regional economic and trade cooperation on bilateral and multilateral basis including a very important TRACECA project for linking the region to Europe through all possible TRACECA routes. Over all, a number of issues of common interest were identified and the Group agreed to continue working together on these issues.

Source: TABDC

CHAPTER SIX: PRIVATISATION

OVERVIEW

There was little progress in privatisation in the first quarter of 2002. Two management contracts have been signed with ESB International and Terna. The former is to manage JSC "Elektrogadatsema" (transmission) and "Electrodispecherizacia" Ltd. (dispatch) and the latter JSC Vartsikhehesi Cascade (Hydro Power Plant). A tender to identify the future management company of Tbilisi Water Utility is under way. Privatisation of the medium and large enterprises (MLE) showed almost no results. Privatisation of telecommunication assets is stalled and it seems that stronger political will is needed to push the process forward.

SMALL ENTERPRISE PRIVATISATION

Privatisation of small enterprises is still the most successful. As of 1st April 2002, 13,736 small enterprises had been approved for privatisation and 16,349 had actually been privatised[1] since 1993. During the corporatisation and restructuring of MLEs, parts of them are established as small enterprises which explains the constantly increasing number of newly approved or privatised small enterprises. In the first quarter of 2002, 159 small enterprises were privatised. The sectoral breakdown given in Table 6.1 shows that most of the small enterprises are still in the trade and service sectors, which together constitute around 80 per cent of the total number of privatised small enterprises.

Table 6.1: Small Privatisation by Sector (MSPM classification) as of 1 April, 2002

	Sector	Approved	Privatised	% of total privatised	Privatised in 2002
1	Manufacturing	397	325	2.0	2
2	Energy	60	80	0.5	-
3	Bread products	142	125	0.8	-
4	Agriculture & food	772	919	5.6	9
5	Construction	440	372	2.3	2
6	Trade	4,704	5,502	33.7	57
7	Services	5,604	7,265	44.4	75
8	Oil products	172	174	1.1	-
9	Health	803	629	3.8	3
10	Social sphere	442	717	4.4	9
11	Transport	200	241	1.5	2
	Total	13,736	16,349	100.0	159

Source: Ministry of State Property Management

According to the breakdown given in Table A6.2 of the Statistical Appendix, the regional pattern has not changed: most of the small privatised enterprises are in Tbilisi. The majority of the regions made some progress in privatising small enterprises in the first quarter of the 2002. Privatisation of small enterprises in the Autonomous Republic of Achara is still well behind the other regions: there were no privatisation cases in the first quarter and the privatisation process has been stalled for months.

[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.

The acquisition of enterprises by insiders is still widespread, suggesting that government receipts from privatisation could have been higher if more transparent methods had been used. However, the fact that the enterprises are in private hands is the most important development in the longer term: if insiders find that they are not capable of managing enterprises successfully, they are likely to sell them to more efficient owners. Moreover, this process has already been started and it seems that the re-sale market operates quite successfully.

MEDIUM AND LARGE ENTERPRISE PRIVATISATION

Medium and large enterprises that are still in the state ownership are proving to be difficult to privatise. Many of the tenders failed to attract 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 of the low price. The main obstacles to privatising these enterprises are indebtedness, poor condition of the assets of the enterprise, overstaffing, the size itself, and influential interest groups.

In the first quarter of 2002, there were almost no changes in approving and actual incorporation of state enterprises. Table 6.2 shows that as of 1 April 2002, the number of the medium and large enterprises approved for establishment as JSCs has remained unchanged at 1,426. The total number of medium and large enterprises established as joint stock companies is 1,361. During the first quarter of 2002, only 2 JSCs were established in the Social sector. The highest numbers of both approved for corporatisation and actually corporatised state enterprises are in the Agriculture and Food sector.

Table 6.2: Corporatisation of MLEs by Sector (MSPM Classification) as of 1st April, 2002[2]

Sector	Approved	Established	Established in 2002
Manufacturing	230	303	0
Bread products	61	45	0
Agriculture and food	391	305	0
Architecture and construction	228	164	0
Retail and Wholesale Trade	86	62	0
Services	22	22	0
Oil products	49	36	0
Gas	60	47	0
Transport and Communications	120	131	0
Social sphere	57	58	2
Healthcare	56	58	0
Energy sector	66	130	0
Total	1,426	1,361	2

Source: Ministry of State Property Management

According to the conditions of the Structural Adjustment Credit III (SAC), in order for release of the second tranche, at least 20 out of 29 largest enterprises from the first priority list should be privatised or liquidated. As of April 2002 fourteen enterprises have been privatised from the first priority list and

[2] The MSPM has introduced some changes in this table. The sector "Mining and Chemicals" is now included in the "Manufacturing" sector. The type of activity of some enterprises has been reconsidered and now they are under a different sector than before. The sector "Services" also has been introduced.

in eight enterprises, liquidation/bankruptcy procedures have been started. Thus the conditions for the second tranche of the credit have been fulfilled. To receive the third tranche of the credit all enterprises of the first priority list should be privatised or liquidated. As for the second priority list of large enterprises, 26 out of a total of 29 have been privatised.

The MSPM restructured some medium and large enterprises last year. Restructuring has a positive effect on the process of privatisation. In the case of the largest enterprises it is difficult to sell any enterprise without restructuring. Restructuring separates the viable part of the enterprise from the rest. The viable part becomes more efficient and consequently more attractive to potential investors. The assets can be sold separately and used by other entrepreneurs.

The JSC **Sakartvelos Traktori** has been restructured and divided into three companies - Saktraktori, Imeri and Rioni. The restructured part of the JSC **Medea** will face bankruptcy procedures and the liqiudator is already appointed. Some assets of the enterprise have been sold. JSC **Kolkhida** has been restructured and the enterprise divided into 3 JSCs and 8 Ltds. However, the sales of the restructured enterprises with symbolic selling prices or at zero reserve price auctions have been under consideration for several months. This might suggest that these enterprises are not restructured properly and still contain obsolete and non-core assets or they are not attractive to the investors because of the type of their activity. Another reason for such delay may be the influence of the insiders who are trying to buy the enterprises as cheaply as possible. In cases when the restructuring brings no results an enterprise should be liquidated.

JSC **Elmavalmshenebeli,** producing electric locomotives, is one of the largest enterprises in Georgia. The majority shareholding of the enterprise has been offered for sale several times but without success. It has been restructured and the assets not related to the production process have been separated from the charter capital of the enterprise. A repeated tender for the shares of the enterprise, offered with a 75 per cent discount, still failed to attract bids. Now a tender to privatise 75 per cent of the shares of the enterprise with a symbolic selling price has been announced. It is likely that this tender will have the same result as the previous ones, since there was no financially strong investor interested in purchasing the enterprise before and a symbolic price is often accompanied with conditions (not very attractive) to be fulfilled by the investor. It seems that some interest groups oppose reorganisation or liquidation of the enterprise, which may facilitate the sales of the viable parts of the enterprise.

Some large enterprises are going to face bankruptcy procedures. This 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.

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 competent entrepreneurs. However, 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.

Telecommunications

The privatisation of the telecommunication sector assets is stalled. A repeated tender offering 75 per cent of the shares of Sakartvelos Elektrokavshiri failed to attract bids. The MSPM cancelled the agreement with Commerzbank, acting as a financial adviser to the process of privatisation. There is no tender announced to identify a new financial adviser yet. Privatisation of the telecommunication assets is one of the objectives set by the Poverty Reduction and Economic Growth Programme (PREGP) of Georgia. The failure to privatise telecommunication assets delays the inflow of investments in these assets and consequently precludes their rehabilitation, improvement of efficiency and further development of the field of telecommunications.

Energy sector

There was no progress in privatising the assets of the energy sector in the first quarter of 2002. Some progress was achieved in transferring enterprises of the electricity sector into new management. The Government signed management contracts with ESB International and the Greek company Terna. ESB International will manage JSC "Elektrogadatsema" (transmission) and "Electrodispecherizacia" Ltd. (dispatch). The company won the tender for management in the previous year and is to complete the takeover of the enterprises in the first half of 2002. Terna won the tender for the management of the JSC Vartsikhehesi Cascade (Hydro Power Plant). The process of grouping of the state regional distribution companies into one company is also at the final stage.

According to the PREGP, restructuring and privatisation of fuel-energy complex enterprises is a priority for the Government. Privatisation of the assets will result in investing in the enterprises and their rehabilitation. It will improve the production and distribution of energy, increase payment collection rates and reduce losses. Thus, it is necessary to proceed with the privatisation process, since privatised assets show better performance than state owned ones. Improvement in the energy sector will have an impact on the overall performance of the economy.

Water Supply and Sewage System

A pre-qualification phase of the tender to transfer JSC Tbiltskalkanali (Tbilisi Water Utility) into management has been completed. To participate in the tender a company had to have 5 years experience of providing service to 1.5 million customers, an annual turnover not less than USD 50 million and qualified personnel. Seven foreign companies have met the preliminary conditions, but 2 of them, Severn Trent Water International Ltd. (UK) and Thames Water International Services (UK), opted out of the bidding. Therefore, 5 companies are participating in the bidding process. These are: Compagnie Generale des Eaux (France), Suez Lyonnaise Des Eaux (France), Berlinwasser International GmbH (Germany), ACEA S.p.A. – Acquedotto (Joint Venture, Italy), Anglian Water PLC (UK). These are leading western European companies with sound financial, technical and institutional standing. A sample management contract will be sent to the bidders in the second quarter of 2002 and after that the bidders have 3 months to present technical and financial proposals according to which the winner of the tender will be chosen.

JSC Tbiltskalkanali is 100 per cent owned by the Tbilisi Mayor’s Office and is to be transferred into management for 10 years. After that the contract can be prolonged for 5 years upon the mutual agreement of the parties. To facilitate the rehabilitation of this sector the World Bank is to allocate a credit worth USD 25 million. The credit is for 35 years and has a grace period of 10 years with interest at 0.75 per cent per annum. The credit will allow the water tariff to remain unchanged in the beginning of the reform.

In terms of privatisation of utilities an issue of regulation is very important. The establishment of an independent regulatory body will facilitate competition in the respective industry and protect consumers from abuses of monopolies. The Box 6.1 describes the need of regulation and makes the reference to the privatisation in the UK. It should be noted that, though the utility privatisation in the UK was mostly successful, privatisation of the railways turned up to be a failure and should not be considered as a model.

Box 6.1

REGULATION

In the case of some privatized industries, especially utilities and other enterprises (e.g. airports or toll roads and bridges) which may have some monopoly characteristics, some form of independent regulation will be needed until a fully competitive market has developed or to achieve the benefits of competition. The government will need to address this need at an early stage in the sale preparations.

The desire to distance the privatized utility industries from political control, to provide market credibility, and to separate ownership and regulatory functions has often led to the development of regulators who undertake their responsibilities independently of government. In Britain, since the utilities were privatized at different times and have distinctive regulatory requirements, a separate regulatory office has been established for each industry—telecoms, gas, water and power.

In the U.K. model each office is headed by a regulator appointed for a fixed term, normally five years. There is also a separate body with regulatory duties in relation to airports and air traffic control. Broadly the aim of a regulatory regime is to put in place a framework of regulation which is explicit and transparent in nature and which operates through incentives on managers of the business rather than through the complex administrative arrangements which has characterized control under government ownership.

Where competition cannot be introduced or will take some time to develop, the regulator's role is to protect consumers from abuses of monopoly power. This requires controls on both the price and the quality of output. In addition, regulators are generally responsible for promoting competition and, in certain cases, social and national objectives—such as the provision of an emergency (police, fire and ambulance) telephone service.

The U.K. regulators control relevant prices through a price-cap regime. This operates by fixing the rate at which the regulated industry is permitted to raise the prices of certain of its products or services for a pre-determined period of time. (Other prices may be outside the regulator’s scope because the services are already subject to full competition—e.g. cellular phone services or airport terminal concessions). The starting point for allowable price increases is usually the retail price index (the RPI), a generally available and widely recognised index which is beyond the influence of the companies being regulated. When fixing the price cap the regulator looks ahead and makes an estimate of the efficiency gains the business is expected to be able to achieve over the coming period (the so-called "X" factor). This forecast is generally subtracted from the RPI to produce the individual utility's price cap formula. Account may be taken of major capital investment programs when calculating the price cap.

The main advantage of this approach—in contrast to traditional U.S.-type public utility regulation—is the efficiency incentive for the industry concerned. With no specific controls over profits, the industry has every incentive to reduce costs as far as possible. If it achieves efficiency gains which exceed "X", it retains the benefits of its efforts during the time period in which the cap remains in force.

Source: Guide for Divesting Government – Owned Enterprises, by Henry Gibbon

CHAPTER SEVEN: EMPLOYMENT, INCOMES AND THE SOCIAL SAFETY NET

LABOUR MARKET

The labour market situation remains largely unfavourable and unstable. Whilst unemployment rate figures are generally in line with those for transition economies and, if taken alone, may even suggest optimistic conclusions, the overall picture is flawed by persistent underemployment, widespread hidden and disguised unemployment and salaries falling way below the minimum subsistence level, aggravated further by continuing decreases in the labour force caused by long-term unemployment. All the above-mentioned long-term labour market problems adversely effect the poverty situation that is continuously reflected in painful declines in living standards experienced by increasingly larger numbers of households.

Most of the working age population is either underemployed or non-employed. New stable jobs are rarely created. The labour market is dominated by agricultural subsistence self-employment. A large portion of the employed are engaged in unofficial and unregistered low-paying largely self-employment activities. Just around 20 per cent of the working age population have waged or salaried jobs, over 40 per cent of which are jobs at budgetary organisations paying extremely low salaries. The majority of the unemployed do not bother to register, having no incentives to do so and the vast majority of those employed are hardly earning a living.

UNEMPLOYMENT

The analysis of economic status of the population below is based on the data of the SDS on-going Household Survey[1]. These internationally comparable sets of figures, being calculated according to the ILO principles and methodology (e.g., registration figures cannot be considered a good source of information in internationally adopted terms, i.e., according to the ILO definitions[2]), yield a lot of interesting information on the labour market. The estimates derived from the survey figures are instrumental for tracking changes in the labour force, employment and unemployment, labour force participation rates, and the population outside the labour force. There is no doubt that the household survey results are indispensable for following the overall trends in the labour market and household income. However, a lot remains beyond the figures and beyond the survey. In accordance with internationally applied methodology, the survey does not take into consideration the size of remuneration. In addition, it does not cover those engaged in the informal economy, nor does it reflect the full extent of underemployment and poverty.

[1] The continuous Household Survey has been implemented by the SDS since Q3 1996 with the financial support of the World Bank and in co-operation with *Statistics Canada*. The SDS was implementing the Labour Force Survey (LFS) in 1998-1999 with the assistance from the ILO and the UNDP and figures for those years come from the LFS (see Statistical Appendix Table A7.1).

[2] In accordance with the ILO definition, employment is based on any work done for an hour during the reference period (a week).

Table 7.1: Economic Status, Q1 2000 – Q4 2001
(thousands)

Economic Status	Q I 2001	Q II 2001	Q III 2001	Q IV 2001
Total population over 15 years old	**3, 277**	**3, 269**	**3, 139**	**3, 083**
Total economically active population (labour force) (1)	**2, 066**	**2, 197**	**2, 144**	**2, 048**
Total economically active population (labour force) (2)	**2, 195**	**2, 314**	**2, 246**	**2, 165**
Employed	***1, 818***	***1, 944***	***1, 913***	***1, 838***
Hired	681	672	636	630
Self-employed	1, 034	1, 189	1, 194	1, 127
Unemployed (1)	**248**	**253.1**	**230.8**	**210.5**
Unemployed (2)	**377**	**369.9**	**332.8**	**327.3**
Unemployment rate (per cent) (1)	**12.0**	**11.5**	**10.8**	**10.3**
Unemployment rate (per cent) (2)	**17.2**	**16.0**	**14.8**	**15.1**

Source: Data from the SDS Household Survey
Note: (1) ILO Standard (or "strict" methodology), i.e., excluding "discouraged" workers.
(2) ILO "Loose" methodology, i.e., including "discouraged" workers.
** At the time of writing of this issue of GET, The latest available results of the on-going Household Survey were those for Q4 2001.*
For a more detailed table and 1998-2000 figures see Statistical Appendix Table A7.1.

Quarterly indices for the national unemployment rate in 2001 did not change dramatically in annual terms compared to a year before. In Q4 2001, the improvement in the national unemployment rate equaled just 0.1 percentage points both by the ILO "strict" and "loose" methodologies (see Statistical Appendix Table A7.1), however, in quarterly terms, it improved by 0.5 percentage points by the "strict" standard, and grew by 0.3 percentage points by the "loose" standard. The gap between the two measurements grew compared to the previous quarter, while remaining unchanged in annual terms. Statistically changes in the gap between the two ILO measurements of unemployment can support assumptions on "migration" into and out of the labour force, or "labour market flows" that, according to the ILO terminology, is considered to be one of the key indicators of the labour market. Labour market flows, describing how many persons have moved into and out of the labour market, rather than just changes in the number of employed, unemployed and those outside the labour force, can serve as an indicator of the capability of the labour market to absorb unemployed rather than "produce" them.

The bigger the gap, the more people are outside the labour force. The fewer people are economically active, the lower will be the ILO "strict" standard unemployment rate calculated from the smaller base of the labour force number. For the optimistically low indicators of the unemployment rate to be real signs of improving trends in the labour markets, the participation rate should be growing or, at least, be stable at the same level. Otherwise, a higher or lower "strict" standard unemployment rate does not of itself indicate an improving or deteriorating situation. Behind the persistently large gap there is usually long-term unemployment and unstable insecure jobs when many people, in the light of dim employment prospects, are not even actively looking for job any more and others do not start looking for job immediately after losing one. Both the unemployed and the "discouraged" workers outside the labour force are virtually "non-employed", i.e., both these groups do not have job and stand high risk of poverty.

The labour force participation rate ranging between about 63 and 68 per cent over recent years has been quite high, although it conceals frequent incidence of underemployment and low remuneration. This is a reflection of an extremely hard household income situation when even the former "discouraged" workers, i.e., those who were not looking for job since they did not believe the job that they might have found was worth active search, having lost all other sources of income, engaged in self-employment, most probably low paying and very likely unstable.

The participation rate fell by almost 2 percentage points over the quarter and grew by almost 1 percentage point to 66.4 per cent in Q4 2001, compared to Q4 2000. Behind the optimistically high participation rate figures are a large number of pension age workers, who have to remain active on the labour market, usually hardly earning a subsistence, to compensate for the token pension assistance. The national unemployment rate is the lowest in these age groups – at 5.1 per cent for those between 60 and 69 years old and at 1.5 per cent for those over 70. Unemployment rate is the highest among the younger age groups - about 16 per cent for those under 20 and almost 20 per cent for those in between 20 and 29 years old age group – gradually decreasing with each older age group.

The largest contributor to the national unemployment rate (10.3 per cent by the "strict" standard in Q4 2002) is Tbilisi, where the unemployment rate was, as always, the highest, at 23.8 per cent in Q4 2001. In line with the usual trend, the urban unemployment rate was not comparable to the rural rate: 20.7 and 27.3 respectively by the "strict" and "loose" standards. Among the regions, according to the trend, the highest unemployment rate was in Achara (13.7 per cent). The rural unemployment rate is usually supernaturally low – this time at 2.9 per cent by the ILO "strict" methodology and 6 per cent – by the ILO "loose" methodology, as always, distorting the national figures. The existing Law on Employment artificially contributes to misrepresentation of the unemployment situation in the villages and in the whole country as well. Considering each farmer owning 1 ha or more of agricultural land, or his/her family member as self-employed artificially reduces the unemployment rate, since the majority of those employed are engaged in agricultural self-employment. At the same time, the participation rate is automatically raised. In reality, while land is the basic source of income for most rural households and provides them with a subsistence minimum, many village dwellers, especially those whose lot of land is not very large and those who cannot afford to work their land, are hardly earning a subsistence.

Having said that the rural unemployment rate is usually almost 7 times lower than the urban one and about 2.5 times lower than the national one, one has to say as well that over half of the rural unemployed fall under the category of "discouraged" workers, which means that most of those country dwellers who neither have a job, nor a plot of agricultural land in the family, are not even looking for job, as such job search would be definitely in vain. According to anecdotal evidence, a vast proportion of the rural population is elderly people, and younger people migrate to cities in search of some employment. While some of them manage to find at least some kind of job and sometimes even help their relatives in villages, others join the urban unemployed.

The registration-based unemployment figures are not reliable for analysis of the situation on the labour market since they cover only a small share of the unemployed, and at the same time some people on records could be working unofficially. Therefore, a picture drawn using registration figures would not be comparable in ILO terms. In addition, the State Employment Service is being reorganised, and as part of the procedure the unemployed registered before have to undergo re-registration. It would be interesting to see the results of this exercise, though, it is unlikely that re-registration would stimulate a boom in unemployment records. The unemployment benefit remains purely symbolic (an equivalent to approximately USD 6 per month with eligibility lasting for the first six months of the unemployment only), while the chances of finding a job through registration remain minimal.

In a situation where the unemployed are not covered by sound unemployment insurance schemes or any other form of support, providing at least a subsistence minimum, the unemployed are especially at risk both from an economic and social point of view, and prolonged periods of unemployment, bring with them not only loss of income, but also diminishing employability of the job-seeker. Long-term unemployment persists, and being out of practice results in loss of qualification and access to information on available jobs. It contributes to growing poverty and leads to social isolation and social exclusion. Both the economic and social dimensions of this persistent and serious problem are enormous and have to be tackled with policy measures and programmes aimed at raising the employability of the long-term unemployed and reintegrating them into the labour market.

EMPLOYMENT

Slow growth and lack of job creation in the formal sector have resulted in a decline in the numbers of wage and salaried workers and a rise in self-employment and the numbers of unpaid family workers. Although the percentage of dependent (or hired) employment in total employment shows a declining trend, this still continues to constitute a fairly high proportion – over 60 per cent in Q4 2001. However, while employment in state-owned enterprises and organisations is still widespread and is still largely perceived as a conventional "permanent employment", self-employment is on the upswing both as a primary and secondary activity. The household survey figures qualify self-employment as a main activity only. Even so, there is a noticeable trend, whereby self-employment dominates both the total employment and labour force: in Q4 2001, it accounted for over 61 per cent of the former and about 55 per cent of the latter (see Table 7.1 and Statistical Appendix Table A7.1).

The share of agricultural self-employment amounted to almost 84 per cent in Q4 2001. Self-employment in agriculture is largely a pre-defined status, since, as mentioned above, 1 hectare of agricultural land in the possession of a family renders its members self-employed by definition (Law on Employment). However, whereas land for many, especially rural, households is the basic source of livelihood, whether 1 hectare of land is enough to keep an average family of four employed enough to earn at least minimum subsistence remains a controversial issue. According to the SDS household survey figures, 58 per cent of the agricultural self-employed are unpaid family workers. The vast majority of village dwellers in this category, that constitutes almost half of all the self-employed, 39 per cent of total employment[3] and 35 per cent of total labour force in the economy, are most likely to be at risk of poverty. Nevertheless, assuming that urban unemployed and underemployed have no land to work on whatsoever, they are likely to be in much more extreme poverty than the rural poor.

While poverty in the countryside is more associated with a lack of cash income, urban poverty involves insufficient food supply and undernourishment. A vast majority - over 90 per cent - of non-agricultural self-employed are so called own-account workers, i.e., self-employed who neither have any employees nor are members of co-operatives or shareholders. This category of the self-employed, accounting for almost 12 per cent of total employment, hardly earns a subsistence. Therefore, a relatively moderate national unemployment rate and a rather high participation rate fail to demonstrate the extent of poverty that people are experiencing.

In marked contrast to expanding self-employment, hired employment is shrinking, that is primarily preconditioned by contraction of the state sector that still accounts for over half of dependent employment (66 per cent in Q4 2001). In Q4 2001, wage and salary earners accounted for 34 per cent of total employment[4]. Since the state sector is still the main supplier of waged and salaried jobs, the downward trend of hired employment is likely to continue at least in the short term, as further staff cuts in the state sector, especially budgetary organisations are likely to follow. This process is socially sensitive to a great extent, as staff cuts in education and healthcare are anticipated. An unfavourable business climate and poor job creation in the private sector are contributing to the downsizing of hired

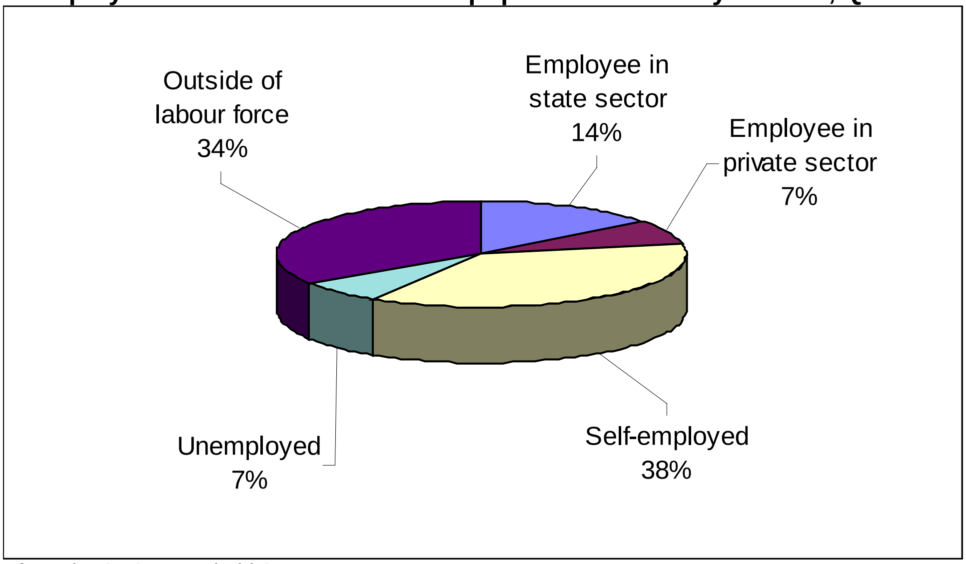
[3] Within developed economies unpaid family workers typically account for as low as virtually 0 to 4 per cent of employment ("Key Indicators of the Labour Market 2001-2002", ILO).
[4] In developed economies, the proportion of hired workers is as high as 80 or even 90 per cent of the total employement (Ibid.).

employment. Anecdotal evidence suggests that many hired employees, especially those in the state sector, where salaries are mostly low, are also engaged in self-employment as a secondary activity.

The SDS household survey results suggest that at least 67 per cent of those employed are the working poor, of which 39 per cent are rural unpaid family workers, almost 16 per cent are employees at budgetary organisations and another 12 per cent are non-agricultural own-account self-employed. Overwhelming self-employment indicates a worsening labour market situation where more and more people are either non-employed or engaged in low-income, low-productivity and unstable activities, mostly in the informal sector.

Widespread part-time employment, mostly involuntary, indicates the manner in which people attempt to adjust to downward labour demand choosing to accept short-time work rather than not to work at all. The patterns of employment are changing towards part-time employment and temporary employment. Time-related underemployment[5] relates to the number of employed persons "whose hours of work in the reference period are insufficient in relation to a more desirable employment situation in which the person is willing and available to engage"[6]. So called "external groups" including agency or firm temporaries, outsourcing, subcontracting and casual workers, i.e., short-term workers, represent quite a substantial share of hired employment, indicating labour underutilisation. Part-time workers are more vulnerable from the point of view of their employability, since their career prospects and their competitiveness on the market are restricted. Much of the part-time and temporary work is involuntary and tends to be poorer quality employment rather than full-time work in respect of pay, benefits, security and access to on-the-job training.

Figure 7.1: Employment characteristics of the population over 15 years old, Q4 2001



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.

The majority of the population over 15 years are subdivided, according to the economic status, between the two largest groups: self-employed account for 38 per cent and those outside of labour

[5] A resolution concerning the measurement of underemployment and inadequate employment situations, adopted by the 16th International Conference of Labour Statisticians, Geneva, 1998 calls it "visible underemployment".
[6] "Key Indicators of the Labour Market 2001-2002", ILO

force – for 34 per cent. Compared to a year before, in Q4 2001, the share of the population outside the labour force, the share of employees in state sector and that of employees in private sector shrank by 1 percentage point each. In contrast, there was a corresponding increase in the share of the self-employed of 3 percentage points, implying that economic hardship was dealt with by persons previously outside the labour force re-entering the work force and by those who resorted to self-employment in order to offset a loss of household income resulting from loss of job in dependent employment, both in the state and private sectors. The share of the unemployed (ILO "strict" standard) remained unchanged over the year. Of those employed in the state sector, over 66 per cent worked in budgetary organisations, with low and irregular salaries and would have to engage in alternative employment to support the family. It is likely that many of the jobs in private sector, with the exception of those at large private companies, are insecure, unstable and low paid; it is also very likely that many of them would be in the informal sector.

The majority of jobs, especially in cities, are created in the informal sector. The informal economy, dominated, as overall employment, by irregular self-employment, is represented largely by unrecognised, unrecorded and unregulated small-scale activities. Underemployment is widespread. The majority of the employed are engaged in low-paying and insecure segments of the labour market and working under poor conditions. Stable long-term full-time jobs are rare, both in the formal and informal sectors. Hidden and disguised unemployment are widespread and growing long-term unemployment leads to the downsizing of the labour force, and, hence to the misleadingly low unemployment rate. The economic status figures fail to reflect all the drama of the situation, since the ILO methodology of counting the unemployed ignores the size of labour remuneration and its consistency with the size of the minimum subsistence.

The Poverty Reduction and Economic Growth Programme (PREGP) prepared by the Government, with support of international organisations states the following main goals: the reduction of poverty through support to the economic growth leading to the creation of new jobs; a higher living standard; and ensuring the participation of all citizens in the country's development process. Fully and effectively addressing the issue of poverty reduction, being the main goal of the PREGP, and considering it from a long-term perspective is impossible to achieve without promoting the creation of new jobs, which in turn requires improvement of the country's investment climate and small and medium business development.

SALARIES AND WAGES

The average monthly nominal salary of hired employees across the economy was GEL 98 in Q4 2001[7], according to the SDS household survey figures. Although in nominal terms the indicator grew by almost 13 per cent, inflation and growing electricity and gas tariffs were eroding salaries in real terms (See Chapters II and IV). The share of the average monthly salary in the minimum subsistence of a family of four was 45 per cent in Q4 2001.

Over 43 per cent of all waged and salaried workers – budgetary organisations[8] employees – were earning on average GEL 58.5 per month in Q4 2001. In accordance with a presidential decree that re-introduced the concept of a minimum salary in 1999, after a 4-year gap, salaries of this category of hired workers range between GEL 20 and GEL 66. Employees of public enterprises and organisations accounting for over 22 per cent of hired workers were paid GEL 107.4 per month on average in Q4 2001. Monthly remuneration of another category of wage and salary earners (almost

[7] At the time when this issue of GET was being written, the Household Survey figures for Q1 2002 where not yet available.
[8] A budgetary organisation is a public organisation fully financed by the state budget.

29 per cent) - private sector employees - was GEL 115 on average, hired employees under “other” category (about 3 per cent) were earning monthly GEL 106.9 and just over 2 per cent of hired workers – those working in foreign organisations or joint ventures – had a monthly salary of GEL 474.4 on average.

Average monthly salaries of transport and telecommunication employees (GEL 154.4), construction workers (GEL 141.7) and employees engaged in electricity, gas and water supply (GEL 131.8) were among the highest, whilst those of education employees (GEL 62.3) and healthcare employees (GEL 59.8), as usual, among the lowest. While the three sectors characterised by relatively higher salaries accounted for 23.5 per cent of the total number of hired employees, the share of those working in two others with the lowest salaries was 32.5 per cent. Wages and salaries in the sectors where the remaining 44 per cent of hired workers were engaged ranged between GEL 84.2 and GEL 145.3.

Salaries of public sector employees (65 per cent of hired workers) as well as remuneration of the majority of private sector employees remain predominantly way below subsistence minimum. Whilst hired employment remains the primary source of income for urban households, it is as unstable as any other source of household income in the country. Instances of non-payment of salaries are frequent, resulting in building up budgetary arrears, and the growth of salaries in real terms is eroded by inflation.

MINIMUM SUBSISTENCE LEVEL

Since a governmental decision ”On Introducing Changes into Calculation Methodology and Re-calculation of the Minimum Subsistence Level” was passed in August 1999 and a draft presidential decree “On Defining and Applying Subsistence Minimum” was drawn up, no other formal steps have been taken to put it into practice. Though a new methodology to calculate the minimum subsistence is ready at the SDS and is published as an “alternative” minimum subsistence, the methodology, introduced in early 1990s, is still being used and published as an “official” one. It can be argued which of the methodologies better takes into consideration the real basket that can secure a reasonable minimum subsistence, however, it is clear that the minimum subsistence levels, calculated in accordance with the new “alternative” methodology are closer to the average salary levels in the economy, i.e., are much lower than the “official” level. If the share of the average monthly salary in the minimum subsistence of a family of four, calculated by the old “official” methodology was, around 48 per cent in Q4 2001, the same share in the minimum subsistence, calculated by the new “alternative” methodology would be almost 77 per cent. The SDS survey results suggest that on average the remuneration of 76 per cent of hired employees across the economy was below even the “alternative” measurement of minimum subsistence for a family of four in Q4 2001 (GEL 127.8). Subsisting on an equivalent of about USD 60 per month for a family of four does not seem to be an easy task. However, even a family of four with only one member working and the rest being dependents would not be considered among the most vulnerable, therefore subject to be receiving a state social allowance (see below), since to fall under this category, a household has to consist of non-employed pensioners and/or orphans only.

Table 7.2: Minimum Subsistence Levels, 2001
(GEL)

Minimum Subsistence as of end of period	Official Minimum			Alternative Minimum		
	For a working man	For an average consumer	For a family of four	For a working man	For an average consumer	For a family of four
Q1 2001	115.8	101.6	201.6	73.8	65.4	123.9
Q2 2001	119.2	104.5	207.3	77.3	68.5	129.6
Q3 2001	113.9	100.0	198.2	74.0	65.5	124.1
Q4 2001	118.0	103.5	205.2	76.2	67.5	127.8
Q1 2002	124.8	109.5	217.2	79.7	70.5	133.7

Source: State Department for Statistics Monthly Reports

SOCIAL POLICY AND THE SOCIAL SAFETY NET

The vast majority of the population, including informal sector employees, the self-employed and the unemployed, as well as their family members, have no social protection whatsoever, and the assistance for those covered by the social safety net is symbolic rather than minimal. The system of social protection provided by the state requires a fundamental restructuring, and an economically viable, affordable and equitable social safety net is to be created. The problem of poverty in old age is particularly acute, as the current pension system, being the heritage of the Soviet era, has long proven to be insolvent. In the conditions of a transition economy reforming the social safety net with the aim of effectively alleviating poverty appears to be of vital importance. Currently, social policy reform aimed at introducing a sustainable pension system is among the top priorities in the country.

Social reforms are acknowledged by the Government to be a long-term strategic objective. The main goals of its Poverty Reduction and Economic Growth Programme (PREGP) are the elimination of poverty through support to economic growth leading to creation of new jobs; raising the living standards of the population; and ensuring the participation of all citizens in the country's development process. It is necessary, the PREGP says, to develop targeted social protection mechanisms to cover as many of the unprotected as possible.

A presidential decree "On First Priority Measures Aimed at Realisation of the Social Development Concept" of 7th April 2002, provides for measures to be taken to regulate labour relations, raise the effective use of labour force and improve the employment situation; as well as improve the pension system; and facilitate drawing up and implementation of state programmes in the social sphere. According to the decree, the task of alleviating the difficult social situation of the population is of paramount importance.

State Social Allowance

In accordance with a presidential decree of 26th March 2002, the Social Allowance for vulnerable families, provided for by the 2002 Budget Law, is now targeted at households comprised exclusively of "poor non-working pensioners" or of orphans, disabled children and invalids, and families with at least 7 children. In fact, it represents a topping-up of symbolic pensions of the poorest elderly and a modest child allowance for the most destitute families. The State Social Allowance payable to recipients, in accordance with the decree, is GEL 22 for a qualifying household consisting of one member, or for each orphan under guardianship, and GEL 35 for a pensioners' family of two or more, and for a family with at least 7 children.

Unemployment Benefit

In accordance with a presidential decree of 22nd April 2002, the amount of the standard monthly Unemployment Benefit payable for the first six months of registered unemployment is raised for the second two months and third two months of unemployment by GEL 2 and GEL 3 respectively and is fixed at GEL 14 for the duration of the eligible period. To become an official benefit recipient, 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 usually at least half the actual one and the number of the benefit recipients is insignificant. Currently, the State Employment Service is being reorganised, and the unemployed are to undergo a re-registration procedure.

Pension System

Reform of the pension system is among the main goals of PREGP, as the current pension system, under the conditions of a narrow tax base, a big informal economy, and constant tax under-collection and non-compliance, has long proved to be unsustainable and insolvent and continues to accumulate arrears.

Currently, the pension system in the country is basically represented by the United State Social Safety Fund (USSSF) – the state pension fund providing a flat rate old age pension to the majority of pensioners. The amount of the unified pension at GEL 14 per month, that does not take account either of the years worked or the salary history, falls far below any minimum subsistence level (slightly over 12 per cent of the official minimum subsistence of an average consumer in Q1 2002). In accordance with the pay-as-you-go (PAYG) principle, pensions are financed by the payroll tax proceeds[9] and, therefore, fully depend on the level of tax collection. Under the circumstances, when the number of those paying taxes is diminishing and tax avoidance and evasion are widespread, the system has been accumulating arrears for several years already.

Most of the prerequisites necessary for the smooth functioning of a PAYG system are currently not in place, violated or biased:

- The current *dependency ratio*[10] is 1:1.2, while for a pay-as-you-go system to be sustainable it should be at least 3:1. The low dependency ratio, i.e., the smaller than necessary number of payroll taxpayers, in its turn, is a reflection of several conditions: the diminishing number of hired employment and the growing informal economy.

- Tax incompliance is widespread which results in tax under-collection. The number of those who are evading payroll tax payment (both employees and employers) is large: the budgetary payroll is often late, many companies are not functioning, and some contributors are not paying in full. Low wages and no link between the future benefits and current contributions result in no incentive for payment of contributions, and a relatively high payroll tax rate discourages tax compliance on the part of the employers.

- The amount of average taxable salaries/wages is low which results in the low *replacement rate*[11] of the current PAYG universal pension. The average pension flat rate of the majority of pensioners was just over 15 per cent of the average hired employees' monthly salary as of the end of Q3 2001[12].

[9] 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.
[10] The number of pensioners as a percentage of the number of people employed, or contributor to beneficiary ratio.
[11] The average pension in terms of the average wage.
[12] When this issue of GET was being written, the results of household survey for Q4 2001 were not available.

Any PAYG system is based on a solidarity contribution[13] principle, and is effectively an element of the social safety net, and thus, can only provide basic minimum pensions to the elderly. The existing pension system, however, fails even to carry out this basic function, let alone provide adequate benefits to the elderly. The crisis that the current PAYG pension system has been facing is severe and painful economically, politically and socially. Neglecting its short- and long-term consequences would place the vulnerable at serious economic risk and may result in growing poverty, social disintegration, marginalisation and social exclusion, while elaboration and implementation of an effective social policy would offer a more solid base for long-term economic growth.

According to the PREGP, the current system is "unable to accomplish two main objectives of the state pension system: diminish the poverty level among the elderly and ensure an adequate consumption rate for senior citizens". As the programme states, "a principal goal of Georgia is to introduce a new system, which will safeguard the achievement of both objectives". The PREGP, under the main directions of social policy, outlines the reform of the pension system, aimed at establishing a financially sustainable modern pension system suited to changing demands of a transition economy.

Certain measures directed to the reorganisation of the pension system have already been taken, while others are underway. As a result of adjusting the lists of pensioners, the number of the pensioners on record has been reduced to approximately 850,000, after double entries and non-existent recipients have been eliminated. According to the PREGP, the growth rate of the arrears has been halted. Hopes for improvement of the situation with payment of pensions and eliminating delays is associated with the new contractor of the pension fund - Bank Alliance (consisting of Intelectbank, Bank Respublica and Agroindustrial Bank). Substantial work is being carried out on further verification of registered pensioners and, finally, introduction of personal identification cards is envisaged.

According to the PREGP, implementation of the pension reform programme has already started, with the support of the World Bank and other donors that provides for the transition of the pension system to insurance principles (see Table 7.2 below). As part of the pension reform programme, a three-year draft programme on introduction of personified registration has been worked out and has already been submitted to the President for ratification. The draft programme also implies the transfer of the payroll tax collection back to the USSSF[14]. To this end, a draft presidential decree was submitted to the Government that provides for the working out of the proposal on transfer of the function of the collection of the payroll tax (that according to the draft decree is to be renamed an insurance contribution) to the pension fund. Other components of the pension reform programme include the creation of an automated system of management and a database for introduction of differential pensions; introduction of differential pensions; introduction of a mandatory private pension system; introduction of a voluntary pension system; and working out the legal framework regulating social insurance, state pensions, and introducing corresponding changes and amendments into the Tax Code.

Automation and tracking of individual contributions will require very heavy investment. Private pension schemes are to be encouraged and legally regulated, however this is unlikely to have any short-term effect on the state pension system, and for the foreseeable future state pension rates will remain low. A state PAYG system is to be used to provide a basic pension for all, topped up by mandatory and/or voluntary private schemes.

[13] 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.
[14] In 1998, this function was transferred from the fund to tax inspection.

The five-year programme of introducing a multi-pillar system is to be carried out step by step (see Table 7.3). According to the programme, it is essential to guarantee a transparent environment in the pension system; to draft appropriate legislation and improve existing normative acts; to ensure continuous payment of current pensions and gradual repayment of accumulated arrears; to implement personification and to introduce identification cards; and, finally, to ensure step-by-step transfer towards insurance principles and a differentiated pension system.

Table 7.3: Programme of a Three-pillar National System for Social Welfare and Retirement Insurance, 2001 - 2005

Characteristics	Pillars		
	I	II	III
Timeframe	2001-2004	From 2005	From 2002
Description	Mandatory	Mandatory	Voluntary
Form of management	Managed by the state	Privately managed	Privately managed
Objectives	Distributive plus insurance	Accumulative plus insurance	Accumulative plus insurance
Type	Minimal pension guarantee defined by incomes or preliminary defined	Individual savings of an employer and/or an employee	Individual savings of an employer and/or an employee
Financing	Financed from taxes	Managed, fully funded	Fully funded

Source: Poverty Reduction and Economic Growth Programme of Georgia, Version for Discussions, Final Document, Draft

A multi-pillar system is to provide a plurality of possibilities and availability of choice for those who can afford to make provisions for their future pensions, as well as increase personal responsibility and create savings funds for investment. However, before the system is in place and becomes fully effective, there is a long way to go. The first private pension insurance company in Georgia – Georgian Pension Investment Holding (GPIH) founded in May 2001, at this stage already offers, in addition to the existing universal PAYG scheme, voluntary private pension insurance to the population. It is not likely, though, that a big share of the population would be able to afford participation and/or have confidence in private voluntary schemes, at least, in the short and medium term. Privately managed retirement savings systems might be more useful as a complement to rather than as a substitute for universal social insurance. The PAYG pillar is going to be mandatory under the reformed pension system and still very important for the majority of the current pensioners, as a basic social safety net. Therefore, improving payroll tax collection and broadening the tax base are still very important short-term goals.

Box 7.1

Pension System: A Three Pillar Model

The World Bank has a model for pension reform that it uses to encourage countries to pursue reform. The World Bank model is a three pillar model:

Pillar 1 is the mandatory, PAYG system run by the central government;
Pillar 2 is a mandatory system of individual retirement accounts run either by the central government or by private pension funds;
Pillar 3 is a voluntary system of individual retirement accounts run by private pension funds.

More About Pillars

Pillar 1

PAYG Pay-as-you-go pension programmes are in use throughout the world. Under the PAYG system, governments collects taxes from current workers that are used to pay the pensions of current retirees. The system is stable as long as there are enough workers to fund the pension liability with taxes that are not onerous. Under this system, there is no individual retirement account for workers or retirees; a worker's payments are not based on what he or she will receive after retirement, and a pensioner's benefits are not based on what he or she paid in. PAYG systems are defined benefit systems. Defined benefit systems are characterized by low-risk to the pensioner but also have low gains.

Public pension Public pensions are pensions provided by a government body. Individuals and/or their employers may contribute to public pensions, and governments generally cover any shortfall between contributions and benefits.

Defined benefit Defined benefit pensions promise pensioners a certain monthly benefit that is not based on their contributions to the pension system while they worked. Defined benefit pension systems are usually also PAYG systems. Defined benefit systems are characterised by low-risk to the pensioner but also have low gains.

Pillar 2

Defined contribution Defined contribution pensions are based on a worker's individual contributions to a retirement account. Pensions are calculated based on the amount the worker contributed and the earnings from investment of that money. Workers, therefore, bear more of the risk, but the gains from financial investments of their retirement accounts accrue to them. In other words, these pensions systems have a higher risk but also generally a higher yield. Workers may bear all of the risk associated with defined contribution pensions unless the government sets up guarantee provisions to reduce such risk.

Pillar 3

Private pension funds Privatization of pension programmes is one focus of pension reform activities. Private pension funds are private companies that take pension contributions from workers, invest the funds, and maintain individual accounts for each worker. These funds then pay workers their contributions plus earnings upon retirement, death, or disability (depending on the country's laws). Private funds are usually regulated by an agency of central government and have to follow rules related to investing funds, reporting to account holders (workers), and paying benefits. Workers can invest pension funds with any of a number of private companies offering such retirement programmes. Depending on the country, tax incentives for investment in private pension funds may or may not be available.

Source: Private Pension Reform in Bulgaria, http://www.socialsector.net

CHAPTER EIGHT: THE EU-GEORGIAN RELATIONS

GEORGIA'S TRADE WITH THE EU

The figures from Q1 2002 show a decrease in EU-Georgian trade compared to the same period of 2001. In Q1 2002, turnover amounted to USD 44.7 million. This is 28.6 per cent less than in Q1 2001.

During Q1 2002 Georgian exports to European markets decreased by 22.5 per cent (by USD 3,7 million) and European export to the Georgian market decreased by 30.9 per cent (by USD 14,2 million).

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

Year	Turnover	Exports	Imports	Balance
2001 Q1	62.653	16.653	45.995	-29.342
2002 Q1	44.676	12.905	31.772	-18.867

Source: State Department for Statistics

In Q1 2002, Georgia had a negative trade balance with all EU Member States except the UK (this fact could be explained by export of gold in semi-manufactured forms, which become an important export item valued at USD 6.4 million). Compared to the previous year, Georgia's trade deficit with the EU countries decreased by 35.6 per cent, which reflects the overall trade reduction. Germany, the UK and Italy remained the largest trade partners for Georgia. Turnover of these countries with Georgia constituted about 67 per cent of the total amount of Georgia-EU trade in Q1 2002.

Table 8.2: Georgia's Trade with Individual EU Countries
(USD thousand)

	Turnover	Export	Import	Balance
UK	11.734	7.649	4.085	3.564
Austria	1.598	2	1.596	-1.594
Belgium	1.602	589	1.013	-424
Luxembourg	46	0	46	-46
Denmark	1.755	280	1.475	-1.195
Finland	446	0	466	-446
France	2.553	208	2.346	-2.138
Germany	11.799	1.033	10.767	-9.734
Greece	3.294	1.639	1.655	-16
Ireland	205	56	149	-93
Italy	6.492	1.124	5.368	-4.244
Netherlands	2.193	129	2.064	-1.935
Portugal	129	0	129	-129
Spain	574	196	378	-182
Sweden	255	0	255	-255
Total	44.676	12.905	31.772	-18.867

Source: State Department for Statistics

In Q1 2002, Georgia's trade with the member states of the European Union constituted 20.3 per cent of total trade turnover[1]. In the same period of the previous year this indicator was 26.8 per cent.

Georgia's exports to the EU market still remain quite low, despite the fact that Georgia has been a recipient of the Generalized System of Preferences (GSP) scheme from the European Union since 1995.

GENERALIZED SYSTEM OF PREFERENCES

The EU introduced the Generalized System of Preferences in 1971. The EU's GSP is related to many products, in particular industrial products – 96 per cent as opposed to 74 per cent for agricultural products, as listed in the HS (Harmonized System) nomenclature. The emphasis on industrial products is due to GSP's industrialization objectives. The GSP, as applied by the EU, grants almost all industrial products duty-free access. Preferential access is given to about 400 agricultural products often at a reduced rather than zero-duty rate.

The EU GSP scheme is for a ten-year period. The current scheme will last until 2005. In June 2001, the European Commission adopted a proposal for revision of the GSP scheme for the period of 2002-2004. The aim of the proposal is to simplify the rules and structure of the GSP scheme. These changes will further encourage exporters from countries that are beneficiaries of the EU GSP scheme. The labour and environmental incentives should be underlined under the revised proposal. These incentives allow beneficiary countries to implement more effective policy in labour and environmental sectors since the proposal envisages a double reduction of the current additional tariff.

It is important to mention that Georgian companies rarely apply for the scheme of Generalized System of Preferences. In 2001, Georgia exported to European markets goods valued at USD 57.6 million and only USD 4.3 million were exported under the GSP scheme, according to the figures from the Ministry of Economy, Industry and Trade. This fact supports the assumption that Georgian export faces impediments to the EU market. These impediments are mostly caused by the differences in standards and certification systems. Another problem is lack of information about GSP in Georgia. Many businessmen do not know how to access the system.

On the other hand, it is noteworthy that since 1995 the issue of GSP certification on Form "A" goods increased. According to the Ministry of Economics, Industry and Trade, only 20 GSP certificates were issued in 1997, three years later this amount grew to 355. Last year the Ministry issued 307 GSP certificates.

And finally, one of the problematic areas of the EU-Georgia trade relations remains a remarkable discrepancy in the European and Georgian statistical data. For example, in 2000, the State Department for Statistics registered Georgian exports to the European Union as USD 68.3 million. At the same time, for the same period, the statistical institute of the EU, Eurostat registered imports from Georgia as USD 228.2 million. This kind of misunderstanding prevents a clear picture of trade between the two sides and has negative effect on the EU-Georgian economic relations.

[1] Georgia's total turnover amounted to USD 219.6 thousand. *Source: State Department for Statistics*

THE EU INTERSTATE PROJECT: INOGATE

INOGATE[2] is the European Union's interstate project that runs through the TACIS programme. INOGATE was launched in 1996, and at the moment twenty-one countries from the Caucasus, Central Asia, Eastern Europe and the European Union participate in the project.

The objective of the INOGATE programme is to improve the security of European energy supply by promoting regional integration of the oil and gas pipeline systems and facilitating transport from the region to Europe and the West[3].

During the period 1996-2001 INOGATE implemented various projects in the energy sector in the Caucasus and Central Asia to a total value of EUR 69.0 million.

Georgia has been a member of INOGATE from the beginning and actively participates in projects. During this five-year period Georgia was a recipient of several programmes amounting to a total of EUR 10.6 million[4].

Two INOGATE projects were implemented in Georgia in 1996. The objective of these projects was a rehabilitation of crude oil and oil products transportation networks as well as rehabilitation, modernization and rationalization of existing gas transmission networks. The programmes focused on rehabilitation of existing crude oil and oil products pipelines, oil processing facilities and transport systems; support of gas transportation from the region to European markets by promoting investments in rehabilitation, modernization and expansion of gas transportation facilities in the region.

In subsequent years, programmes implemented included Institutional Issues and Strengthening of Regional Co-operation project, Priority Emergency Investments in Oil and Gas Infrastructure project and Small-Scale Investments for Energy Sector project.

The Institutional Issues and Strengthening of Regional Co-operation project is an important one. The objectives of the project focused on the implementation of an Umbrella Agreement (see box 8.1), establishment of common oil and gas interstate operators for infrastructure rehabilitation or new construction. Initially, the INOGATE programme started only for Tacis countries, but later by the adoption of Umbrella Agreement it became open to other European countries as well.

It is anticipated that the INOGATE programme will have a positive influence on the development of the Georgian economy. INOGATE transcends the framework of energy aspects and plays an important role in the regional integration process, creates closer ties in economic and political relations between Georgia and its neighboring countries, and facilitates the attraction of foreign investors and international financial institutions in the country.

[2] INOGATE – Interstate Oil and Gas Transport to Europe
[3] Source: European Commission
[4] Source: Ministry of Foreign Affairs of Georgia

Box 8.1

What is the INOGATE Umbrella Agreement?

Developed within the institutional pillar of the INOGATE Programme, the INOGATE Umbrella Agreement (UA) is an interstate agreement that sets out an institutional system designed to rationalize and facilitate the development of interstate oil and gas transportation systems and to attract the investments necessary for their construction and operation.

To date, it has been signed by 21 states from Central Asia, the Caucasus, Eastern Europe and the EU. Additional Protocols, either addressing issues of general application (such as the settlement of disputes and the protection of the environment) or elaborating the terms of specific projects, will be signed in due course.

The general beneficial effects of the Umbrella Agreement are manifold:

- First of all, it signals the will of the signatory States to co-operate with each other in order to facilitate, and indeed to make possible, the commercial exploitation of the oil and gas reserves of the Caspian Sea region by arranging its efficient transportation to the energy markets of Europe and the West.
- It introduces the concept of a Common Operator of an interstate transportation system, with the aim of avoiding complicated and inefficient operation of said system (such as pipeline or multi-modal transport) by several national authorities.
- It also introduces the concept of a Common Project Manager, responsible for the oversight of the construction of an interstate transportation system, in order to ensure synchronisation and observance of common technical specifications of the several national segments.
- It provides a uniform guarantee towards investors and towards each other that the Participating States shall not implement any subsequent legislative amendments which are detrimental to existing projects.
- It provides for the elaboration of commonly agreed technical specifications and operating procedures.
- It provides for commonly agreed regulations of environmental protection corresponding to international standards in the field.
- It provides for a mechanism of settlement of disputes between any combination of States, investors and third parties on the basis of the rules of the ICC and UNCITRAL; such mechanism is already at an advanced stage of development, being the subject of an additional Protocol expected to be adopted by the Beneficiaries in the near future.
- All in all, the Umbrella Agreement and its associated Protocols are designed to offer maximum flexibility in the institutional structure of specific projects while establishing a commonly agreed series of parameters compatible with international financial, technical and operational standards, in order to minimize investment risk, maximize profitability and, consequently, attract foreign investment with the best possible terms.

The implementation of the Agreement is flexible and enforces the principle of multiple pipeline routes as set out in the declaration of the Council of the EU, dated 27/4/98, and in the EU/US Statement on Caspian Energy Issues, dated 18/5/98.

The Agreement does not modify or put an end to other treaties in force relating to the oil and gas transit sector. It does not preclude State Parties from entering into other forms of intergovernmental co-operation in this sector. The Agreement contributes to the development of rules governing international oil and gas transit activities. The Agreement can be also a catalyst to the effective application of other transit rules established pursuant to other important Treaties in the oil and gas sector (e.g. Energy Charter Treaty).

The Umbrella Agreement is open to all interested countries. This means that it can be acceded to by any country, notwithstanding its status as an oil and gas producing or transit country.

The INOGATE Umbrella Agreement is in force as an international treaty as of February 2001

Source: European Commission

CALENDAR OF EVENTS

JANUARY 2002

4 **Fight against smuggling** On the decision of Avtandil Jorbenadze, State Minister, an independent commission was formed for the fight against smuggling. It involves three presidential advisors and deputy ministers of economic services. The aim of the commission is to work out measures for eliminating import of smuggled goods into the country.

14 **Energy** Minister of Fuel and Energy, David Mirtskhulava, has become a member of the International Council in Energy. This organisation has existed for 95 years and 90 countries are members.

21 **Business** A constituent session of the confederation of Georgian Businessmen was held. The confederation involves the Taxpayers' Union, Investment Fund of Georgia, International Chamber of Commerce and AmCham (American Chamber of Commerce). Niko Lekishvili, chairman of the Taxpayers' Union, was elected the Confederation chairman.

31 **State Budget** The Parliament of Georgia approved a state budget for 2002 at a special session. The budget revenue part of 2002 is determined at GEL 1,039,869,000; that of expenditure – GEL 1,259,527,500.

FEBRUARY

8 **Customs/Technical Assistance** Avtandil Jorbenadze, Minister of State, Phillip Remler, Deputy Chief of Mission, US Embassy to Georgia and James Kelly, a representative of the US Customs Department, director of the programme on border protection and security of Georgia, discussed issues of reform and reorganisation of the customs service of Georgia. Mr. Kelly mentioned that the US government, at the present stage planned to assist the Customs Department of Georgia. In particular, a pilot project will be implemented for improving customs procedures in Tbilisi airport.

11 **Customs** The government of Poland agreed to meet a request from the Ministry of Economy, Industry and Trade of Georgia and from 2002 lifted customs duties from tea imported from Georgia to Poland. Until this decision by the government of Poland, Georgian tea was taxed at 15 per cent.

12 **Foreign Debt** An agreement on rescheduling a debt of Georgia to Armenia in the amount of USD 19.6 million was signed during an official visit to Tbilisi of Vardan Oskanian, Foreign Minister of Armenia. The debt will be repaid over 20 years with annual rate of interest of 3 per cent.

22 **Gas Transit** Final agreement was signed between Azerbaijan and Georgia in Baku within the Azeri gas transporting from the Shah-Deniz deposit. After the pipeline starts operation, Georgia will get 5 per cent of the natural gas volume transported through it in the form of a tariff for transit.

24 **Securities markets/Currency** Meeting of International Association of CIS Exchanges was held in Baku, with participants from Kazakhstan, Georgia, Ukraine, Azerbaijan, Russia and Uzbekistan. Participants discussed issues connected with the securities market and changes that took place at CIS currency markets in connection with the introduction of the EURO.

27 **Customs/WCO** Due to non-payment of participation fees for two years, from 1997 the World Customs Organization (WCO) moved Georgia's Customs Department to passive member status, after being an active one since 1995. Georgia fully covered the indebtedness and paid participation fees for this year, thus regaining active member status.

MARCH

4 **Export** Agency of Export Credit and Insurance was formed in Georgia, the objective of which is to promote the formation and development of small entrepreneurship and to support export policy. The agency was formed with the support of the Black Sea Trade and Development Bank (BSTDB) and the Ministry of Economy, Industry and Trade.

14 **Oil and Gas** International Conference "Oil, Gas, Energy and Infrastructure" was held in Tbilisi. During the conference, an agreement was signed between the investors in the project on South-Caucasian pipeline system (gas pipeline Baku-Tbilisi-Erzrum) and the Georgian government. The agreement was signed on behalf of Georgia by Giorgi Chanturia, GIOC president and on the part of the investors by representatives of SOCAR, BP, TotalFinaElf, LUKAgip, Statoil, Nico and TPAO.

15 **Foreign Affairs** Parliament confirmed Levan Mikeladze's candidacy to the post of extraordinary and plenipotentiary ambassador of Georgia to the USA. Mr. Mikeladze will also fulfill the functions of the Ambassador to Canada and Mexico.

19 **Transport** Poti port received international certificate of license from Russian Marine Shipping Register. The decision was based on the positive results of inspection of the system of quality.

26 **Social Safety Net** A presidential decree "On Social Allowance for Vulnerable Families" was passed. According to the decree, the Social Allowance for vulnerable families, provided for by the 2002 Budget Law, is targeted at households comprised exclusively of "poor non-working pensioners" or of orphans, disabled children and invalids, and families with at least 7 children.

APRIL

2 **Customs** Levan Dzneladze, the Tax Revenues Minister, announced at a press conference that the British company ITS suspended its activities in Georgia. He advised that from April 1st, pre-import inspecting will be conducted by the Customs Department.

5 **Customs** As mentioned at a meeting of President Eduard Shevardnadze with Mehmet Kececiler, a Turkish State Minister, a new checkpoint at the Georgia-Turkey border was opened. A systematic growth of goods turnover between the two countries has made a new border checkpoint in Kartsakh necessary, which unlike the one at Vale-Akhaltsikhe, will work all the year round. The Turkish side is ready to allot a USD 10 million credit for finishing the construction of the Georgian section of the road up to the Kartsakh checkpoint. The construction works are to start in June.

5 **Customs** An agreement on co-operation in the customs sphere was signed between Georgia and Turkey. Minister of the Tax Revenues of Georgia Levan Dzneladze and State Minister of Turkey Mehmet Kececiler signed the agreement on mutual aid and co-operation on customs issues.

5 **EBRD** At April 5th session of the Presidential Investment Council, Temur Basilia, presidential adviser on economic reforms issues, delivered information on the strategy of activities of the *European Bank for Reconstruction and Development (EBRD)* in Georgia over 2002-2003, approved by the Bank Board of Directors on the 26th March. The EBRD plans to concentrate its investment activities on such spheres of the private sector as energy, transport, banking system and communications.

7 **Economics** A decision continuing the programme has been reached between the government of Georgia and the US which finances the work of the former prime Minister of Poland, an author of the "Shock therapy", Leszek Balcerovicz and his group in Georgia.

7 **Social Development** A presidential decree "On First Priority Measures Aimed at Realisation of the Social Development Concept" was passed providing for measures to be taken to regulate labour relations, raise the effective use of the labour force and improve the employment situation; as well as improve pension system; and facilitate the drawing up and implementation of state programmes in the social sphere.

8 **European Parliament** A resolution adopted by the European Parliament "EU Relations with South Caucasus" highlights the need for supporting and continuing the financing of all programmes on regional co-operation in the South Caucasus. The document stresses that the European structures should take part in the implementation of economic projects in the South Caucasus, especially in the energy sector.

9 **Privatisation** The Ministry of State Property Management worked out a draft presidential decree "On Forming an Agency for Development of Enterprises with State-share Participation". The State Property Management Ministry will conduct control over this agency. The major task of the agency will be development of the enterprises with state share participation; protection of state interests in these enterprises; optimisation of dividends mobilisation in the state budget; co-ordination and implementation of state share and stocks management; rational use of the property; increase cost efficiency; promotion of the privatisation process.

10 **EU Assistance** On April 10th, a document was signed in Tbilisi, according to which the Customs Department will receive EUR 850,000 from the EU. The sum will be spent on the services of foreign and local experts, who will work on elaboration of the Georgia's customs legislation and its harmonization with the European legislation in the customs sphere. Last summer, a comparative analysis of the customs legislation of Georgia and the EU was conducted with the participation of Austrian customs experts, in the framework of Tacis programme.

11 **Small and Medium Enterprises** Mevlud Tsiklauri, director of the Agency for Small Business Promotion, presented the Programme for Supporting Small and Medium Enterprises of Georgia for 2002-2004 at a press conference on April 11th. The programme foresees support of small and medium enterprises. However, before that, changes should be introduced into the law of Georgia "On Support of Small Enterprises". The draft law has been prepared and presented for discussion to the government. It foresees the introduction of the concepts of small and medium enterprises, establishment of criteria of the number of employees engaged and capital turnover.

15 **Energy** Parliament ratified a credit agreement with the World Bank on allotting USD 27.4 million for developing the energy sector. The credit agreement for the World Bank project on power market maintenance totalling USD 55.7 million was signed between the government and the International Development Association of the World Bank (IDA) on June 18th 2001. Under the contract sources of financing are IDA – USD 27.4 million, German Credit Bank for Reconstruction *KfW* – USD 12.4 million, European Bank for Reconstruction and Development – EUR 1 million, JSC *Electrogadatsema* - USD 8.7 million, LLC *Electrodispetcherizacia* – USD 2.2 million, and LLC *Wholesale Electricity Market* of the electric power - USD 4.2 million.

16 **Tax System** A concept of a new taxation system of Georgia should be ready by 10th of June. As stated at the April 16th presentation of a new taxation system of Georgia, this document was worked out in the Institute of Economic Development of Georgia on the initiative of the Parliamentary faction "Entrepreneurs", with the financial support of Gogi Topadze, head of the faction and entrepreneur. The faction, in co-operation with the Open Society Georgia Foundation, foresees introduction of essential changes into the Tax Code of Georgia. 42 experts took part in the elaboration of a new alternative project. The group involved both Georgian and foreign economists and financial experts.

19 **Gas Pipeline** The final agreement on Baku-Tbilisi-Erzrum Gas Pipeline was signed at an international conference, launched in London, with participation of fuel and energy departments of Azerbaijan, Georgia, Kazakhstan, and foreign companies such as Chevron Texaco, BP, Pricewaterhouse Coopers, Schlumberger, Burren Energy, Statoil, Parker Drilling, AMBO, EBRD, and CPC, dedicated to issues of Central Asian and Caspian fuel-energy complex development.

After the pipeline starts operation, Georgia will receive, in the form of tariff for transit, 5 per cent of the natural gas volume, which will be transported through it. At full loading of the pipeline Georgia will get 1.5 billion m^3 of natural gas, when at present the country consumes annually not more than 750 million m^3 of gas. Georgia will also have an opportunity to sell annually 500 million m^3 of gas at privileged prices.

19 **Transport** On April 18-19, at a European conference of transport ministers (ECMT) in Tbilisi, launched under the aegis of the World Bank, a seminar was held on the issues concerning transport policy in the South Caucasian countries. The seminar discussed questions of transport policy in the region, development of transport lines, co-operation and sharing of international experience.

20 **Tourism** On April 18-20, the fourth international exhibition-fair of the Silk Road Countries was held in Tbilisi. 60 organizations and companies from 10 countries participated. The organiser was *Expo Georgia* exhibition centre with the support of Georgia's State Department on Tourism and Resorts.

22 **Social Safety Net** A presidential decree "On Additional Measures in the Field of Social Safety of the Unemployed" was passed. According to the decree, the amount of the standard monthly Unemployment Benefit payable for the first six months of registered unemployment is raised for the second two month period and the third two months of unemployment by GEL 2 and GEL 3 respectively and is fixed at GEL 14 for the duration of the eligible period.

25 **IMF/Georgia** A regular visit of the IMF Mission headed by David Owen, head of Southern Division of II European Department, started on April 25th. During the visit, the IMF experts conducted an analysis of the fulfilment of its recommendations. Special attention was paid to the issues of improving the macroeconomic situation and the development of fiscal and monetary-credit policy of Georgia.

During this regular visit, the IMF Mission familiarized itself with the course of structural changes, the situation in the budgetary sphere, the fulfillment of obligations on external debt and related issues. On a preliminary assessment, the IMF is ready to allocate USD 60 million to Georgia instead of an earlier proposal of USD 48 million. The sum will be received in two equal tranches in the end of May and in December if the IMF Mission positively evaluates how Georgia has fulfilled the IMF recommendations.

Georgia has been co-operating with the IMF since 1994. Over that period USD 390 million in credits has been received from this international financial organisation.

27 **IMF and the World Bank** At the spring meetings of the World Bank and the International Monetary Fund a decision was adopted on additional support to the initiative on assisting seven former Soviet Union republics (members of CIS) with the lowest level of income: Azerbaijan, Armenia, Georgia, Kyrgyzstan, Moldova, Tajikistan and Uzbekistan (CIS-7). The aim of this initiative is "to strengthen the measures directed at the reduction of poverty and stimulating economic growth while simultaneously providing stability of the fiscal and foreign debt situation". The press release says that the initiative is based on the principle of "intensification of the process of development and reforms and greater independence of CIS-7 in implementing this process" in relation to the international community, which is ready to support "the countries conducting the subsequent policy of reforms".

30 **US Assistane to Georgia** USA government alloted to Georgia a USD 20 million grant for food and processing industry rehabilitation. In summer the first stage of the project will start during which foreign and Georgian specialists will study the situation in the food and processing industry of Georgia. The first phase will last a year. After that a plan will be made for second phase, which will be longer.

MAY

7 **Parliament/Lawmaking** A draft law "On Financial Leasing", adopted at the May 7th plenary session in the third hearing, determines the forms of leasing, powers of leasing relations participants and a concrete mechanism of legal regulation in this sphere.

13 **World Bank** During the visit to the World Bank headquarters in Washington, which finished on May 13th, Giorgi Isakadze, Deputy State Minister, head of the delegation, launched talks on the possibility of continuing the municipal development and decentralisation project. A protocol of intent was signed, allocating USD 19.4 million within a second project of municipal development and decentralisation. The total cost of the project is USD 28 million. The two sides discussed the terms of the credit agreement.

13 **Co-operation** Control Chamber of Georgia and Control Chamber of the Ukraine signed an agreement on co-operation. This was signed by heads of these services Sulkhan Molashvili and Valentin Simonenko. The agreement foresees co-operation in such issues as sharing of experience, improving a system of staff training for the audit structures in a single educational centre, which has to be formed.

14 **Parliament/Minister of Finance** On May 14th the Parliament of Georgia at its plenary session unanimously confirmed the candidacy of Mirian Gogiashvili to the post of the Minister of Finance. Before that he worked as a secretary of the Co-ordination Council in Anticorruption Policy. Gogiashvili's candidacy was put forward by President Eduard Shevardnadze and was approved by 14 parliamentary factions.

14 **Energy/Staff** President appointed an ad hoc commissioner on energy. It is said in the presidential instructions that the introduction of a new post is aimed at forming a long-term conception of stable energy development, the introduction of new high-efficient technologies and mobilization of foreign investments. Archil Prangishvili, professor of the Technical University, a correspondent-member of the Georgian Academy of Science, is appointed to the post of emergency representative in the energy sphere. Georgia's state bodies are charged with the task of assisting him in organisation issues

15 **Earthquake** USD 150 million is required for repairs of damage in the April earthquake in Tbilisi. This is pointed out in an emergency appeal to the population of Georgia and its allied countries and international organisations, prepared by the Georgian experts with the support of UNDP. It is mentioned that USD 30 million are required for first priority emergency works.

15 **Banks** Microfinance Bank of Georgia (MBG) celebrated its third anniversary. Ms. Doris Koehn, the new chairman of the ***MBG*** Board, said at May 15th press conference that over this period the Bank managed to be among the five leading banks of Georgia. In 2001, the bank had assets of USD 35 million. The loan portfolio at the end of 2001 was USD 23.5 million, which was lent to 5,350 clients. By April 30th 2002 the Bank loan portfolio had increased to USD 25 million, and the number of clients increased to 6,305. Since 1999 the bank has made 13,044 loans. The average loan of GEL 8,000 makes it clear that MBG mainly serves the group of micro and macro enterprises operating in Georgia. 98 per cent of loans allocated are being repaid by the clients on time.

18 **EU Days in Tbilisi** May 14-18 Georgia hosted ceremonies dedicated to the Days of the EU in Georgia and the 10th anniversary of the European Union's Tacis Programme. Tacis Programme provides grant finance for know-how to foster the development of market economies and democratic societies in the New Independent States and Mongolia. Within the programme 300 projects have been implemented in Georgia in such important spheres as policy advice, energy, agriculture, transport, statistics and education. The programme enables such significant projects as the Europe-Caucasus-Asia transport corridor (TRACECA) and oil and gas transportation from the Caspian region to European countries.

21 **Georgian – Turkish Economic Relations** Economic relations between Georgia and Turkey should be intensified. A Turkish State Minister, Tunja Toksai, spoke about this at his May 21st

meeting with the President of Georgia. President Eduard Shevardnadze mentioned that an agreement "On Stimulating Investments" signed between the two countries promoted the strengthening of bilateral economic relations. Now Turkey is one of the lead investors in Georgia but still, stressed the President, Georgia should intensify economic and trade co-operation.

21 **Georgian – Dutch Business Relations** A meeting of Dutch and Georgian businessmen was held in Tbilisi. Since 1998, the government of Holland has been implementing several projects in Georgia.

22 **EBRD** The Georgian delegation participated in the annual session of the European Bank for Reconstruction and Development in Bucharest. The delegation members were Temur Basilia, presidential adviser on economic reform issues (head of delegation), Irakli Managadze, president of National Bank, Jemal Inanishvili, head of Poti port, Vladimir Pateishvili, Chairman of Supervisory Board of Bank of Georgia. The Georgian delegation members discussed, in particular, EBRD's activities strategy in Georgia in 2002-2003, approved by the Bank Board of Directors on March 26, 2002.

22 **WTO Ministerial Conference in Tbilisi** Mike Moore, director general of the World Trade Organisation, spoke at the WTO Ministerial Conference of Central Asian and Caucasian trade Ministers in Tbilisi. According to Mr. Moore, the introduction of these countries into the world trade system "will promote both economic and political stability of the region". He stressed the readiness of the WTO to assist this process. Mr. Moore pointed to fact that the WTO at present attaches special attention to technical assistance for developing states with a transitional economy. In his opinion, support of donor-countries and WTO members enabled the doubling of resources of a special fund formed within the organisation. This lays a basis for increasing assistance to developing countries and providing for their full value participation in world trade.

24 **Assistance/Japan** Government of Japan continues financing the supply of agricultural machinery to Georgia. A memorandum was signed in Tbilisi on continuing the 2KR programme, started in 1996 financing the delivery of a variety of agricultural equipment to Georgia by the government of Japan. Over these years 1,046 units of agricultural machinery worth over GEL 24 million were brought to Georgia. This year the programme should finance 600 agricultural units, for which the Japanese government will have allotted a USD 3 million grant.

25 **Regional Seminar for Farmers** Tbilisi hosted a seminar for farmers from Georgia, Armenia and Azerbaijan, organised by the Israeli Centre *Mashav* and co-financed by the Eurasia Foundation.

27 **Privatisation** A regular tender for the privatisation of the state airline company Georgia Airlines was launched. 100 per cent of shares are being put to international commercial tender. The deadline for applications to be presented to the Ministry of State Property Management is June 27th. The initial sale price of the shares is USD 931,000.

30 **Banks** First quarter results for TBC-Bank show it to be the biggest commercial bank in Georgia by assets, liabilities, credit portfolio and major rates. The Bank is also the biggest financial organisation in the country. By April 2002, TBC-Bank assets were GEL 151.7 million,

with liabilities of GEL 129 million, and the loan portfolio exceeded GEL 85 million. According to deposits, the market share of the bank was 21.2 per cent. Fourth quarter results from last year put *Bank of Georgia* as the biggest commercial bank in the country. Its assets were GEL 137 million. TBC-Bank was then in the second place with assets of GEL 118.7 million.

APPENDIX I:
CONCEPT OF THE NEW TAXATION SYSTEM OF GEORGIA

The following team of authors worked on the concept:

Niko Orvelashvili, Team Leader, Chairman of the Board of Directors of Georgian Economic Development Institute (GEDI),
Irakli Shavishvili, Director of "Libo-Audit",
Kakha Damenia, Association of Young Economists,
Otar Zoidze, Chairman of the Board of Chamber of Notaries,
Akaki Chargeishvili, Association of Young Lawyers,
Gia Jandieri, Coordinator of the Programme of Pension Reform of OSGF,
Tariel Gotsiridze, Financial Director of Rustavi-2 TV Broadcasting Company,
Vazha Salamadze, President of Business Law Centre

GENERAL PART

The new concept of the taxation system implies a fundamental reform of the current system mainly aimed at:

1. Legalisation of the taxation base through simplification of the current system (reducing the number of payments and introducing maximum transparency into the rules of calculation and payment of taxes);
2. Making the new taxation system appropriate for its environment so as to render the code an enforceable legal act and tax payments calculable and payable to the Budget;
3. A sharp reduction of tax evasion and weakening of the motives for corrupt transactions;
4. Orientation of the system towards economic growth promotion by way of stimulating investment;

The draft Tax Code is based on the following principles:

1. Tax payers and the public administration shall regulate taxation-related issues on equal terms;
2. Each payment should be based on a clearly fixed concept. It should have a clearly expressed purpose and intention;
3. The payment and rules of tax administration shall not abuse human rights, including economic and social rights. The weight of an averaged tax burden should be reasonable and bearable to the tax-payer and should overall not exceed 30 per cent of GDP;
4. The introduction of taxes should be economically reasonable with predictable and justifiable long-term outcomes. Introduction of taxes with the aim of attaining some short-term fiscal or other local effects is inadmissible if in the medium and long run this may turn into an impediment for economic growth;
5. It is unjustified to introduce a tax unless it entails a reasonable fiscal effect;
6. Taxes should not breach obligations undertaken under international agreements;
7. Maximum harmonization of the tax code with current Georgian legislation including first and foremost the Constitution, and the Civil and General Administration Code. The norms and terminology of the Fiscal Law should as far as possible be brought into conformity with norms and concepts established by existing legislation;
8. Special terms of the Tax Code should be based on concepts specified by accounting and auditing standards;

9. The introduction of taxes is unjustified if the possibility of their administration is doubtful and the anticipated effect is not subject to prognosis. The tax administration regime should be transparent and should as far as possible exclude opportunities for corrupt actions.
10. The powers of the tax administration should be balanced by corresponding responsibilities. The delegation of powers to the administration unless they are balanced by responsibility and subject to control is inadmissible as such powers are, as a rule, abused;
11. The competence of the tax administration as a body responsible for the fulfillment of the plan should be extended to that of the body supervising the observance of law. The establishment and sustainable functioning of efficient control mechanisms for the execution of the Tax Code should be made a principal criterion for the assessment of the work of tax administration officers. Incentives for tax administration officers should relate to law enforcement and establishing of an atmosphere of supremacy of law and effective management of the system rather than fulfillment of the plan.
12. Taxes must be stable, allowing for long-term planning on the part of tax-payers. The procedure for introducing changes into Tax Code should be subject to strict regulation. Changes adopted may be put into force only from the beginning of a new fiscal year.

CHAPTER I: GEORGIAN TAXATION SYSTEM

The principle innovations offered by this part of the draft Code are as follows:

New definition of taxes. The draft defines taxes not as a non-equivalent and uncompensated transfer of sums to the State but as a liability of certain persons before the State so that latter can provide its citizens and all legal residents on the territory of Georgia with a secure life and work environment. Thus, this new definition defines the taxes as a reciprocal liability of the State and a tax-bearer to each other. Such a definition makes it clear to the tax-payer that taxes are not just some tribute but a sum payable by a tax-payer to the state administration on legal grounds, which by force of law must be used for his own interests.

Repeal of sub-legal acts (instructions) in taxation. The Draft Code contains detailed directives concerning calculation of tax rates and samples of the accounting forms (declarations). Therefore, it does not envisage the elaboration and publication of guidelines relating to taxation. Such an approach would counter to both international practice (forbidding specification of taxation procedures by subordinated normative acts ranking lower than the Law) and domestic experience (which proves that very often instructions, instead of clarifying the rule of law, make it even more incomprehensible). Moreover, there are frequent cases when a definition given by an instruction contradicts the same rule of law it defines. Another significant ground in favour of rebuffing instructions is that they are not nation-wide. As a rule, instructions are not easily available for most of taxpayers whereas, provided they are available, an administrative officer is fully guided by these instructive norms even when these instructive norms are in contrast to the corresponding norms of the Code. Apart from the fact that this places a taxpayer and an administrative officer in unequal positions, it is also distorts legal understanding by administrative officers and hampers their professional development.

Sharp reduction of the number of existing payments. Currently, there are 12 nation-wide and 6 local taxes imposed by the Tax Code. According to the draft Code the number of nation-wide taxes shall be limited to 3 and that of the local taxes to just one type. The rest of the taxes shall all be withdrawn except for those listed below:

Nation-wide taxes:

1. Income-tax (for physical, entrepreneurial and non-entrepreneurial legal entities);
2. Value Added Tax;
3. Excise Tax.

Local Taxes:

1. Property tax (including taxes imposed on land, property of physical and legal entities, owners of vehicles)

As to the withdrawal of taxes from the Code, part of them may be transformed into license or local taxes (e.g. on gambling and resorts) while others are regarded as completely unjustified at this stage.

The withdrawal of the social tax and its transformation into a personified social insurance contribution is noteworthy. The social insurance reform that is currently underway, implies resolving of this problem as well. Although certain steps have already been made in this direction, there is still a long way to go. Unless the transformation of the social tax into a personified social insurance contribution is made in due time and unless this tax in its present distorted form is invalidated, the anticipated positive outcomes of the tax reform may prove unattainable or its effect may be dramatically undermined. As far as the current liabilities of the United State Social Safety Fund are concerned, they will be covered from proceeds of other national taxes.

Another subject for discussion is environment taxes. Their purpose, justification and regime of administration sharply differ from classical revenue taxes. Therefore, it has been proposed that these taxes should be made subject to regulation by a special law on environmental financial instruments instead of a Tax Code. Even if environment taxes (financial instruments) are retained in the Code, due to their distinct specificity, they should be regarded independently from revenue taxes and categorised separately.

Change of the system of local taxes. Under the present Code property and land taxes were attributed to nation-wide taxes. Considering our experience and international practice as well, these payments have been shifted to the group of local taxes. Under the new draft, the property tax also includes another currently existing nation-wide tax - on vehicle ownership.

As a result of a critical analysis of the current system of local taxes, 5 of the 6 types of local taxes have been completely rejected as they fail to comply with the main principles of the new draft code. The only remaining type of local taxes - on gambling business - is referred to rather as a license payment than as an instrument to be regulated by the Tax Code.

According to the proposed draft, property tax becomes a major revenue source for local budgets, which are better controlled and administered by municipalities than by central authorities. However, under this draft, a property tax combines real estate and also, according to the legislation, property subject to mandatory registration and some categories of moveable property groups, as well as agricultural and non-agricultural, industrial land.

Specification of property tax as the only local tax does not exclude the possibility of financing local budgets from the proceeds of nation-wide taxes. This issue, though, goes beyond the frame of regulation by the Tax Code and into the competence of the Budget Law.

CHAPTER II: TAX ADMINISTRATION

Norms addressed in this chapter are based on the parity principle between tax-payers and state administration in the sphere of tax relations. The tax-payer has civil rights as provided by the Georgian Constitution (Articles 20, 21,40, 42 and 45), including presumption of innocence, which is an important innovation.

According to the principles and norms referred to in the code, a taxpayer's rights and their protection are secured. Representatives of the tax administration are granted only the right to claim fulfillment of tax liability from taxpayers. If a taxpayer considers it a relevant claim and agrees to it, then its fulfillment becomes compulsory whereas, non-compliance is regulated under a simplified order without legal action.

Where a taxpayer does not agree to the claim of tax administration he is conferred the right to produce in a written form, a well-grounded reason for the rejection of such claim within 12 days from its presentation. In such cases the administration shall immediately bring a suit against the taxpayer. Proceeding from the presumption of honesty, the administration has to bear the burden of proving the claim in court.

If the claim of the tax administration is acknowledged as lawful and allowed by court, the court shall impose on the taxpayer a sum twice as much as that of the unfulfilled liability in favour of State Budget. Besides, the taxpayer shall have to bear all legal costs himself.

If the claim of the tax administration is not allowed then the court shall require it to pay the sum to the taxpayer under the same order.

In that case, the Head of the Tax Administration shall forthwith put in a claim for the amendment of the damage caused to the State against the tax administration officer, who has been found immediately responsible for presenting a wrongful claim to the taxpayer and shall also suspend him from duties until the end of the proceedings.

Advancing the role of the court in dealings with the public renders more openness to the process and reinforces and guarantees legal protection.

The new system provides for the creation of a special fund for incentives to the tax administration employees and notably, the proceeds from the execution of such court decisions shall serve as the major source for the fulfillment of this fund.

CHAPTER III: INCOME TAX FOR INDIVIDUAL PERSONS

Under the new concept, the former profit and income taxes have been combined into a single income tax.

The Chapter on income tax for individual persons contains the following principal innovation:

1. Two modes of payment will be concurrently valid and the taxpayer himself will have to make a choice at his convenience:

A. 20 per cent taxation rate with a right to enjoy deductions;
B. 10 per cent taxation rate without the right to enjoy deductions

Those taxpayers, who choose the first option, will have to maintain records on current incomes and expenses as well as monthly statements so as to reduce their combined income by expenses deductible from a documented verifiable taxable income. The second option implies denial of tax concessions for those who have chosen this mode of payment.

All taxpayers who choose the first option shall have to notify the Tax Administration of this choice in advance.

Another innovation is reduction of taxation rates for bank profits and dividends.

CHAPTER IV: INCOME TAX FOR LEGAL ENTITIES

There are following principal innovations in the income tax for legal entities:

1. Detailed specification of the norms and a list of expenses to be included in the prime cost of production (works, services) by the Code;
2. To entitle supervisory counsels (partners) to define norms of amortization costs within the framework specified by the Code for the long-term (more than a year);
3. Taxation of re-invested profits on preferential terms.

CHAPTER V: VALUE ADDED TAX

The concept regards this tax as a leading nation-wide tax. Out of four models in the international practice the choice fell on the third model of the value added tax, which given the present situation in Georgia was considered the most acceptable and effective. According to the proposed method this tax is practically universal.

VAT is imposed on transactions and not on taxpayers as provided by current legislation. Therefore, it will not be necessary to be registered as a separate VAT payer and to establish lower limit of VAT.

It is the newly produced value that is the object for levying VAT calculated as the difference between gross taxable income and expenses incurred to gain this income. Therefore, it is no longer necessary to offset an already paid VAT, thus relieving responsibility from one taxpayer for the actions of another taxpayer and on the other hand eliminating an important source of corruption. The only operation on which a zero VAT rate is preserved (right for VAT refund on expenses) is the export of goods. However, this right shall become valid only when the taxpayer acknowledges the receipt of income from exports. Apart from this, the right to reimburse VAT will be applied despite the fact whether VAT is withheld from the amounts paid to the supplier or not.

The new concept dispenses with a tax invoice, introducing instead an internationally accepted commercial invoice (i.e. cash demand). The invoice shall have requisite indications for ascertainment so that it is regarded as a document demonstrating the right to deduction of expenses.

A period of VAT calculation is a calendar month. The date on which a declaration is to be presented is the 15th day of the month following that of the calculation and the period of tax payment is the following 10 days. This payment period permits a taxpayer to determine his liability before the State. The norm is based on the priority of the fact of tax payment against declaration of the tax.

The VAT rate is based on 15 per cent taxable turnover. Also this rate is provisional and may vary from case to case.

According to the new concept, the changes shall apply to the list of tax-exempt operations under preparation.

CHAPTER VI: EXCISE TAX

Proceeding from its specific nature, no major changes have been made with regard to this payment as compared to the currently active Code, except for voiding of an invoice.

CHAPTER VII: PROPERTY TAX

While this tax is the only local tax it is regarded as a major financial instrument of self-government and local control. This tax is imposed on the following assets:

1. Land and facilities;
2. Fixed assets used for economic activities;
3. Vehicles;
4. Other property subject to mandatory registration

The principal innovation regarding this tax is the introduction of progressive scales. Enabling corrective territorial coefficients is also essential as far as it allows autonomous bodies to obtain additional effective instruments of urban policy management.

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

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and

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

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

1. RUSSIAN SCENARIO OF THE US DOLLAR CRISIS

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

What is this prognosis based on?

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

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

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

One of the significant features of the "new economy" (e.g. Internet technology) is that it requires huge primary investment, the benefits from which may be realized only through a very large scale development of a given project. Starting from the initial level of profitability, even a slight increase in investment is then likely to stimulate a significant growth in profits. At the same time, some controversy has arisen concerning profitability and productivity; in particular, from the very beginning there was high expectation that the "new economy" might facilitate a sharp rise in the level of productivity but this did not occur: it was the Nobel Prize laureate Prof. Robert Solow, who was the first to express doubts concerning the important role of computerization in the growth of productivity, which were recently proved by empirical estimations performed by other American economists (Deikin, 2001, pp. 22-23).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Two scenarios could be considered:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

3. DANGER OF A GLOBAL ECONOMIC CRISIS AND GEORGIA

Regarding the trend of developments in the world, a significant rise in prices for oil is not very likely to occur. As regards a moderate rise, this could be reflection of the increase of insurance components in costs of oil production and transportation on one hand and of certain delays in supply on the other hand. It should also be underlined that the possibility of carrying out acts of terrorism by terrorists against oil-producing Islamic countries is practically excluded as this would deprive them of a potential justification to declare "Jehad" - a religious war - against the West.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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STATISTICAL APPENDIX

CONTENTS *

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

Table A3.1: State Budget Revenues, January-April 2002

(GEL million)

	Revenue target	Actual revenues	Difference	Performance compared to target	Growth over the year
Total Revenues and Grants	299.88	263.51	-36.37	87.9%	15.8%
Total Revenues	279.08	262.14	-16.94	93.9%	16.3%
State Budget Tax revenues	233.4	218.34	-15.06	93.5%	9.1%
Central Budget Tax Revenues	167.2	153.82	-13.38	92.0%	6.8%
Non-tax Revenues	45.68	43.8	-1.88	95.9%	73.1%
Revenues of Special states Funds	66.2	64.52	-1.68	97.5%	15.0%
United State Social Safety Fund	53.56	53.57	0.01	100.0%	18.3%
Roads Fund	12.64	10.95	-1.69	86.6%	1.4%
Grants	20.8	1.37	-19.43	6.6%	-37.7%

Source: Ministry of Finance

Table A3.2: Crosstabulation of State Budget Expenditures by Economic and Functional Classification, Q1 2002
(GEL million)

	Total	Salaries	Business trips	Social contributions	Other goods and services	Interest payments	Subsidies and current transfers	Capital expenditures	Programme expenditures	Net lending
General Govrnment	42.84	4.60	1.03	1.56	4.27		0.36	0.01	1.92	29.09
Defence	7.89	2.03	0.15	0.13	3.73		1.85			
Law and Order	18.04	7.16	0.16	0.65	4.07		6.01	0.01		
Education	7.18	3.47	0.02	1.28	1.64		0.47		0.32	
Health Care	8.29	0.30	0.00	0.08	0.24		4.72		2.94	
Social Security	58.23	0.02		0.01	30.95		26.67		0.58	
Housing and Heating	0.95	0.01		0.00	0.48		0.46			
Culture Sports Religion	5.62	0.39	0.00	0.13	0.09		4.25	0.08	0.68	
Energy-Heating	11.43	0.04		0.02	0.00		11.37			
Agriculture	1.23	0.82	0.01	0.39	0.01				0.00	
Construction and Mining	0.10	0.07	0.00	0.03	0.00					
Transport and Communications	8.47	0.03		0.01				8.43	0.01	
Other Economic Activities	0.48	0.28	0.00	0.12	0.02		0.01		0.06	
Other	58.70	0.01		0.00	11.34	31.55	11.97	1.00	0.02	2.81
Total	229.44	19.22	1.37	4.39	56.85	31.55	68.13	9.52	6.53	31.90

Source: Ministry of Finance

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

	2000													2001				
	ANNUAL (1)	Jan-01	Feb-01	Mar-01	Apr- 01	May-01	Jun-01	Jul-01	Aug-01	Sep-01	Oct-01	Nov-01	Dec-01	ANNUAL	Jan-02	Feb-02	Mar-02	Apr-02
NET INTERNATIONAL RESERVES	**-409,387**	**-421,572**	**-429,077**	**-430,397**	**-433,199**	**-424,397**	**-408,967**	**-400,743**	**-407,555**	**-400,723**	**-397,741**	**-406,442**	**-339,315**	**-335,729**	**-363,822**	**-365,946**	**-368,539**	**-386,075**
Gold	1,007	1,007	1,007	1,007	1,007	1,007	1,025	1,025	1,025	1,113	1,113	1,113	1,058	1,058	1,058	1,058	1,240	1,240
Foreign Exchange	216,052	233,842	226,714	240,772	245,954	239,114	241,629	256,627	265,968	267,721	272,946	294,373	328,216	331,803	334,294	334,674	328,613	320,195
Use of IMF resourses	-549,832	-576,215	-578,433	-595,634	-601,251	-590,190	-578,370	-582,170	-595,175	-589,661	-591,755	-621,891	-591,406	-587,559	-618,555	-620,661	-613,335	-622,454
Other Foreign Liabilities	-76,614	-80,205	-78,364	-76,541	-78,908	-74,328	-73,251	-76,225	-79,372	-79,896	-80,045	-80,037	-77,182	-81,031	-80,618	-81,016	-85,056	-85,056
NET DOMESTIC ASSETS	**801,124**	**787,470**	**789,784**	**789,721**	**796,458**	**790,642**	**792,414**	**805,687**	**822,797**	**805,465**	**811,510**	**824,533**	**769,171**	**765,585**	**795,219**	**801,285**	**801,330**	**820,709**
Net Claims on General Government	754,118	770,865	772,850	735,492	738,306	743,121	753,822	763,845	772,034	759,031	759,717	772,363	739,138	739,129	750,264	757,859	730,654	742,995
Net Claims on Republican Government	760,750	777,274	782,074	745,412	748,050	754,748	768,321	776,253	781,094	774,251	778,430	784,301	749,415	749,415	758,754	765,676	742,910	751,255
O/w Loans to Republican Government	774,375	774,225	774,225	773,725	773,454	786,026	796,565	805,414	805,186	804,990	806,832	806,829	767,625	767,625	776,925	786,625	767,625	770,625
Net Claims on Unified Social Security Fund	-10	-15	-10	-3	-83	-201	-388	-65	-436	-770	-772	-801	-919	-925	-983	-791	-732	-834
Other Extrabudgetary Funds (net)	-6,623	-6,395	-9,214	-9,918	-9,661	-11,427	-14,111	-12,343	-8,623	-14,450	-17,941	-11,136	-9,357	-9,361	-7,507	-7,026	-11,524	-7,426
Claims on the Rest of Economy	77,878	81,378	79,505	77,659	80,013	75,440	74,329	77,322	80,476	81,057	81,213	81,199	78,335	78,335	81,760	82,122	82,092	82,061
Net Claims on Banks	2,619	1,468	1,752	-708	2,360	2,198	2,315	405	403	153	717	203	1,165	677	507	501	519	-441
Other Assets (net)	-33,491	-66,241	-64,324	-22,721	-24,222	-30,117	-38,052	-35,885	-30,116	-34,776	-30,137	-29,232	-49,467	-52,555	-37,313	-39,198	-11,936	-3,906
RESERVE MONEY (M1)	**391,737**	**365,898**	**360,707**	**359,324**	**363,258**	**366,245**	**383,447**	**404,944**	**415,243**	**404,742**	**413,769**	**418,091**	**429,857**	**429,857**	**431,397**	**435,339**	**432,791**	**434,634**
Currency in Circulation	329,157	306,326	309,332	309,988	314,716	313,479	319,906	343,861	349,850	338,250	349,528	351,511	365,669	365,669	361,839	369,189	361,629	366,022
Banks' Deposits	62,580	59,572	51,375	49,336	48,542	52,765	63,541	61,083	65,393	66,493	64,241	66,579	64,188	64,188	69,557	66,150	71,162	68,612
Required Reserves	38,943	39,029	40,640	40,872	43,608	43,745	48,585	48,301	50,888	51,293	52,052	52,172	53,300	53,300	55,815	57,844	57,613	59,571
Balances on Correspondent Accounts	23,636	20,543	10,735	8,464	4,935	9,021	14,956	12,782	14,505	15,200	12,189	14,408	10,888	10,888	13,742	8,306	13,549	9,041

Source: National Bank of Georgia

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

	2000													2001				
	ANNUAL (1)	Jan-01	Feb-01	Mar-01	Apr- 01	May-01	Jun-01	Jul-01	Aug-01	Sep-01	Oct-01	Nov-01	Dec-01	ANNUAL	Jan-02	Feb-02	Mar-02	Apr-02
NET FOREIGN ASSETS	**-12,610**	**-12,549**	**-18,113**	**-3,313**	**-10,522**	**-4,432**	**6,188**	**-19,467**	**-6,645**	**-2,276**	**8,559**	**-4,791**	**3,707**	**3,708**	**-9,102**	**-32,892**	**-16,365**	**-7,531**
Gold	39	15	11	11	4	4	4	4	4	4	4	4	4	4	4	4	4	4
Foreign Exchange	104,953	114,923	113,595	129,673	122,713	135,193	140,268	113,275	123,010	134,703	145,113	136,824	151,117	151,118	177,262	169,400	157,085	158,219
Foreign Liabilities	-117,601	-127,487	-131,719	-132,996	-133,238	-139,628	-134,083	-132,746	-129,659	-136,982	-136,557	-141,618	-147,414	-147,414	-186,368	-202,296	-173,454	-165,753
NET DOMESTIC ASSETS	**315,572**	**308,932**	**308,157**	**303,523**	**314,474**	**315,301**	**328,405**	**350,180**	**360,612**	**368,882**	**370,187**	**378,637**	**379,887**	**379,887**	**399,787**	**426,777**	**427,432**	**417,693**
Domestic Credit	422,187	419,246	429,366	426,367	438,737	444,162	442,447	469,553	485,922	490,007	497,893	511,675	479,469	479,469	494,024	523,137	525,725	541,136
Net Claims on General Government	-16,159	-12,794	-14,556	-16,285	-17,033	-19,241	-20,377	-19,222	-17,304	-17,928	-18,749	-16,047	-14,513	-14,513	-21,106	-15,677	-10,181	-3,620
Net Claims on Republican Government	-8,533	-4,790	-6,988	-7,943	-8,341	-8,499	-8,324	-6,558	-4,386	-6,339	-6,964	-3,498	-2,344	-2,415	-5,282	-3,125	1,371	7,997
Claims on the Rest of Economy	438,346	432,040	443,922	442,652	455,770	463,403	462,824	488,775	503,226	507,935	516,641	527,722	493,982	493,982	515,130	538,814	535,905	544,755
Other Assets (net)	-106,615	-110,314	-121,209	-122,844	-124,263	-128,861	-114,042	-119,373	-125,310	-121,125	-127,706	-133,038	-99,581	-99,582	-94,237	-96,360	-98,293	-123,442
DEPOSIT LIABILITIES	**302,962**	**296,383**	**290,044**	**300,210**	**303,952**	**310,869**	**334,593**	**330,713**	**353,968**	**366,607**	**378,746**	**373,846**	**383,595**	**383,595**	**390,685**	**393,884**	**411,066**	**410,162**
Domestic Currency Deposits	67,094	54,765	52,496	50,248	49,521	54,939	61,993	61,052	61,481	62,656	61,140	67,430	54,989	54,989	56,358	55,063	59,794	61,930
Foreign Currency Deposits	235,868	241,618	237,548	249,962	254,431	255,930	272,600	269,660	292,487	303,951	317,606	306,416	328,606	328,606	334,327	338,821	351,272	348,232

Source: National Bank of Georgia

Table A4.3: Monetary Survey

(GEL thousand)

	2000													2001				
	ANNUAL (1)	**Jan-01**	**Feb-01**	**Mar-01**	**Apr- 01**	**May-01**	**Jun-01**	**Jul-01**	**Aug-01**	**Sep-01**	**Oct-01**	**Nov-01**	**Dec-01**	**ANNUAL**	**Jan-02**	**Feb-02**	**Mar-02**	**Apr-02**
NET FOREIGN ASSETS	**-421997.1**	**-434121.4**	**-447190.1**	**-433709.8**	**-443720.8**	**-428828.4**	**-402778.2**	**-420209.7**	**-414199.4**	**-402998.4**	**-389182.0**	**-411233.2**	**-335607.3**	**-332021.1**	**-372924.3**	**-398838.1**	**-384904.0**	**-393605.9**
Gold	1,046	1,021	1,017	1,017	1,010	1,010	1,028	1,028	1,028	1,116	1,116	1,116	1,061	1,061	1,061	1,061	1,243	1,243
Foreign Exchange	321,004	348,765	340,309	370,444	368,667	374,307	381,897	369,903	388,978	402,424	418,059	431,197	479,333	482,921	511,556	504,074	485,698	478,414
Foreign Liabilities	-744,047	-783,908	-788,516	-805,171	-813,397	-804,145	-785,704	-791,141	-804,206	-806,539	-808,357	-843,546	-816,002	-816,003	-885,542	-903,973	-871,845	-873,263
NET DOMESTIC ASSETS	**1,039,966**	**1,020,757**	**1,027,777**	**1,028,838**	**1,045,443**	**1,037,255**	**1,037,880**	**1,073,257**	**1,098,595**	**1,091,387**	**1,098,288**	**1,115,559**	**1,068,052**	**1,064,466**	**1,108,247**	**1,144,757**	**1,142,256**	**1,151,284**
Domestic Credit	1,254,183	1,271,489	1,281,722	1,239,518	1,257,056	1,262,723	1,270,597	1,310,719	1,338,433	1,330,095	1,338,823	1,365,238	1,296,942	1,296,932	1,326,049	1,363,118	1,338,471	1,366,192
Net Claims on General Government	737,959	758,070	758,294	719,206	721,273	723,880	733,444	744,622	754,730	741,104	740,969	756,317	724,625	724,616	729,159	742,182	720,474	739,375
Net Claims on Republican Government	752,217	772,484	775,086	737,469	739,709	746,249	759,997	769,695	776,707	767,912	771,466	780,803	747,071	747,000	753,473	762,551	744,281	759,253
Treasury Obligations	5,415	5,647	5,199	4,883	5,153	5,944	6,922	9,952	11,717	12,098	11,886	15,083	15,925	15,925	14,555	14,785	16,411	21,384
Net Claims on Local Government	-4,629	-2,434	-1,378	-3,229	-2,311	-2,068	-3,573	-2,567	-2,987	-4,174	-3,186	-5,379	-4,404	-4,333	-3,221	-3,282	-3,676	-2,596
Net Claims on Pension Fund	-2,983	-15	-10	-3	-83	-201	-388	-65	-436	-770	-772	-801	-919	-925	-983	-791	-732	-834
Other Extrabudgetary Funds	-6,647	-11,966	-15,404	-15,032	-16,041	-20,100	-22,591	-22,440	-18,554	-21,865	-26,539	-18,306	-17,123	-17,126	-20,110	-16,296	-19,399	-16,447
Claims on the Rest of Economy	516,224	513,418	523,428	520,312	535,783	538,843	537,153	566,097	583,702	588,991	597,854	608,921	572,316	572,316	596,890	620,936	617,997	626,816
Other Items (net)	-214,217	-250,732	-253,944	-210,680	-211,613	-225,467	-232,717	-237,463	-239,838	-238,709	-240,535	-249,678	-228,889	-232,466	-217,801	-218,362	-196,215	-214,908
BROAD MONEY (M3)	**617,969**	**586,636**	**580,587**	**595,128**	**601,722**	**608,427**	**635,102**	**653,047**	**684,395**	**688,388**	**709,106**	**704,326**	**732,445**	**732,445**	**735,323**	**745,918**	**757,352**	**757,678**
Broad Money, excluding foreign currency deposits (M2)	382,101	345,017	343,040	345,167	347,291	352,497	362,502	383,387	391,908	384,437	391,500	397,910	403,839	403,839	400,996	407,097	406,081	409,446
Currency Outside Banks (M0)	315,007	290,253	290,543	294,918	297,770	297,558	300,509	322,334	330,428	321,782	330,360	330,480	348,850	348,850	344,638	352,034	346,286	347,516
Currency in Circulation	329,157	306,326	309,332	309,988	314,716	313,479	319,906	343,861	349,850	338,250	349,528	351,511	365,669	365,669	361,839	369,189	361,629	366,022
Currency in Commercial Banks	-14,151	-16,073	-18,789	-15,070	-16,946	-15,922	-19,398	-21,527	-19,422	-16,468	-19,168	-21,032	-16,819	-16,819	-17,201	-17,155	-15,343	-18,506
Deposit Liabilities (GEL)	67,094	54,765	52,496	50,248	49,521	54,939	61,993	61,052	61,481	62,656	61,140	67,430	54,989	54,989	56,358	55,063	59,794	61,930
Foreign Currency Deposits	235,868	241,618	237,548	249,962	254,431	255,930	272,600	269,660	292,487	303,951	317,606	306,416	328,606	328,606	334,327	338,821	351,272	348,232

Source:National Bank of Georgia

Table A4.4: Urban Consumer Price Index and Inflation
(per cent)

	Period	Consumer Price Index (December 1997 = 100)	Inflation Rate (per cent) (i) from previous period	Inflation Rate (per cent) (ii) from same period in previous year
Annual				
	1993	0.8		
	1994	52.0		6,457.7
	1995	81.9		57.4
	1996	93.2		13.8
	1997	100.0		7.3
	1998	110.7		10.7
	1999	122.7		10.9
	2000	128.4		4.6
	2001	132.8		3.4
	2002	0.0		4.7
Monthly				
	2000 Jan	123.2	0.4	8.5
	Feb	122.9	-0.2	3.1
	Mar	122.8	-0.1	1.1
	Apr	122.5	-0.2	-0.4
	May	122.4	-0.1	1.1
	June	122.1	-0.3	2.3
	Jul	121.7	-0.3	4.3
	Aug	123.2	1.2	5.6
	Sep	125.5	1.8	6.4
	Oct	127.0	1.2	7.2
	Nov	127.7	0.6	5.3
	Dec	128.4	0.5	4.6
	2001 Jan	129.3	0.7	4.9
	Feb	130.1	0.6	5.8
	Mar	130.1	0.0	5.9
	Apr	131.4	1.0	7.2
	May	130.1	-1.0	6.3
	June	129.6	-0.4	6.2
	Jul	128.7	-0.7	5.7
	Aug	129.0	0.3	4.7
	Sep	128.3	-0.6	2.2
	Oct	129.1	0.7	1.7
	Nov	130.9	1.4	2.5
	Dec	132.8	1.4	3.4
	2002 Jan	135.44	2.0	4.7
	Feb	137.02	1.2	5.3
	Mar	137.53	0.4	5.7
	Apr	140.00	1.8	6.6

Source: State Department for Statistics

Table A5.1.1: Registered Foreign Trade Balance, Q1 2002

(USD thousands)

Countries	Q1 2002		Q1 2001	
	Import	Export	Import	Export
Total foreign trade	161,414	57,667	161,922	71,425
CIS	71,508	19,117	60,683	28,287
Armenia	3,807	3,478	6,000	1,666
Azerbaijan	14,587	2,145	15,876	2,275
Belarus	131	110	198	239
Kazakhstan	3,354	277	1,453	905
Kyrgizstan	47	27	70	0
Moldova	29	20	48	41
Russia	37,342	10,253	26,650	20,145
Tajikistan	0	15	2	20
Turkmenistan	1,733	53	659	165
Ukraine	10,380	1,999	8,696	2,684
Uzbekistan	98	740	1,031	147
EU	31,760	12,905	45,998	16,654
Austria	1,596	2	1,880	236
Belgium	1,013	589	1,152	5,977
Finland	446	0	3,931	0
Denmark	1,475	280	661	316
France	2,346	208	5,201	102
Germany	10,755	1,033	15,154	2,212
Greece	1,655	1,639	938	917
Ireland	149	56	125	0
Italy	5,368	1,124	4,412	3,137
Luxembourg	46	0	0	0
Netherlands	2,064	129	2,352	1,486
Portugal	129	0	348	25
Spain	378	196	328	498
Sweden	255	0	813	186
UK	4,085	7,649	8,703	1,562

Source: State Department for Statistics

Table A5.1.2: Registred Foreign Trade Balance, Q1 2002
(USD thousands)

Countries	Q1 2002		Q1 2001	
	Import	Export	Import	Export
Other countries				
Australia	183	45	13	6
Bahama Islands	1,850	0	266	180
Butan	1	11	1	0
Bosnia	0	0	0	3
Brazil	3,600	0	451	0
Bulgaria	3,795	30	2,379	68
Canada	72	0	74	0
China	969	210	939	139
Columbia	30	3	18	0
Croatia	2,306	0	86	0
Cyprus	149	3	360	31
Czech Rep,	695	70	430	136
Ecuador	191	0	220	0
Egypt	16	0	19	3
Estonia	63	0	2	0
FYROM(Macedonia)	4	5	12	0
Gambia	2	2,446	0	0
Ghana	0	73	0	0
Gibraltar	30	1,352	158	316
Guinea	0	0	0	46
Honduras	0	0	147	0
Hong-Kong(China)	53	0	205	1
Hungary	1,056	0	1,230	117
India	994	223	265	1,018
Indonesia	29	0	890	2
Iran	1,893	1,200	821	976
Island	0	0	25	0
Israel	374	110	80	198
Jamaica	0	0	3	0
Japan	929	298	1,208	315
Jordan	0	0	0	25
Korea PDR	202	0	7	0
Korea Rep.	88	0	186	8
Lebanon	132	0	941	11
Latvia	231	135	328	75
Libia	2	0	0	0
Liechtenstein	4	0	48	67
Lithuania	275	571	3,639	593
Malavi	44	0	70	0
Malaysia	0	0	52	0
Mauritania	46	0	26	0
Monaco	1	0	0	0
Mongolia	0	119	0	31
Mozambique	0	0	0	1
Norway	24	3	0	0
New Zealand	33	0	237	0
Newer	367	0	608	15
Panama	0	182	0	0
Peru	46	0	0	0
Philippines	49	0	0	20
Poland	750	76	921	120
Romania	1,414	0	2,168	11
Saudi Arabia	0	0	2	0
San-Marino	0	1	0	0
Singapore	24	5	31	1
Slovakia	132	0	160	0
Slovenia	448	0	2,491	0
South Africa	7	3	484	0
Sri-Lanka	41	0	260	0
Switzerland	2,118	4,390	2,446	4,401
Syria	69	3	92	183
Taiwan (China)	42	0	114	0
Tanzania	0	0	4	0
Thailand	38	0	4	0
Tonga	0	0	11	0
Turkey	20,262	12,657	23,472	15,800
United Arab Emirates	1,427	4	1,172	88
USA	10,297	1,419	4,880	1,429
Vietnam	8	0	0	0
Virgin Islands (GB)	42	0	129	0
Yugoslavia	55	0	134	0
Zimbabwe	127	0	484	0

Source: State Department for Statistics

Table A5.2.1: Georgia's Registred Exports and Imports by Harmonized Tariff Schedule (HTS) Chapters, Q1 2002

(USD thousands)

HTS Category	Import	Export
01 - Live Animals	15	0
02 - Meat and edible meat offal	2,766	20
03 - Fish and crustaceans, molluscs and other aquatic invertebrates	448	54
04 - Dairy produce; birds eggs; natural honey; edible products of animal origin, not elsewhere specified or included	884	4
05 -Products of animal origin, not elsewhere specified or included	1	-
06 -Live trees and other plants; bulbs, roots and the like; cut flowers and ornamental foliage	82	7
07 -Edible vegetables and certain roots and tubers	284	240
08 -Edible fruit and nuts; peel of citrus fruit or melons	822	1,912
09 -Coffee, tea, maté and spices	375	1,163
10 -Cereals	3,533	992
11 -Products of the milling industry; malt; starches; inulin; wheat gluten	4,417	-
12 -Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruits; industrial or medicinal plants; straw and fodder	29	375
13 -Lac; gums, resins and other vegetable saps and extracts	2	-
14 -Vegetable plaiting materials; vegetable products not elsewhere specified or included	7	2
15 -Animal or vegetable fats and oils and their cleavage products prepared edible fats; animal or vegetable waxes	1,862	26
16 -Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates	615	7
17 -Sugars and sugar confectionery	7,260	278
18 -Cocoa and cocoa preparations	1,243	85
19 -Preparations of cereals, flour, starch or milk; bakers' wares	860	28
20 -Preparations of vegetables, fruit, nuts or other parts of plants	480	220
21 -Miscellaneous edible preparations	1,092	88
22 -Beverages, spirits and vinegar	307	9,197
23 -Residues and waste from the food industries; prepared animal feed	193	-
24 -Tobacco and manufactured tobacco substitutes	5,795	343
25 -Salt; sulfur; earths and stone; plastering materials, lime and cement	1,162	53
26 -Ores, slag and ash	20	4,103
27 -Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	44,199	2,074
28 -Inorganic chemicals; organic or inorganic compounds of precious metals, of rare earth metals, of radioactive elements or of isotopes	1,095	563
29 -Organic chemicals	353	12
30 -Pharmaceutical products	11,010	597
31 -Fertilizers	139	4,318
32 -Tanning or dyeing extracts; tannins and their derivatives; dyes, pigments and other coloring matter; paints and varnishes; putty and other mastics; inks	379	8
33 -Essential oils and resinoids; perfumery, cosmetic or toilet preparations	1,704	288
34 -Soap, organic surface-active agents, washing preparations, lubricating preparations, artificial waxes, prepared waxes, polishing or scouring preparations, candles and similar articles, modeling pastes, "dental waxes" and dental preparations with a bas	1,232	24
35 -Albuminoidal substances; modified starches; glues; enzymes	105	-
36 -Explosives; pyrotechnic products; matches; pyrophoric alloys; certain combustible preparations	309	-
37 -Photographic or cinematographic goods	100	-
38 -Miscellaneous chemical products	919	25
39 -Plastics and articles thereof	2,206	225
40 -Rubber and articles thereof	790	1
41 -Raw hides and skins (other than furskins) and leather	31	252
42 -Articles of leather; saddlery and harness; travel goods, handbags and similar containers; articles of animal gut (other than silkworm gut)	48	1

Source: State Department for Statistics

Table A5.2.2: Georgia's Registred Exports and Imports by Harmonized Tariff Schedule (HTS) Chapters, Q1 2002

(USD thousands)

HTS Category	Import	Export
44 -Wood and articles of wood; wood charcoal	583	731
45 -Cork and articles of cork	181	-
46 -Manufactures of straw, of esparto or of other plaiting materials; basketware and wickerwork	0	-
47 -Pulp of wood or of other fibrous cellulosic material; waste and scrap of paper or paperboard	1	-
48 -Paper and paperboard; articles of paper pulp, of paper or of paperboard	4,054	9
49 -Printed books, newspapers, pictures and other products of the printing industry; manuscripts, typescripts and plans	920	76
50 -Silk	11	-
51 -Wool, fine or coarse animal hair; horsehair yarn and woven fabric	96	-
52 -Cotton	23	-
53 -Other vegetable textile fibers; paper yarn and woven fabric of paper yarn	7	-
54 -Man-made filaments	260	-
55 -Man-made staple fibers	249	-
56 -Wadding, felt and nonwovens; special yarns, twine, cordage, ropes and cables and articles thereof	81	7
57 -Carpets and other textile floor coverings	119	1
58 -Special woven fabrics; tufted textile fabrics; lace, tapestries; trimmings; embroidery	9	-
59 -Impregnated, coated, covered or laminated textile fabrics; textile articles of a kind suitable for industrial use	62	0
60 -Knitted or crocheted fabrics	38	-
61 -Articles of apparel and clothing accessories, knitted or crocheted	177	-
62 -Articles of apparel and clothing accessories, not knitted or crocheted	205	147
63 -Other made up textile articles; sets; worn clothing and worn textile articles; rags	921	142
64 -Footwear, gaiters and the like; parts of such articles	669	23
65 -Headgear and parts thereof	4	0
66 -Umbrellas, sun umbrellas, walking sticks, seatsticks, whips, riding-crops and parts thereof	5	-
67 -Prepared feathers and down and articles made of feathers or of down; artificial flowers; articles of human hair	3	-
68 -Articles of stone, plaster, cement, asbestos, mica or similar materials	528	1
69 -Ceramic products	879	5
70 -Glass and glassware	1,207	101
71 -Natural or cultured pearls, precious or semi-precious stones,precious metals, metals clad with precious metal and articles thereof; imitation jewelry; coin	68	6,434
72 -Iron and steel	2,404	10,884
73 -Articles of iron or steel	2,234	545
74 -Copper and articles thereof	117	980
75 -Nickel and articles thereof	6	-
76 -Aluminum and articles thereof	540	1,937
78 -Lead and articles thereof	9	17
79 -Zinc and articles thereof	9	-
80 - Tin and articles thereof	12	-
81 -Other base metals; cermets; articles thereof	103	1
82 -Tools, implements, cutlery, spoons and forks, of base metal; parts thereof of base metal	101	57
83 -Miscellaneous articles of base metal	384	30
84 -Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	10,015	2,399
85 -Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles	13,446	1,440
86 -Railway or tramway locomotives, rolling-stock and parts thereof; railway or tramway track fixtures and fittings and parts thereof; mechanical (including electro-mechanical) traffic signalling equipment	3,997	1
87 -Vehicles other than railway or tramway rolling stock, and parts and accessories thereof	5,752	185
88 -Aircraft, spacecraft, and parts thereof	7,854	2,463
89 -Ships, boats and floating structures	-	-
90 -Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories thereof	1,648	461
91 -Clocks and watches and parts thereof	29	6
92 -instruments; parts and accessories of such articles	6	1
93 -Arms and ammunition; parts and accessories thereof	155	724
stuffed furnishings; lamps and lighting fittings, not elsewhere specified or included; illuminated sign illuminated nameplates and the like; prefabricated buildings	1,638	69
95 -Toys, games and sports requisites; parts and accessories thereof	235	72
96 -Miscellaneous manufactured articles	155	123
97- Works of art, collectors' pieces and antiques	30	7

Source: State Department for Statistics

Table A6.1: Establishment of JSCs by Region, as of 1st April, 2002
(Number of enterprises)

Region	Approved for privatisation	Total number of established and registered JSCs
Abkhazia	**34**	**0**
Achara	**86**	**35**
Tbilisi	**432**	**417**
Guria	**56**	**61**
Lanchkhuti	12	14
Ozurgeti	35	39
Chokhatauri	9	8
Racha-Lechkhumi and lower Svaneti	**12**	**9**
Ambrolauri	6	3
Lentekhi	2	3
Oni	1	1
Tsageri	3	2
Samegrelo and upper Svaneti	**180**	**196**
Abasha	10	9
Zugdidi	54	62
Martvili	12	12
Mestia	1	0
Senaki	27	30
Chkhorotsku	16	18
Tsalenjikha	23	24
Khobi	12	13
Poti	25	28
Imereti	**234**	**245**
Kutaisi	80	87
Tkibuli	16	12
Tskaltubo	18	17
Chiatura	17	16
Bagdati	12	12
Vani	11	10
Zestafoni	24	24
Terjola	16	14
Samtredia	17	27
Sachkhere	5	9
Kharagauli	7	6
Khoni	11	11
Kakheti	**120**	**111**
Akhmeta	13	13
Gurjaani	22	19
Dedoplistskaro	10	7
Telavi	27	28
Lagodekhi	10	10
Sagarejo	15	17
Signagi	14	12
Kvareli	9	5
Mtsketa-Tianeti	**41**	**39**
Akhalgori	1	0
Dusheti	12	8
Tianeti	2	0
Mtslheta	23	27
Kazbegi	3	4
Samtskhe-Javakheti	**54**	**47**
Adigeni	2	2
Aspindza	3	1
Akhalkalaki	8	8
Akhaltsikhe	16	15
Borjomi	24	20
Ninotsminda	1	1
Kvemo Kartli	**99**	**118**
Rustavi	33	38
Bolnisi	10	12
Gardabani	20	33
Dmanisi	6	4
Tetritskaro	11	9
Marneuli	17	20
Tsalka	2	2
Shida Kartli	**78**	**83**
Tskhinvali	0	0
Gori	36	38
Kaspi	15	16
Kareli	12	10
Khashuri	15	19
Java	0	0
Total	**1,426**	**1,361**

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 A6.2: Small Privatisation by Region, as of 1st April, 2002
(Number of enterprises)

Region	Approved for privatisation	Total privatised	Privatised in 2002	Merged with medium or large enterprises	Liquidated
Abkhazia	8	-	-	-	-
Achara	325	171		21	-
Tbilisi	4,599	5,062	50	412	-
Guria	314	453	-	3	71
Lanchkhuti	60	100	-	-	17
Ozurgeti	197	254		3	40
Chokhatauri	57	99	-	-	14
Racha-Lechkhumi and lower Svaneti	168	275	-	2	50
Ambrolauri	58	100	-	1	18
Lentekhi	32	47	-	-	23
Oni	47	66	-	1	9
Tsageri	31	62		-	-
Samegrelo and upper Svaneti	1,109	1,533	3	184	278
Abasha	86	97	-	3	13
Zugdidi	211	280	-	7	-
Martvili	53	56	-	2	19
Mestia	12	24	1	3	3
Senaki	249	427	-	140	104
Chkhorotsku	39	63	-	-	23
Tsalenjikha	51	64	-	15	15
Khobi	145	143	-	2	59
Poti	263	379	2	12	42
Imereti	2,734	3,126	51	187	582
Kutaisi	621	817	34	71	211
Tkibuli	223	200	5	-	49
Tskaltubo	274	314	1	10	29
Chiatura	265	305	1	68	44
Bagdati	71	108	-	-	36
Vani	68	108	-	1	17
Zestafoni	411	405	3	12	52
Terjola	132	154	-	-	20
Samtredia	446	456	5	19	59
Sachkhere	94	87	2	-	16
Kharagauli	65	73	-	5	14
Khoni	64	99	-	1	35
Kakheti	1,083	1,320	9	71	178
Akhmeta	178	179	-	18	28
Gurjaani	140	168	2	13	19
Dedoplistskaro	87	110	1	34	3
Telavi	217	272	1	3	36
Lagodekhi	71	79	5	-	15
Sagarejo	128	129	-	3	10
Signagi	138	223	-	-	34
Kvareli	124	160	-	-	33
Mtsketa-Tianeti	318	390	2	25	71
Akhalgori	17	18	-	-	5
Dusheti	87	119	1	1	12
Tianeti	57	65	-	12	12
Mtslheta	128	158	1	12	42
Kazbegi	29	30	-	-	-
Samtskhe-Javakheti	591	939	9	9	95
Adigeni	82	108	3	-	5
Aspindza	30	49	-	1	-
Akhalkalaki	56	97	1	1	10
Akhaltsikhe	245	369	4	7	56
Borjomi	152	272	1	-	20
Ninotsminda	26	44	-	-	4
Kvemo Kartli	1,136	1,590	10	20	154
Rustavi	355	461	4	4	60
Bolnisi	61	138	1	6	-
Gardabani	269	282	-	-	36
Dmanisi	20	73	-	-	7
Tetritskaro	113	237	3	4	17
Marneuli	284	362	2	6	10
Tsalka	34	37	-	-	24
Shida Kartli	886	1,025	15	47	161
Tskhinvali	-	5	-	5	-
Gori	314	376	7	19	52
Kaspi	201	191	5	-	15
Kareli	139	182	-	-	62
Khashuri	232	271	3	23	32
Java	-	-	-	-	-
MSPM	465	465	10	-	-
Total	**13,736**	**16,349**	**159**	**981**	**1,640**

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 - Q4 2001

(Thousand)

	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	Q IV 2000	Q I 2001	Q II 2001	Q III 2001	Q IV 2001
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	3, 199	3, 277	3, 269	3, 139	3, 083
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	2, 095	2, 066	2, 197	2, 144	2, 048
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	2, 215	2, 195	2, 314	2, 246	2, 165
Employed	*2, 101*	*2 ,283*	*1,887*	*1,741*	*1, 725*	*1, 784*	*1, 792*	*1, 633*	*1, 705*	*1, 890*	*1, 890*	*1, 878*	*1, 818*	*1, 944*	*1, 913*	*1, 838*
Hired	714	737	786	741	737	743	741	710	679	695	675	691	681	672	636	630
Self-employed	1, 387	1 ,546	1,092	990	973	1, 023	1, 030	905	912	1, 087	1, 095	1, 080	1, 034	1, 189	1, 194	1, 127
Unemployed (1)	*231*	*179*	*260*	*249*	292	268	266	284	246	212	174	217	248	253.1	230.8	210.5
Unemployed (2)	*356*	*272*	*309*	*301*	333	308	314	342	382	309	292	337	377	369.9	332.8	327.3
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	10.4	12.0	11.5	10.8	10.3
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	15.2	17.2	16.0	14.8	15.1
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*	*65.5*	*63.1*	*67.2*	*68.3*	*66.4*
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*	*51.6*	*50.1*	*54.1*	*55.7*	*55.0*
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*	*57.5*	*56.9*	*61.2*	*62.4*	*61.3*

Source: The State Department for Statistics, Labour Force Survey, Household Survey

Note: (1) ILO Standard (or "strict" methodology)
(2) ILO "Loose" Methodology

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
ECB	European Central Bank
ECU	European Currency Unit
EMI	European Monetary Institute
EMS	European Monetary System
EMU	Economic and Monetary Union
ERM	Exchange Rate Mechanism
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	Generalised System of Preferences
H	Half year
ha	hectares
HS	Harmonised Commodity Description
HTS	Harmonised Tariff Schedule
ICC	International Chamber of Commerce
IDP	Internally Displaced Person
IFAD	International Fund for Agricultural Development
ILO	International Labour Organisation
IMF	International Monetary Fund
INOGATE	Interstate Oil and Gas Transport to Europe
ISIC	International Standard Industrial Classification
JPY	Japanese Yen
JSC	Joint Stock Company
KWh	Kilowatt hour
LDC	Least Developed Countries
LFS	Labour Force Survey
LIBOR	London Inter-bank Offered Rate
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
NTB	Non-tariff Barriers
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
PREGP	Poverty Reduction and Economic Growth Program
PRGF	Poverty Reduction and Growth Facility (IMF)
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-Caucasus-Asia
TRI	Trade Restrictiveness Index
TRIMs	Trade-Related Investment Measures
TRIPS	Trade-Related Intellectual Property Rights
TRL	Turkish Lira
UNCTAC	United Nations Conference on Trade and Development
UNCITRAL	United Nations Comission on International Trade Law
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