

Summary of remarks by

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An Economy in Trouble

January 11, 1999

The second half of 1998 brought more severe economic hardship to Georgia. The events in Gali resulted in 50,000 internally displaced citizens and put a serious burden on the budget. The assassination attempts against President Eduard Shevardnadze and persistent activity against the state by both internal and external forces continue to slow progress. These difficulties, coupled with the Russian financial crisis, have significantly disrupted economic activity in Georgia. In a recent Georgia working group meeting, David Onoprishvili, Georgia's minister of finance, reviewed the recent economic and political developments in Georgia.

The Russian crisis has severely undermined the recent improvements in the Georgian economy. In addition to other measures, the National Bank of Georgia had to cease its currency intervention and move to an exchange rate for a free-floating currency. Due to lower international reserves after the devaluation of the lari, initial overshooting was not so high, but the banking sector has lost at least \$100 million since the financial crisis began. The World Bank's second trench of \$20 million was, for the first time, given to the National Bank of Georgia instead of being put into fiscal use. Georgian remittances from Russia, estimated at \$30 million, stopped. The gross domestic product (GDP) declined by more than \$300 million. Foreign investment, which was calculated into the 1998 budget, did not materialize. The foreign investment for 1998 was \$200 million, close to the \$170 million in 1997 (1994-1996 combined was less than \$100 million). Onoprishvili said that after the adjustment of figures because of the depreciation, the 1999 budget would be in the Parliament by February 1.

The minister of finance stressed that the lack of tax collection remains the primary burden on the economy. The tax collection-to-GDP ratio is 8 percent-9 percent, one of the lowest among the CIS countries. The tax laws underwent significant changes in November, and numerous tax exemptions were abolished. Among others, the value-added tax (VAT) on agricultural goods will be increased, all petroleum products will have a flat 60 percent excise duty, and excise stamps on cigarettes and alcohol will be introduced in February. While there have been some changes in structure and reshuffling of personnel, Onoprishvili was not overly optimistic. The Georgian government hopes that these changes will improve the government's tax and customs revenue collection as well as transparency, but the mentality and the institutions have not changed.

Combating corruption is another difficult issue for the government, especially in the areas of tax inspection and customs, where salaries are low. New amendments to the criminal and administrative codes, with severe criminal penalties for tax law abuses, have been implemented. From June 1999 until 2001, a private, internationally recognized firm will assist the Georgian State Customs Department in international standards for customs tax collection. Georgian officials believe this will prove Georgia's commitment to working with international financial organizations and continuing on its path toward a free market economy.

On the bright side, the first successful privatization has been completed. With the help of the World Bank, the U.S. company AES purchased the Telasi electric distribution company for \$25 million and is expected to pay the \$8 million-\$9 million debt. The next big area for privatization will be the telecommunications sector. In addition, this year Georgia expects to net \$2 million-\$3

million from early oil transit revenue. While this amount is negligible in the short term, the oil pipeline will draw more investment and infrastructure in the future.

Impact on domestic stability

With the ongoing economic problems, maintaining domestic stability remains a challenge. The local elections in November saw the left and right unite against the ruling Georgian Citizen's Union Party (CUP). While the opposition alliance may not last, there is a danger that it could win the parliamentary elections this year. Minister Onoprishvili said that these groups are pro-Russian and pro-Communist and partially financed from outside. He warned that if the antigovernment coalition wins the parliamentary elections, it would be very difficult to carry on with the economic reforms. With a parliament in opposition to the president, even the presidential elections in 2000 may become challenging.

The main problem for the CUP is that if it cannot point to concrete results in the next few months, it will risk losing all credibility in the idea that reformers are capable of solving Georgia's problems. With basic salaries and pensions not paid in months and severe disruptions in electricity and heat in winter, there is a general dissatisfaction among the people. If the situation does not improve, the opposition will have a real chance of victory by continuing to criticize the CUP, leading a populist campaign promising free education, health services, and electricity. The continuation of reforms is important to show the public that the reformist policies do indeed produce results and thus help prevent economic disorder and a reversal of the reform process. Support from the international community therefore is essential.

In the meantime, Georgia will continue to work on diversifying its economy. Promoting more exports, especially in the agriculture sector, is likely to produce positive results. For example, because there is no market distribution mechanism for them, fruits end up rotting. One positive impact of the depreciation is that the local market will develop with increased local production, reducing imports of even basic goods such as milk.

Tourism is another potential growth industry for Georgia. On this issue, clearly the problem with Abkhazia has had a negative impact. More than the Russian state forces interfering in Abkhazia, it is the occasional generals who take matters into their own hands that create the biggest problems. While negotiations will certainly continue in 1999, the situation remains grim.