

Georgia: Request for Three-Year Arrangement Under Poverty Reduction and Growth Facility—Staff Paper; Staff Supplement and Statement; and Press Release on the Executive Board Discussion

In the context of the Request for Three-Year Arrangement Under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff paper for the Request for Three-Year Arrangement Under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on **October 27, 2001**, with the officials of Georgia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on December 6, 2000.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff supplement of **January 8, 2001**, and staff statement of **January 12, 2001**, updating information on recent developments.
- a Press Release summarizing the views of the Executive Board as expressed during its **January 12, 2001**, discussion of the staff report that completed the request and/or review.

The document(s) listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Georgia*
Memorandum of Economic and Financial Policies by the authorities of Georgia*
Technical Memorandum of Understanding*

*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

GEORGIA

Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility

Prepared by the European II and Policy Development and Review Departments

Approved by Jorge Márquez-Ruarte and Christian Brachet

December 6, 2000

- The discussions were held in Tbilisi during October 17 – 27, 2000.
- The mission team consisted of Mr. Owen (head), Ms. Bassett, Mr. Hartley, Ms. Moss, Mr. Mumssen, (all EU2), Mr. Baunsgaard (FAD), and Mr. Srinivasan (PDR). Mr. Lane, resident representative, participated in the discussions.
- The mission cooperated with overlapping missions from FAD, LEG, MAE, and the World Bank.
- The mission met with President Shevardnadze, State Minister Arsenishvili, Mr. Basilia (economic advisor to the President), Mr. Nogaideli (Minister of Finance), Mr. Managadze (President of the National Bank of Georgia (NBG)), other government officials, parliamentarians, members of the donor and diplomatic communities, NGOs, and the press.
- The attached letter from President Shevardnadze and the Memorandum of Economic and Financial Policies (Appendix III: LOI and MEFP) set out an economic program for 2001–2003, for which the authorities are seeking financial support from the Fund under an arrangement supported by the Poverty Reduction and Growth Facility (PRGF). Upon Board approval of this request, SDR 108 million (72 percent of quota) would be available under the arrangement, disbursed in quarterly installments over three years.
- The authorities have submitted an interim Poverty Reduction Strategy Paper (I-PRSP), which will be considered by the Board in conjunction with the request for a PRGF-supported arrangement. The joint assessment by the staffs of the Fund and the World Bank is circulated separately.

Contents	Page
Executive Summary	3
I. Recent Developments	4
II. Policy Discussions.....	12
A. Medium-term strategy.....	12
B. Fiscal policy and reform.....	13
C. Monetary policy and financial sector reform	15
D. External debt and trade policy.....	16
E. Structural reform and poverty reduction	17
III. Program Monitoring.....	21
IV. Staff Appraisal	21
Boxes	
1. Impact of the Drought.....	8
2. Recent reforms in tax and customs administration	10
3. Anti-corruption strategy.....	19
4. Energy sector	20
Figures	
1. Macroeconomic Indicators.....	5
2. Revenues and Expenditure Arrears.....	6
3. Performance of Monetary Indicators	7
4. Foreign Exchange Market and International Reserves	9
5. Monetary Indicators	11
Tables	
1. Selected Economic and Financial Indicators	24
2. Macroeconomic Framework	25
3. General Government.....	26
4. Accounts of the National Bank of Georgia and Monetary Survey	27
5. Summary Long-Term Balance of Payments.....	28
6. External Debt Outstanding.....	29
7. External Debt Service	30
8. Indicators of Fund Credit.....	31
9. Projected Payments to the Fund as of September 30, 2000.....	32
Appendices	
I. Fund Relations.....	33
II. Relations with the World Bank and with the EBRD.....	37
III. Letter of Intent and Memorandum of Economic and Financial Policies	40
IV. Technical Memorandum of Understanding	58

Executive Summary

- **Macroeconomic performance has improved markedly since mid-2000.** Budgetary restraint and efforts to strengthen tax administration have contributed to a substantial strengthening of the fiscal position. Net credit to government was curtailed and the NBG was able to purchase large amounts of foreign exchange, while keeping the exchange rate stable and inflation under control, notwithstanding the adverse effects of a recent drought on the agricultural sector.
- **The authorities' macroeconomic program for the second half of 2000 was broadly on track through October.** The deterioration in fiscal performance was halted and tax revenues exceeded monthly targets, although individual excise taxes remained below expectations due to continued problems with smuggling and corruption. Crucially, the accumulation of core budgetary expenditure arrears was stopped from end-June. All monetary targets were met and net international reserves substantially exceeded the targets.
- **The policy discussions focused on how to achieve a further substantial fiscal adjustment.** As an immediate measure, the authorities revised the draft budget for 2001 in order to incorporate more realistic financing assumptions and keep expenditure commitments in line with realistic revenue projections. In order to increase tax collections, the authorities plan to accelerate reforms in the tax and customs administration.
- **Institutional reforms aimed at improving governance and reducing poverty are at the heart of the medium-term policy agenda.** In order to support economic growth and poverty reduction, the authorities are planning to undertake a comprehensive set of structural reforms. Institutional reforms play a particularly important role in Georgia where governance and corruption problems have undermined both fiscal policy and economic growth. The newly established anti-corruption commission has published a strategy paper that has been strongly endorsed by the president and the speaker of parliament.
- **The success of the economic program depends on measures to address the large external debt burden.** The staff encouraged the government to seek a new round of debt rescheduling with bilateral creditors at the Paris Club and also to start implementing measures to reduce the large debts of the energy sector. Financial support by creditors and donors will remain crucial over the medium term.
- **The authorities have requested financial support from the Fund under an arrangement supported by the PRGF.** Access under the new arrangement, as proposed in this paper, would be SDR 108 million, or 72 percent of quota, disbursed in quarterly installments over three years.

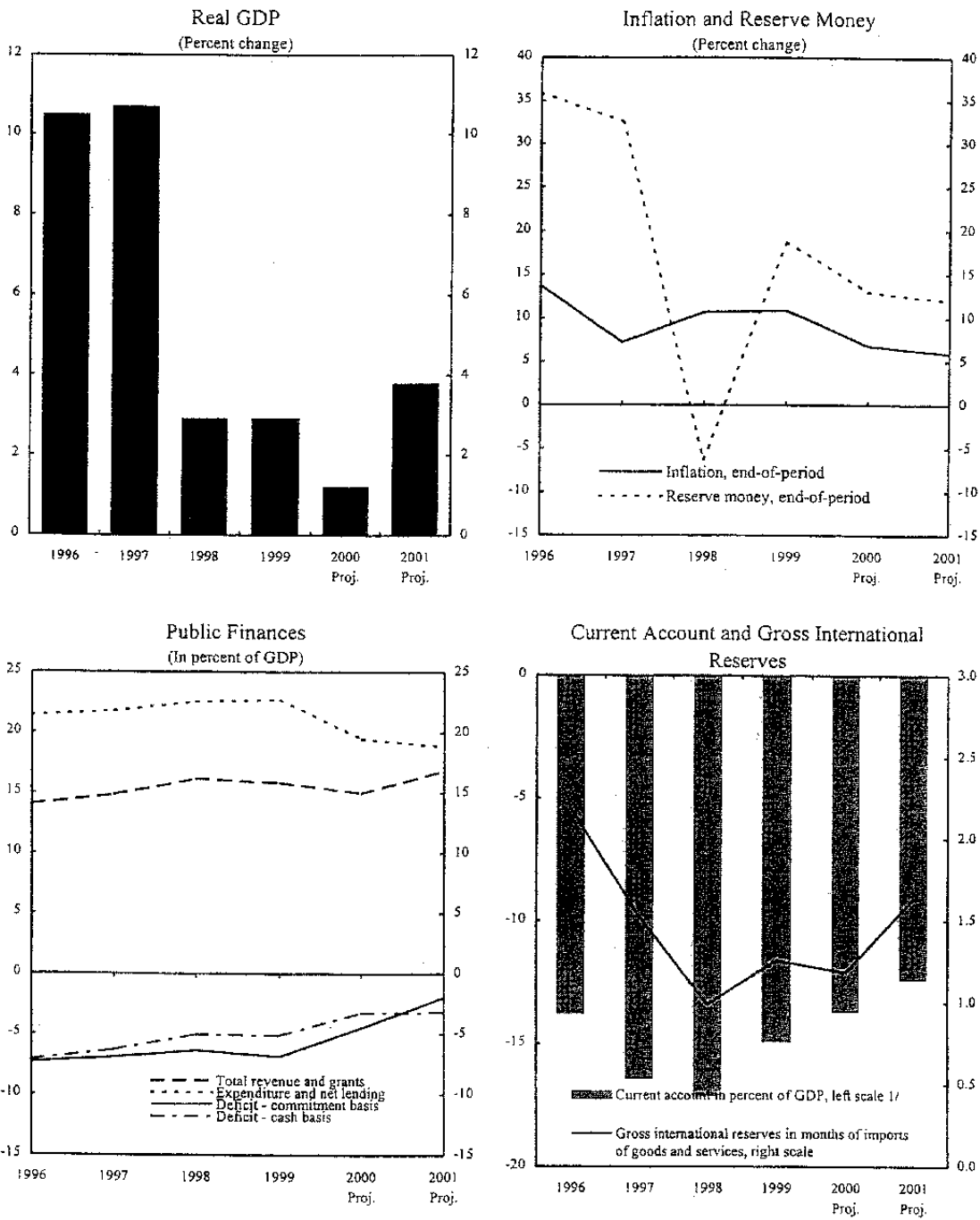
I. RECENT DEVELOPMENTS

1. **There has been a marked improvement in macroeconomic performance in recent months.** The deterioration in fiscal performance since mid-1999, which coincided with parliamentary and presidential elections, was halted in mid-2000 after a newly appointed government produced a revised budget, incorporating a strong fiscal adjustment, in line with recommendations by the Fund staff. Since then, tax revenue collections have increased sharply and the balance of payments position has also strengthened, despite the adverse effects of a recent drought (Figure 1).¹
2. **The macroeconomic program developed with staff assistance during a mission in June was broadly on track through end-October.** In particular, tax revenues exceeded monthly targets for June through October (Figure 2). Targets for cigarette and petroleum revenues were missed, because of insufficient progress in combating smuggling, though revenues on these products were higher than in the first half of 2000. The accumulation of core budgetary expenditure arrears has been negligible since end-June.² All monetary targets were met, with very little expansion of net credit to government, and net foreign assets of the NBG exceeded the end-October target by US\$36 million (Figure 3).
3. **The recent drought has caused considerable damage to some crops, but economic losses in agriculture were largely offset by growth in other sectors.** Real GDP growth is projected at 1¼ percent in 2000 and 4 percent in 2001 (Table 1), although there are uncertainties about the impact of the drought (Box 1). Growth was mainly driven by service sectors such as transport, trade, hotels and restaurants, and communications. Inflation has remained under control, although consumer prices picked up in September and October, partly due to an increase in food prices following the drought. End-year inflation is projected at 6¾ percent in 2000.

¹ In the context of the 1999 Article IV consultation, completed on April 21, 2000, Executive Directors noted that the momentum of reform had flagged, leading to substantial policy slippages under the previous ESAF arrangement. They stressed the need for a significant strengthening of fiscal policy and a bold strategy to tackle governance and corruption problems.

² Core expenditures are defined as wages, pensions, food, medicine, health program, expenditure for internally displaced persons (IDPs), stipends, transfers to the state medical insurance company (SMIC), and domestic and external interest payments.

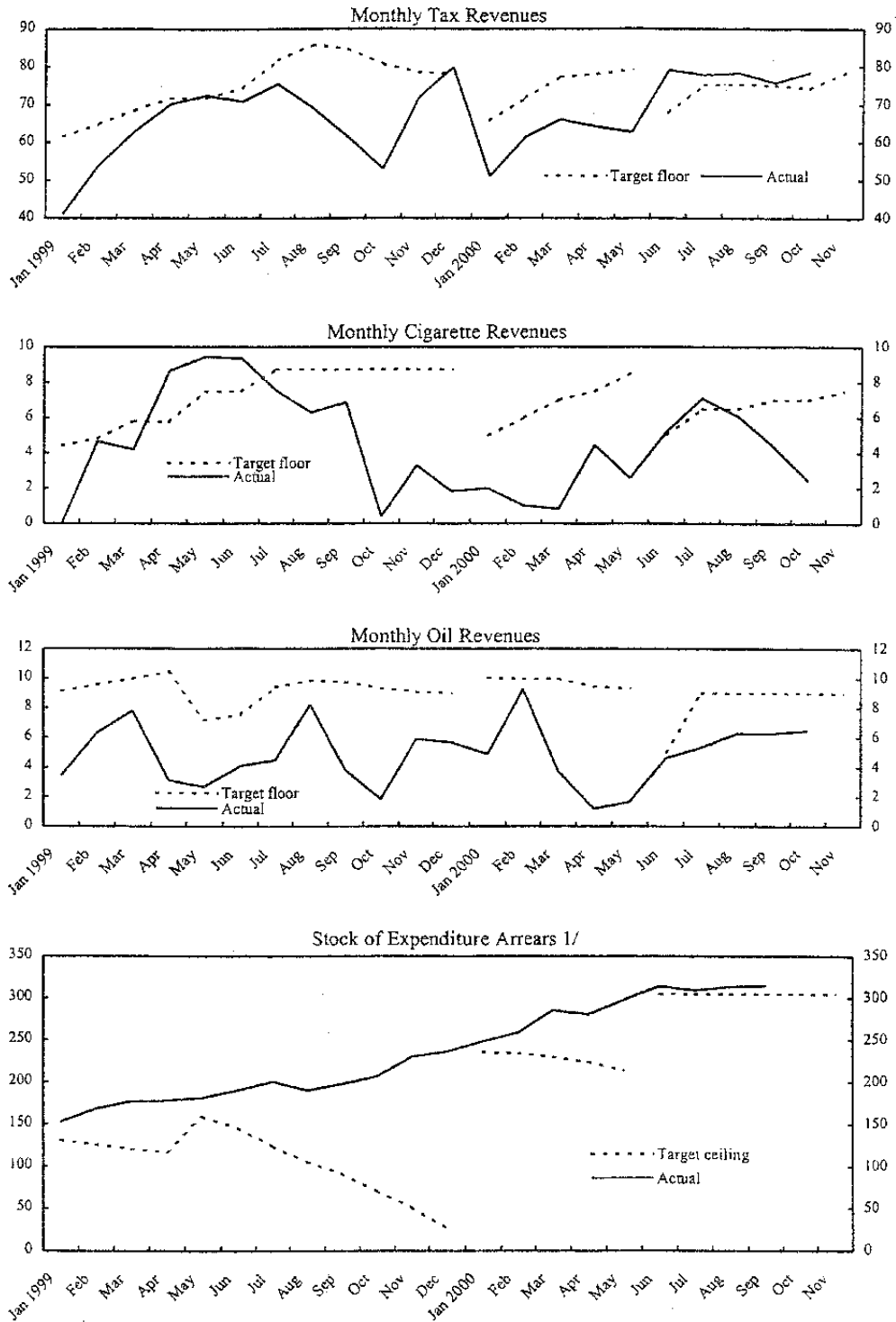
Figure 1. Georgia: Macroeconomic Indicators, 1996-2001



Sources: Georgian authorities; and Fund staff estimates.

1/ Excluding official transfers.

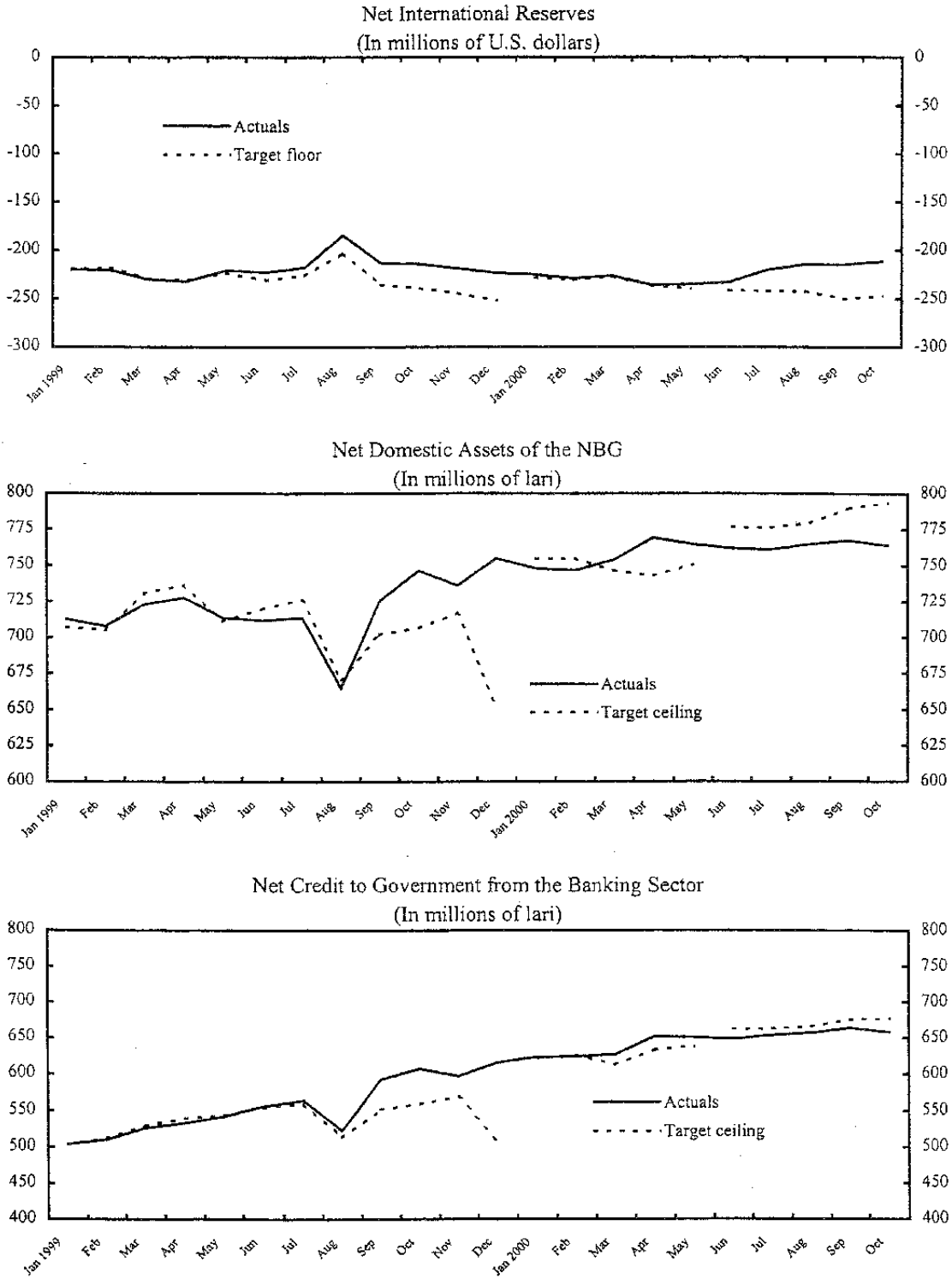
Figure 2. Georgia: Revenues and Expenditure Arrears, 1999-2000
(In millions of lari)



Source: Georgian authorities; and Fund staff estimates.

1/ Targets for arrears have been adjusted for the end-year stock in 1999; and to reflect revised monthly targets starting from end-May 2000.

Figure 3. Georgia: Performance of Monetary Indicators, 1999-2000



Source: National Bank of Georgia; and Fund staff estimates.

Box 1: Impact of the drought

Lack of rainfall in the eastern part of Georgia led to a sharp reduction in agricultural production in 2000, especially of wheat, corn, and sunflowers. Initial official estimates put the aggregate output loss in agriculture at lari 430 million, implying a value added loss of about lari 280 million (4½ percent of GDP). Based on these loss estimates, the authorities have provisionally reported a real decline in agriculture (which accounts for about a quarter of GDP) of 18½ percent for the first three quarters of 2000. However, this sharp decline was largely offset by an average growth rate of 6½ percent in the rest of the economy.

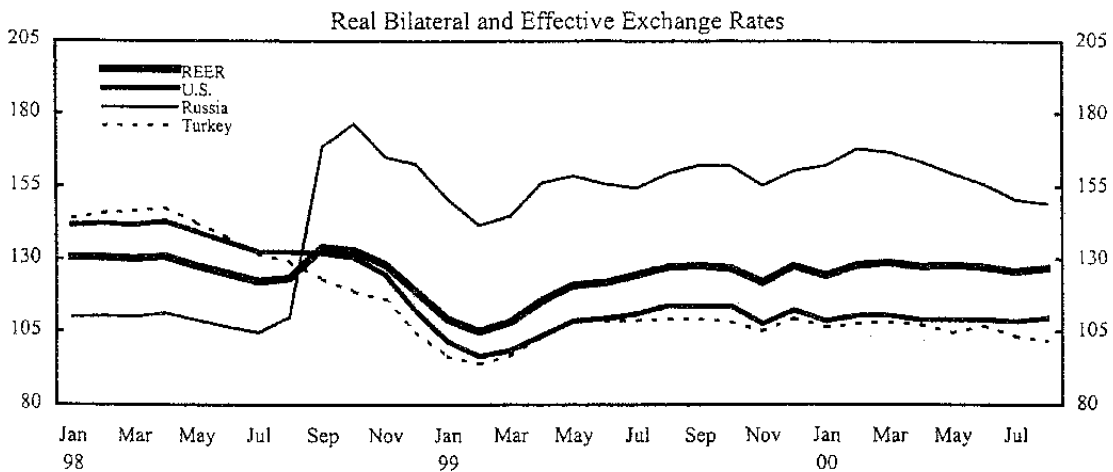
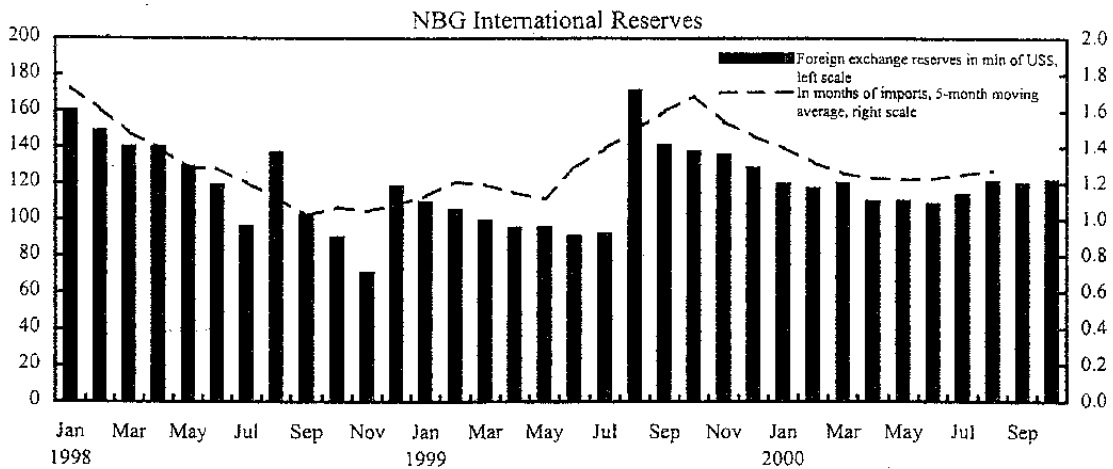
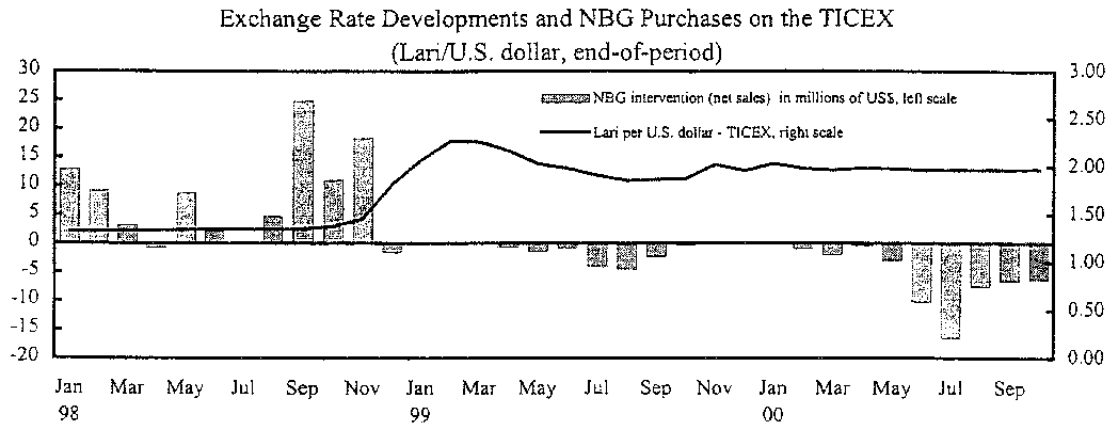
The economic impact of the drought is, however, difficult to quantify precisely. It is not clear whether losses did indeed reach the originally estimated scale, especially as wine production was less affected than expected. Moreover, as a large share of agricultural production takes place in the informal economy (mostly subsistence farming), it is difficult to measure production volumes. This also means that spillovers to the rest of the economy, including to banking, international trade, and tax revenues, are likely to be limited. Indeed, the stable exchange rate and continued purchases of foreign exchange by the central bank indicate that the impact on the balance of payments has been small. International donors have so far provided some US\$10 million in aid to finance imports of seeds, fertilizer and diesel fuel. However, the impact of the drought may extend into early 2001, due to the seasonality of agriculture and adverse effects on hydroelectric power generation.

4. **The improved fiscal performance in the second half of the year was driven by a rebound in revenue collections and lower expenditure commitments following the approval of a revised budget in July (Table 3).** The commitments deficit of the general government fell from 5¾ percent of GDP in the first half of 2000 to an expected 3½ percent in the second half, implying a full-year deficit of 4½ percent of GDP, compared to 7 percent in 1999. After disappointing tax revenue collections of 13¾ percent of GDP in the first half of the year, collections recovered to an estimated 14½ percent of GDP in the second half of the year, reflecting accelerated reforms in the tax department (Box 2), but to some extent also incidents of advance tax payments.

5. **During the year, expenditure commitments were gradually reduced toward more realistic levels, arresting the accumulation of expenditure arrears.** Total expenditure and net lending are projected to fall to 19½ percent of GDP in 2000, from 22¾ percent in 1999. With the passage of the revised budget, the accumulation of core expenditure arrears was curtailed, after lari 78 million (1¼ percent of GDP) were accumulated during the first half of the year. Total financing fell to 3¼ percent of GDP in 2000, from 5 percent in 1999, mainly reflecting a reduction in borrowing from the NBG. The share of treasury bills remained low, with short maturities, and privatization receipts fell.

6. **Prudent monetary policy contributed to low inflation and a stable exchange rate in 2000.** After fiscal pressures exerted considerable strain on credit policy in the first half of the year, net credit to the government was curtailed in the second half. Meanwhile, the NBG purchased some US\$59 million of foreign exchange during the first ten months of the year, while the exchange rate remained stable at just below 2 lari per U.S. dollar (Figure 4). The resulting increase in net foreign assets led to an acceleration of reserve money growth in the second half of 2000, although growth remained moderate at 7¼ percent in the 12 months to October (Table 4).

Figure 4. Georgia: Foreign Exchange Market and International Reserves, 1998-2000



Source: National Bank of Georgia; and Fund staff estimates.

Box 2. Recent reforms in tax and customs administration

A comprehensive reform process has begun in the revenue agencies, following the establishment of the ministry of revenues in December 1999. The ministry oversees the tax and customs departments and has implemented a number of initiatives to combat smuggling and tax evasion, including the establishment of a "financial legion" to spearhead tax enforcement. The ministry is also planning to establish a specialized unit responsible for the collection of all taxes on cigarettes and petroleum as a transitional measure until reforms in the customs department are further entrenched.

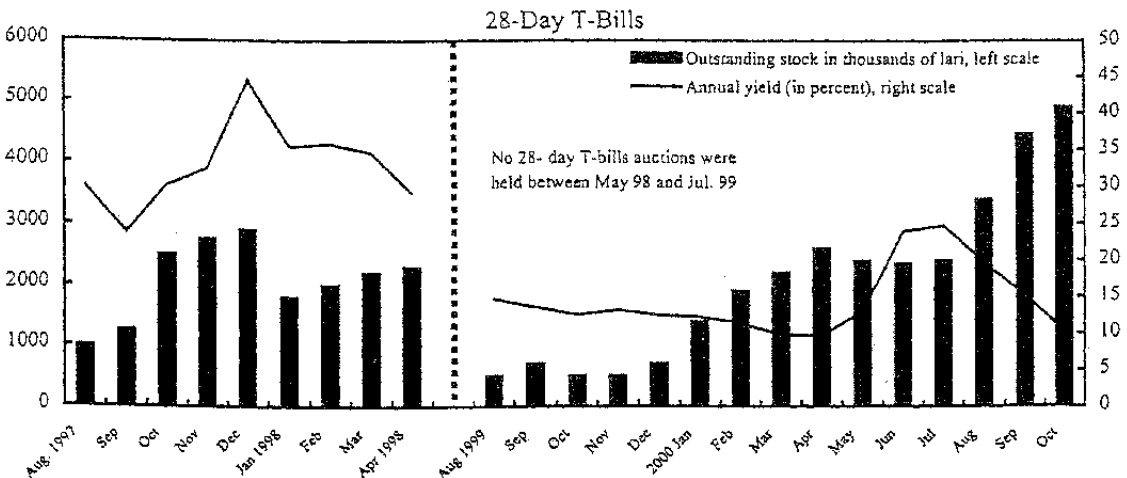
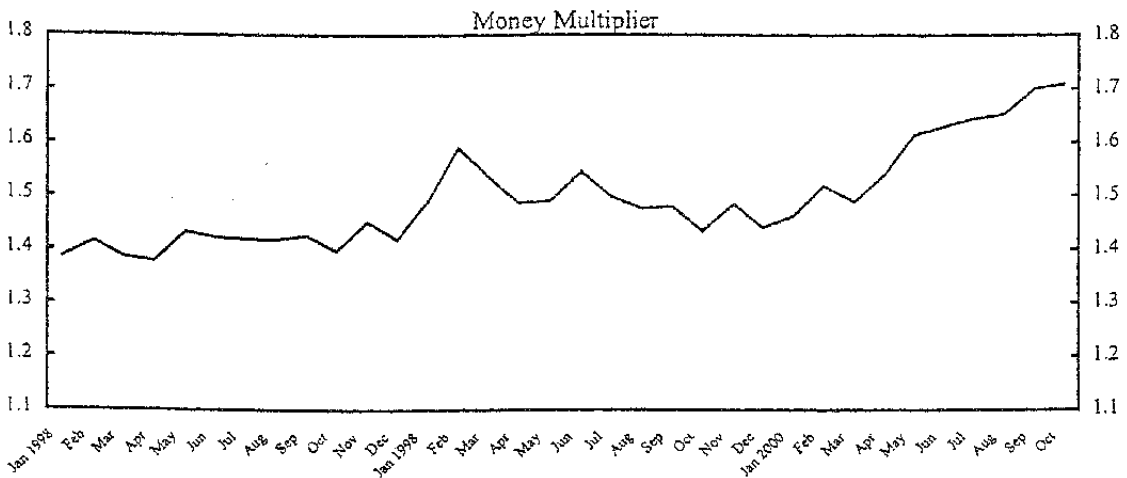
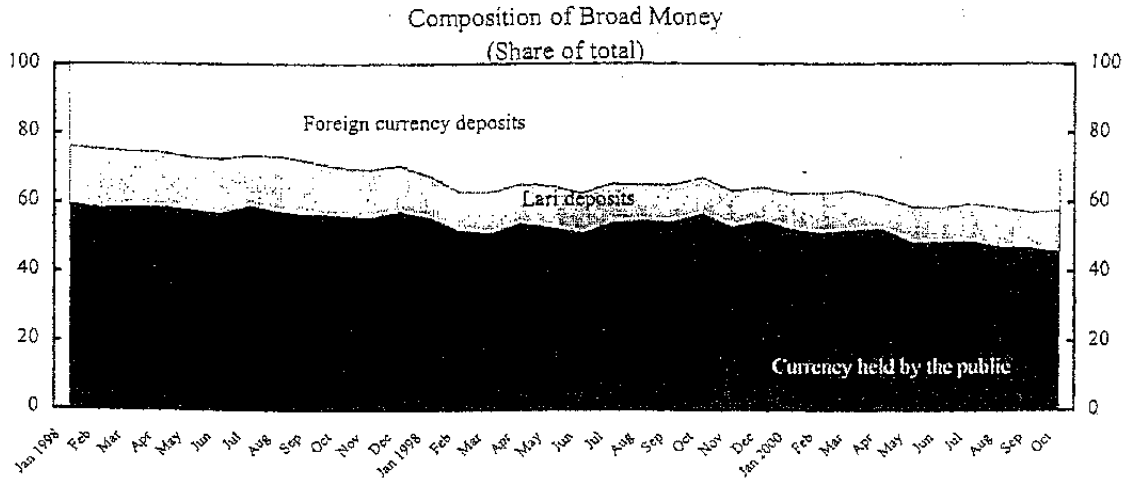
State tax department: An ambitious reform project, supported by USAID, aims at building a modern tax administration, with a focus on organizational changes, human resources reform, training, and computerization. All staff are to be tested, and only staff who pass the test can reapply for a position in competition with applicants from outside the organization. The process has started in headquarters and the regional tax inspectorates in Tbilisi, where 40 percent of staff is new and the overall number of positions has been more than halved. Staff in the large taxpayer inspectorate have been tested in November. The reduction in staff will allow for an increase in salaries paid out of the incentive funds retained by the ministry of revenues from tax and customs collections.

State customs department: Serious policy and technical problems hamper customs collections. The effectiveness of duty assessment and collection procedures is weakened by poor control in initial reporting of imported goods and a flawed processing path of customs declarations. There are also no procedures and systems for administering and controlling duty exemptions. The challenge from smuggling and corruption remains considerable, particularly given incomplete control of parts of the borders and the active involvement in smuggling of external parties and other government agencies that are beyond the control of the ministry of revenues. The reform process in the customs department is still in its early stages. It will focus on the adoption of a code of conduct; the control and monitoring of exemptions; the strengthening of control mechanisms; the revision and completion of customs legislation; and provision of training and equipment. Successful implementation of the reforms will require renewed donor assistance, responding in particular to identified training needs and computerization of customs operations.

7. **The remonetization process continued in 2000.** Broad money grew by 31 percent in the 10 months to October 2000, reflecting an increase in the money multiplier due to a substantial increase in foreign-currency deposits (Figure 5) and, to a lesser extent, a 2 percentage point reduction in reserve requirement. The increase in deposits, which coincided with an expansion of credit to the nongovernment sector, appears to reflect a resumption of financial sector development, which was interrupted in late 1998 in the wake of the Russian crisis. Part of the increase may also reflect seasonal factors related to external trade-related inflows.³ These are expected to unwind in the last quarter of 2000, resulting in a slowing of broad money growth and credit to nongovernment by year end. Treasury bill yields on 30-day securities fell to 10 percent in October, from almost 25 percent in mid-year, and the government also resumed its auction of 91-day bills, although at a substantially higher interest rate of 22½ percent. The NBG has introduced reverse repurchase operations with commercial banks.

³ In the 12 months to October, broad money growth was 28 percent.

Figure 5. Georgia: Monetary Indicators, 1997-2000



Source: National Bank of Georgia; and Fund staff estimates.

8. The NBG is raising the minimum capital requirement for existing banks to lari 5 million, effective from end-2000.

9. **Georgia's trade volumes grew rapidly in the first half of 2000, with export growth boosted by strong demand from Russia.** Import growth gained further momentum in the third quarter, reflecting an increase in drought-related food imports. While the trade balance is projected to widen in 2000, significant improvements in the services account are expected as a result of increased earnings from transportation (including oil transit fees). The current account deficit (excluding transfers) will narrow moderately, from 15 percent of GDP in 1999 to about 13¾ percent in 2000 (Table 5).⁴ Despite an increase in debt-service obligations, the capital account is projected to improve, following disbursements from the World Bank, EBRD, and bilateral creditors, including the EU, Japan, Germany, and Kuwait. Nonetheless, in view of the overall deficit on the balance of payments, Georgia continued to accumulate external arrears to Turkmenistan. Arrears to Russia were also incurred during the first three quarters of 2000 but will be cleared prior to Board consideration of the program.

II. POLICY DISCUSSIONS

A. Medium-term strategy

10. **The policy discussions focused on how to achieve the sizeable medium-term fiscal adjustment required to reestablish financial sustainability.** A realistic budget for 2001 was considered to be essential to avoid further accumulation of budgetary expenditure arrears and begin the process of repaying existing arrears. The staff and the authorities agreed that efforts to reform fiscal institutions should intensify in order to raise tax collections and improve expenditure control, while at the same time strengthening governance and combating corruption. The authorities and the staff also discussed medium-term reforms of tax policy aimed at broadening the tax base and increasing collection rates.

⁴ There are significant weaknesses in balance of payments statistics, particularly the trade statistics, which are reflected in the large positive errors and omissions, and could imply that the current account deficit is overstated.

11. **Medium-term prospects are closely linked to the external debt burden.** Georgia's stock of external debt has increased by almost 70 percent, from US\$1 billion at end-1994 to about US\$1.7 billion at end-1999 (63 percent of GDP; Table 6). In NPV terms, the total debt stock at end-1999 was about US\$1.5 billion, equivalent to about 213 percent of exports of goods and services, and about 700 percent of central government revenues (Table 5). With a limited capacity to service its debts, Georgia has accumulated arrears on principal payments to bilateral creditors (Table 7). These developments largely reflect the lack of sufficiently strong macroeconomic policies in recent years, particularly in the fiscal area, and an ill-conceived approach to the previous round of debt rescheduling conducted in 1995-97.⁵

12. **While a sustained fiscal adjustment would make the external debt burden more manageable, the authorities also need further debt rescheduling to avoid a bunching of debt-service obligations over the next few years.** Even after rescheduling, the debt burden will remain large and debt service is expected to increase in 2003 and 2004 (Table 5), implying little room for budget deficits, especially if domestic savings and private investment are to rise (a medium-term scenario is set out in Table 2). Fiscal consolidation will also be crucial to support a reduction in the current account deficit. Continued assistance from creditors will be important until foreign direct investment gradually replaces disbursements by donors as the principal source of external finance. Under the proposed policies, the current account deficit is projected to decline continuously, international reserves are expected to cover 2 months of imports of goods and services by 2003, and the stock of external debt, as a share of GDP, is projected to decline from a peak of 63 percent in 1999 to below 50 percent by 2005 (Table 5).

13. **Institutional and structural reforms aimed at improving governance and reducing poverty are at the heart of the medium-term policy agenda.** Institutional reforms play a particularly important role in Georgia where governance and corruption problems have undermined both fiscal policy and economic growth. In order to support economic growth and poverty reduction, the authorities are planning to undertake a comprehensive set of structural reforms, set out in an I-PRSP. The reforms described in the MEFP are fully consistent with the strategy outlined in the I-PRSP.

B. Fiscal policy and reform

14. **The discussions highlighted the need to maintain the recent momentum toward a tighter fiscal stance.** The authorities and the staff agreed that the desired fiscal adjustment should be achieved through a combination of expenditure control and further efforts to increase revenue collections. The fiscal program for 2001 will target a reduction in the commitments deficit to 2 percent of GDP, from 4½ percent in 2000. The primary deficit will be effectively reduced to zero, compared with 1¾ percent of GDP in 2000.

⁵ Previous reschedulings were conducted bilaterally and in an ad hoc manner, leading to a large hump in scheduled debt-service obligations in 2001-02.

15. **The program envisages a further moderate strengthening of revenue collections, in line with trends in the second half of 2000.** Tax revenues in 2001 are expected to increase by ½ percentage point of GDP relative to the second half of 2000, through a combination of tax policy measures and an acceleration of administrative reforms in the tax and customs departments. The 2001 budget incorporates a tax policy package including a modest increase in progressivity of income tax, increases in property tax rates, introduction of a cap on social contributions, increases in presumptive tax rates, and a number of modifications to natural resource taxation.

16. **The ministry of finance plans to introduce to parliament a medium-term tax reform package at the beginning of the new year, aimed at simplifying and broadening the tax system.** This is likely to follow many of the recommendations by Fund staff presented at a tax policy review seminar in Tbilisi in November. However, contrary to staff advice, the authorities are inclined to effectively exempt the agricultural sector from all taxes except land tax. The staff made alternative proposals to assist the sector without introducing distortions in the tax system, but accepted that the authorities' proposals would not significantly undermine aggregate tax collections, given the current very low level of collections from the agricultural sector.

17. **The discussions highlighted the need to restrain expenditure commitments, in order to allow the repayment of arrears.** The 2001 budget allows for an increase in total expenditure commitments and net lending in line with expected inflation. However, as a share of GDP, expenditure commitments will decline. To meet the expenditure target, budgetary assistance will be eliminated for certain publicly-supported organizations and the public sector wage bill will be reduced in real terms through a combination of staff reductions at the central and local government level and some modest reductions in bonus payments. However, expenditures on health, education and poverty benefits will be maintained, in consultation with the World Bank. Moreover, the budget allows for lari 80 million to begin the process of repaying expenditure arrears for wages, pensions, and social transfers. Taking account of arrears clearance, there will be a substantial real increase in spending targeted at the poor.

18. **Total financing in 2001 will be just above 3 percent of GDP, as in 2000, although the composition will be different, with higher privatization proceeds offsetting lower domestic financing.** Privatization proceeds are assumed to reach 1¼ percent of GDP, mostly deriving from the international tender of the state-owned telecommunications companies. Any excess in privatization revenues will be used for repayment of NBG credit and additional repayments of budgetary arrears, in consultation with the staff. External financing is expected to amount to 1¼ percent of GDP, including disbursements of budgetary support from the World Bank. The external financing assumptions also reflect the impact of assumed debt rescheduling during 2001. The domestic financing requirements are less than ½ percent

of GDP, down from 1 percent in 2000 and 2½ percent in 1999. The issuance of treasury bills is expected to rise, while there will be no net credit from the central bank to government.⁶

19. **Achieving the desired fiscal adjustment is to be facilitated by structural reforms aimed at improving revenue collections and expenditure management** (MEFP, paragraphs 24-34). In the revenue area, measures will be implemented to: (i) strengthen the performance of the large taxpayer inspectorate; (ii) initiate a reform process in customs; and (iii) address the VAT refund and tax arrears problems. In the expenditure area: (i) all central treasury functions will be fully consolidated in the ministry of finance; (ii) off-budget accounts will be integrated into the budget; (iii) the expenditure management framework will be improved; and (iv) a system of commitments recording and control will be implemented.

C. Monetary policy and financial sector reform

20. **The NBG has committed itself to maintaining a prudent monetary policy in order to support price stability under a floating exchange rate regime.** End-year inflation is targeted at 6 percent in 2001, compared with just under 7 percent in 2000. Reflecting continued financial development, the monetary program for 2001, developed by the authorities with assistance by the staff, assumes a moderate decline in velocity and an increase in the money multiplier. Reserve money and broad money are targeted to increase by 12½ percent and 18 percent respectively. Net credit to the government from the NBG is assumed to be minimal for the remainder of 2000, and no further increase is envisaged for 2001.⁷ Privatization proceeds in 2001 will be used to repay debts to the NBG, which will subsequently issue new credit to the government on an agreed schedule for budgetary arrears clearance. The main source of additional domestic bank financing of the government will therefore be through moderately increased treasury bill sales. Tight credit policy should provide room for the NBG to make further purchases of foreign exchange to help augment its official reserves in 2001. Accordingly, reserves are assumed to increase to 1½ months of imports of goods and services by end-2001.

⁶ However, the program allows for an adjustment of net credit to the government in case of deviations of net external non-project financing from program assumptions (see attached TMU and Table 1 of the MEFP). A shortfall (excess) in net external financing in 2001 would raise (lower) the ceiling for net credit to government by the full amount, subject to a cap of lari 40 million (½ percent of GDP) on upward adjustment.

⁷ As discussed in the previous footnote, the program allows for adjustments of net credit from the NBG to government to reflect deviations from external financing assumptions. A special cap on upward adjustment applies to end-2000 to reflect the possibility that budgetary support by the World Bank will be delayed into 2001. In this case, the NBG could extend additional credit to the government up to the full amount of the shortfall in 2000 on a temporary basis and would be repaid in full once net external financing returns to the projected level on a cumulative basis.

21. The staff stressed the need to move to a prompt resolution of non-viable banks, including revoking licenses of banks that fail to meet prudential requirements. Key measures to strengthen the legal and regulatory framework for banking supervision and bank resolution were incorporated into the program (MEFP, paragraphs 36-37), in line with recommendations from a recent Fund technical assistance mission. In addition, as efforts to close banks are often blocked in court due to conflicts with other legislation, the authorities are planning to introduce a legal measure to clarify the primacy of banking law in bank-related matters. The NBG reiterated its commitment to raise minimum capital requirements of existing banks to IAR 5 million by the end of 2000, as well as to introduce international accounting standards (IAS) in commercial banks in 2001, after delays this year.

22. **With regard to safeguarding the Fund's financial resources, the NBG forwarded all the material required for a preliminary safeguards assessment to the Fund staff** on September 22, 2000 and noted its intention, as in previous years, to publish an audit, undertaken by an international accounting firm, of its full financial statements for 2000 by June 30, 2001. The Treasurer's Department is currently reviewing the documentation provided by the authorities.

D. External debt and trade policy

23. **Georgia continues to experience serious difficulties in servicing its external debt.** The accumulation of arrears to Turkmenistan and Russia, as well as the large projected financing gaps in the balance of payments in the coming years (Table 5), underscore the need for Georgia to seek another round of debt rescheduling from bilateral creditors.

24. **In light of the difficulties encountered with the previous round of rescheduling, the staff advised Georgia to seek to reschedule its bilateral debts under the aegis of the Paris Club and stressed that obtaining adequate financing assurances from bilateral creditors was critical for the success of the economic program.** The authorities wrote to bilateral creditors in November 2000, expressing their desire to seek a new round of debt rescheduling, which could be held at the Paris Club.⁸ In light of Georgia's difficult balance of payments position, several of its bilateral creditors have agreed to participate. With non-Paris Club creditors, including those that have expressed their unwillingness to participate, notably Turkmenistan, Georgia will seek to reschedule bilaterally on terms that are at least comparable with those offered by the Paris Club.

25. **Projected gaps in the balance of payments are assumed to be filled by debt relief provided by bilateral creditors in the context of the proposed debt rescheduling and by financial support from the Fund under the PRGF.** Based on the strength of the program,

⁸ Without preempting the possible terms and conditions of any debt rescheduling, the macroeconomic framework is based on a working assumption of Georgia securing a nonconcessional flow rescheduling of principal payments falling due to bilateral creditors in 2001-02 and of arrears accumulated through end-2000.

proposed access under the PRGF is 72 percent of quota over the three years of the arrangement, in line with the average for members using resources from the PRGF trust for a second time. The small financing gap in the balance of payments for 2000 would be filled by the first quarterly disbursement under the proposed PRGF arrangement.

26. **Georgia maintains a liberal trade and payments system.** Tariff rates, at 0, 5, and 12 percent, are relatively low by international standards. Most import, export, and exchange restrictions, the state orders system, and capital controls have been eliminated. The only remaining export prohibition was removed in 1999. Georgia became a member of the WTO in June 2000. During the discussions with the staff, the authorities reiterated their intention to further liberalize the trade and payments system in line with commitments to the WTO.

E. Structural reform and poverty reduction

27. **The authorities recognize the need to intensify structural reforms, in order to promote economic growth and reduce poverty.** High priority will be given to institutional reforms aimed at improving governance and reducing corruption. The authorities' economic program described in the MEFP includes measures to promote the effectiveness and transparency of fiscal and financial institutions, combat corruption, particularly in the tax collecting agencies, and address the problem of energy sector debts. The authorities' I-PRSP sets out the broader structural reform agenda, to be implemented over the medium term with support from the World Bank and other international institutions and bilateral donors.

28. **The recently appointed anti-corruption commission has prepared a report proposing a broad set of reforms to increase transparency and strengthen governance (Box 3).** The report includes a set of short-term anti-corruption measures, as well as a broader strategy based on further liberalization of the business environment and strengthening of budgetary institutions, the civil service, law enforcement, and the judiciary. The report has been publicly praised by the president and speaker of parliament and has recently been published. It will be subject to wide public discussion in the coming weeks. The staff stressed the need to move ahead quickly with implementation of some of the key short-term measures and noted that progress would be assessed at the time of the first review of the new Fund arrangement.

29. **In order to address the very high level of energy debts, the staff recommended the introduction of a surcharge on the electricity tariff, initially at a very low level.** The impact on the poor would be offset through increased targeted poverty benefits.⁹ The government agreed that the surcharge, as part of a wider strategy developed earlier in cooperation with the World Bank, was important to begin the process of reducing the US\$500 million debt stock, thereby alleviating the fiscal risks associated with an eventual assumption of the debts by the budget. The staff favored a commitment in the MEFP to a specific tariff increase in April 2001, but accepted the authorities' proposal that the increase

⁹ The main such benefits are family allowances, targeted at poor families, and the provision of free electricity, up to a limit, to certain particularly poor categories of people.

could be delayed until June, and that they should reflect further on the precise size of the initial surcharge (MEFP, paragraph 42c). Implementation of the tariff surcharge would be a structural benchmark. Addressing the debt problem will also support the wider reform efforts in the sector (Box 4).

30. The authorities have elaborated their plans to combat poverty in a strategy paper submitted to the Boards of the Fund and the World Bank as an interim PRSP.

According to this report, about half of the people in Georgia live on less than US\$2 per day and there are indications that poverty has increased over the last few years, despite positive economic growth. The state has not been able to provide an effective social safety net, partly because of general fiscal constraints and partly because social benefits are not well targeted. Instead, many of the country's poor have relied on informal survival mechanisms, including subsistence farming and participation in the shadow economy.

31. In the strategy paper, the authorities propose to embark on a wide range of structural reforms aimed at poverty reduction and economic growth. Five main areas (reflecting the work of five working groups) are highlighted in the I-PRSP:

- **Social sector reforms:** Reforms are to be aimed at improving the allocation of benefits, to achieve a better targeting of the poor. This would include pension reform, the development of unemployment insurance and life insurance, the introduction of a social protection scheme in the form of cash benefits targeted at vulnerable families, as well as health care reform.
- **Supportive macroeconomic policies:** Reforms in tax and customs administration should raise fiscal revenues, while reducing the budget deficit. In addition, tax policy changes will be aimed at broadening the tax base and improving collection ratios, while stimulating investment. Expenditures are to be targeted more toward the social area and there will be improvements in expenditure control. Monetary policy will focus on price stability and the accumulation of foreign exchange reserves. Better supervision and enforcement of prudential regulations should help to strengthen the banking sector.
- **Public administration reform:** Proposed reforms in this area are based on the recommendations of the anti-corruption commission (Box 3).
- **Private sector development and infrastructure:** In order to foster investment, specifically in infrastructure, the report lays out a wide range of measures, including the promotion of import substitution in manufacturing, the restructuring of privatized enterprises, improvements in the state procurement system, the modernization of railways and roads, the privatization and restructuring of the telecommunications and energy sectors, and the attraction of private investment in tourism.
- **Agricultural reform:** The agricultural sector plays a special role in the Georgian economy, contributing a quarter of GDP and involving more than half of the population, mostly in subsistence farming. The I-PRSP proposes a wide range of policy measures in this sector, including the simplification of the rural taxation

system; the promotion of agricultural finance and insurance, the development of rural infrastructure, the attraction of investment in agro-processing, further privatization of agricultural land, completion of the land registration system, and environmental protection.

Box 3. Anti-corruption strategy

In July 2000, a presidential decree announced the formation of a commission led by the chairman of the Supreme Court, responsible for preparing a national anti-corruption program. In September, the draft document, "Basic Directions of the National Anti-Corruption Program," was submitted to the president and a revised document was published in November. The paper lays out a broad strategy to combat corruption including measures in six main areas:

- **Liberalization of the business environment:** limiting the number of supervisory agencies and developing a transparent system for issuing licenses and permits for entrepreneurial activities; revoking unjustified tax privileges and improving tax and customs administration; improving implementation of antimonopoly legislation; simplifying procedures for acquisition and registration of property; instituting uniform accounting practices; simplifying certification and standardization procedures; strengthening enforcement of unfair competition.
- **Strengthening financial management of state resources:** improving budget legislation and transparency; incorporating off-budget operations explicitly in the budget; strengthening state procurement by improving transparency and independence and identifying conflict of interest; establishing internal audit procedures within state agencies and publication of financial reports; strengthening management of corporations with state shares, including legislation for profit and dividend distribution; and improving transparency in the management of foreign loans and grants, and eliminating associated tax breaks.
- **Effectiveness of the state management system:** raising salaries of employees by raising revenues and reducing employment; adopting a code of ethics for public officials; creating a mechanism for examining financial and property disclosures of public officials; removing duplication of functions and implementing uniform structures; creating a single register of lower-level state agencies and their sources of financing.
- **Law enforcement bodies and judiciary:** improving internal and external control of activities of law enforcement agencies, adoption of a code of ethics for law enforcement employees and judges; optimizing staff in law enforcement, reforming judicial examination institutions; improving selection criteria for judges.
- **Development of representative democracy:** improving transparency and fairness of elections, especially in the area of party financing.
- **Education:** reviewing the syllabus of secondary schools with the aim of raising the next generation's legal conscience and civic responsibility and strengthening supervision of entry and state examinations.

The document also contains a list of ten specific near-term measures. These include passage of a law that would define and limit the control public agencies have over enterprises; the requirement that public officials provide documentation about the sources used for financing their purchases of homes and cars; a modification to the criminal code to allow for confiscation of assets received from criminal sources; and a measure to remove permanent posts of the road police to discourage demands for bribes from business and other traffic.

A monitoring agency, reporting to the president, will be established to review progress in implementing the anti-corruption program. It will include representatives of NGOs and civil society. Although the agency will not have the power to take punitive measures, it is possible that a unit will be set up to conduct preliminary investigations against high-level public officials.

Box 4. Energy sector

Power Sector: The weakness of the power sector remains one of the biggest obstacles to economic growth and has created significant hardship for the population. Although Georgia has sufficient power capacity to service basic electricity needs, demand usually exceeds supply and power outages occur on a daily basis, particularly in the winter. The main reasons for this situation are below-cost tariffs and low collection rates (68 percent in 1997, and 45 percent in the first half of 2000, at the wholesale level). As a result the sector has been accumulating large arrears and its assets have deteriorated rapidly.

- **Debts** of the power sector, excluding government guaranteed credit from donors, were estimated at US\$500 million (16 percent of GDP) as of September 1, 2000. Half of this consisted of debt to suppliers, and about a third of unpaid electricity imports. The stock of energy debt is among the main contingent liabilities of the state, with the risk that, without a comprehensive debt plan, the debt burden would eventually fall on the budget. In addition, it deters strategic investors from participating in the privatization process. In an effort to address the problem, the authorities have created a new entity, Sakenergo 2000, a special purpose company that holds most of the non-donor debt of the power sector. In addition, an intergovernmental debt restructuring commission was created, with the task of restructuring and renegotiating the sector's liabilities. The implementation of a small "debt surcharge" on top of existing electricity tariffs as of June 1, 2001 will help initiate the process of servicing the debt and send a positive signal to creditors and potential investors.
- Following the unbundling of the power sector, the government embarked on a **privatization** program with the aim of attracting foreign equity participation. Most generation and distribution units were turned into joint-stock companies. Control of the 70 distribution entities was turned over to municipalities. At the end of 1998, the Tbilisi electricity distribution company, Telasi, was successfully privatized through international tender. A 75 percent stake was acquired by a subsidiary of the AES Americas corporation. Electricity distribution and generation units were divided and mixed into three clusters for the privatization and AES acquired the first cluster consisting of the Gardabani thermal power plant, two hydro power plants, and the Relasi distribution company. The privatization process has recently slowed down, due in part to the uncertainty regarding the sector's debts. The process of restructuring has also created significant opportunities for corruption

Gas Sector: Gas consumption fell by 85 percent between 1989 and 1998, and 40-50 percent of gas lines need rehabilitation. Only 14 percent of connected apartments currently receive gas supply. Unlike the power sector, there is no restructuring strategy and the sector has yet to attract a strategic investor. The privatization of the Tbilisi gas distribution company, Tbilgaz, has been postponed several times, in part because of its debts. Total debt of the sector was estimated at US\$75 million as of April 1, 2000.

Oil and Gas Pipelines: Georgia's strategic location between Europe and Central Asia could provide some substantial transit revenues in the future as well as reliable energy sources. The reconstructed Baku-Supsa pipeline became operational in April 1999. An agreement was signed in October concerning the construction of the Baku-Tbilisi-Ceyhan oil pipeline. If constructed, the pipeline would generate about US\$500 million in foreign direct investment, and annual transit fees of US\$50 million at full capacity (although Georgia has taken on significant contingent liabilities and offered substantial tax exemptions under the agreement). Another planned pipeline would transport Azeri gas from the recently discovered Shah-Deniz field to Turkey. This could yield very substantial transit revenue and may involve a level of investment similar to that for the Baku-Tbilisi-Ceyhan pipeline.

32. **The mission provided comments on drafts of the I-PRSP, highlighting the need to prioritize and establish a clear link between the proposed measures and the very serious fiscal and external constraints that the country faces.** The joint assessment of the I-PRSP by World Bank and Fund staff is circulated separately. The finalization of the strategy will involve consultations with non-governmental organizations, professional

associations, private sector representatives, international organizations, and bilateral donor countries.

III. PROGRAM MONITORING

33. **The authorities intend to implement several measures prior to Board consideration of the program, in order to demonstrate their strong commitment to fiscal consolidation and governance reforms (MEFP, Annex A).** The arrangement will involve quarterly monitoring and disbursements, as well as semi-annual reviews. Quantitative performance criteria and indicative targets under the new program are specified in Table 1 of the MEFP. Continuous performance criteria are specified in paragraph 53 of the MEFP. Technical definitions, adjustment mechanisms, and reporting requirements are provided in the supplementary Technical Memorandum of Understanding (TMU).

IV. STAFF APPRAISAL

34. **Following considerable policy slippage in the year to mid-2000, there has been a substantial improvement in policy implementation in the second half of 2000.** In the wake of presidential elections and the appointment of a new government in April 2000, fiscal policy has been tightened substantially, reducing domestic credit expansion and halting budgetary expenditure arrears accumulation. At the same time, despite the impact of a drought on agricultural output and prices, the balance of payments has strengthened, confidence in the lari has increased, and inflation has remained under control. The new government is also demonstrating greater willingness to address problems of governance and corruption. This improved environment provides a favorable background for the authorities' development of an economic program for 2001–03, which focuses on substantial further fiscal adjustment, and structural reforms to strengthen governance and reduce poverty.

35. **The centerpiece of the program is fiscal consolidation, to put Georgia on a path to fiscal sustainability, establish the ability of the government to meet its commitments, and underpin efforts to resolve the large external debt burden.** Fiscal adjustment needs to be based on steady but realistic increases in tax revenues, founded on genuine reforms of the tax collection agencies. It also requires clear recognition that, because revenue mobilization will take time and there is no room for further debt accumulation, public spending on the present scale cannot be afforded. Expenditure commitments must therefore be strictly limited, while protecting to the extent possible social expenditures and gradually eliminating arrears on wages, pensions, and other social benefits.

36. **Developments in the second half of 2000 represent an important step toward establishing fiscal policy credibility.** Revenues have recovered strongly since mid-year, reflecting determined efforts by the ministry of revenues, though there are concerns about some instances of advance tax payments. The revised budget for 2000, developed with the staff in June and approved by parliament in July, incorporated large cuts in expenditure commitments. As a result, the commitments deficit has fallen sharply, to an estimated 3½ percent of GDP in the second half of 2000, around half the level in the previous four years. Expenditure arrears accumulation has effectively been halted.

37. **The budget for 2001 proposed by the government will consolidate this improving trend.** In the revenue area, it represents an appropriate balance between ambition and realism. It includes a modest package of tax policy measures, and the authorities plan a more comprehensive set of revisions next year to simplify and strengthen the tax code, broadly in line with staff recommendations. But the revenue effort rightly focuses on improvements in tax and customs administration. Here, high-level corruption and smuggling have seriously undermined past efforts to strengthen public finances. The willingness of the authorities to undertake a comprehensive reform of customs, similar to that already under way at the state tax department with USAID support, is therefore particularly important. Higher revenues combined with restraint on expenditure commitments in non-core areas should allow room for a substantial increase in cash spending in 2001 targeted at the poor, including a reversal of wage, pension, and social benefit arrears accumulated in the first half of 2000.

38. **Expenditure restraint needs to be complemented by reforms to increase fiscal transparency and strengthen expenditure monitoring and control.** Two measures to be implemented prior to Board consideration of the program, against considerable resistance from vested interests, clearly demonstrate the authorities' commitment to such reforms. First, the existing off-budgetary accounts of government departments will be fully reflected in the 2001 budget. Secondly, sub-treasuries at the ministries of defense and interior will be closed and their functions transferred to the central treasury at the ministry of finance. These reforms should close off two major avenues for potential misuse of public money.

39. **Fiscal consolidation alone will not be sufficient to close the huge fiscal and balance of payments gaps over the next few years, which reflect a large hump in scheduled external debt-service obligations that emerged from the bilateral debt rescheduling conducted in 1995-97.** The staff therefore strongly supports the authorities' request to its creditors to participate in a new round of debt rescheduling early in 2001. In view of the unsatisfactory outcome of the previous round of bilateral rescheduling, the staff favors a comprehensive, multilateral settlement, preferably at the Paris Club. Such a rescheduling, combined with firm implementation of the authorities' program, should allow Georgia gradually to emerge from its current unsustainable external debt position and reestablish its ability to service its debts. The staff welcomes the decision of the government to address the problem of the external debts of the energy sector, including through introduction of a surcharge on the electricity tariff, so as to avoid the eventual assumption of these debts by the budget.

40. **Monetary policy will continue to aim at maintaining low inflation and a stable exchange rate.** The floating exchange rate regime remains appropriate, given the low level of the international reserves and the vulnerability of the trade balance to shocks. The staff supports the authorities' intention to intervene in the market only to the extent needed to bolster the reserves, in line with program targets. These efforts will be assisted by strict limits on net domestic assets, reflecting no increase in net credit from the NBG to the government.

41. **The recent encouraging trend toward remonetization of the economy can only be sustained through continuing reforms to strengthen the banking system.** This will require firm and even-handed enforcement of prudential requirements and prompt resolution

of non-viable banks, a strengthening of the legal and regulatory framework for bank supervision and resolution, and full implementation of international accounting standards at commercial banks during 2001.

42. **Combating corruption and improving governance will be the key to attracting the investment needed to ensure strong, sustainable growth and poverty reduction.** The staff welcomes the emphasis given to governance and anti-corruption measures within the broad structural reform agenda set out in the authorities' I-PRSP. It is especially encouraging that the report of the anti-corruption commission, which has now been published, will be subject to widespread public discussion throughout Georgia in the months ahead. The I-PRSP has also been produced in a collaborative way, with inputs from a wide range of interested parties and extensive discussion with donors and the public. This open approach bodes well for a successful participatory approach to developing a full PRSP in the months ahead. It is important, however, that structural reforms are not put on hold while this process unfolds. Publication of the anti-corruption report and the I-PRSP will raise expectations among the people of action to address these problems. Rapid and effective implementation of some of the most urgent measures will therefore be essential, especially the near-term measures identified by the anti-corruption commission.

43. **The government of Georgia has requested a 3-year PRGF arrangement.** The proposed level of access and the phasing is based upon the size of Georgia's balance of payments requirements, including the need to reconstitute reserves to more comfortable levels; the reasonably satisfactory recent track record of policy actions and macroeconomic performance; and the strength of the adjustment program. Despite the accumulation of arrears on principal payments to bilateral creditors owing to a difficult balance of payments position, Georgia has continued to remain current on all obligations to the Fund and on interest obligations to all creditors. The staff's medium-term balance of payments projections indicate that although Georgia's external debt is large, and needs to be monitored closely, it should not encounter undue difficulties in meeting its debt-service obligations.

44. **The marked improvement in performance in recent months and the strong program developed by the authorities must be set against the considerable risks to the outlook.** The principal risk is that the recent efforts to strengthen fiscal performance and governance will not prove sustainable, and that substantial policy slippages will recur if vested interests regain the upper hand. Such an outcome, which has happened before, would be a major setback, threatening the prospects for debt rescheduling and probably leading to a further prolonged pause in financial support from IFIs. While such a risk clearly exists, the staff notes that the recent improvement in performance, based on a six-month track record, has been more sustained than in the past, and that the new government has demonstrated considerable ownership of reforms through its participatory approach to developing policies. On this basis, the staff recommends Board approval of the authorities' request for an arrangement under the PRGF.

Table 1. Georgia: Selected Economic and Financial Indicators, 1996-2001

	1996	1997	1998	1999	2000 Projection 1/	2001 Program 2/
(Percentage change relative to previous year; unless otherwise indicated)						
National income and prices						
Nominal GDP	55.0	19.1	7.8	13.4	9.5	11.8
GDP at constant prices	10.5	10.7	2.9	2.9	1.2	3.8
Nominal GDP (millions of lari)	3,786	4,511	4,863	5,513	6,035	6,748
Consumer price index, period average	39.3	7.0	3.6	19.1	4.3	7.6
Consumer price index, end-of-period	13.7	7.2	10.7	10.9	6.8	5.9
General government						
Total revenue (excl. grants)	145	42	13	11	7	20
Total expenditure and net lending	78	21	12	14	-6	8
External sector 3/						
Exports	15	18	-3	0	9	9
Imports	10	37	11	-13	9	6
Money and credit (end-of-period)						
Reserve money	36	33	-6	19	13	12
Credit to enterprises and households (banking system)	-15	38	38	33	17	11
Broad money (including forex deposits)	42	46	-1	21	23	18
Velocity, level 4/	14.8	12.1	13.2	12.4	11.0	10.5
Money multiplier, level	1.23	1.35	1.42	1.44	1.57	1.64
Gross international reserves						
In months of imports of goods and services	2.2	1.5	1.0	1.3	1.2	1.6
In millions of U.S. dollars	158	173	118	132	136	199
Exchange rate, lari/U.S. dollar						
Period average	1.26	1.30	1.39	2.02	1.97	...
End-of-period	1.27	1.30	1.79	1.96	...	...
(In percent of GDP; unless otherwise indicated)						
General government						
Total revenue and grants	14.0	14.8	16.2	15.8	15.0	16.8
Tax revenue 5/	10.8	13.0	13.2	14.2	14.1	14.9
Tax revenue (in percent of current expenditure)	55.6	65.9	64.5	69.1	79.0	87.3
Total expenditure and net lending 6/	21.4	21.8	22.5	22.7	19.5	18.8
Current expenditure	19.5	19.7	20.5	20.5	17.9	17.1
Fiscal balance, commitment basis	-7.4	-7.0	-6.4	-6.9	-4.6	-2.0
Fiscal balance, cash basis	-7.2	-6.3	-5.1	-5.1	-3.2	-3.2
External sector						
Trade balance	-11.7	-16.1	-19.6	-19.8	-19.0	-17.8
Current account balance						
Excluding transfers	-13.9	-16.5	-17.2	-14.9	-13.7	-12.4
Including transfers	-9.2	-10.8	-11.1	-8.0	-8.1	-7.1

Sources: Georgian authorities; and Fund staff estimates.

1/ Reflecting output losses due to the drought, and assuming disbursements by the IMF and the World Bank in the fourth quarter of 2000.

2/ Scenario based on an economic program that could be supported under the IMF's PRGF facility.

3/ Goods only; in US\$ terms.

4/ Annual GDP divided by end-period M3.

5/ Includes general government tax revenue and special state funds. The latter include the Pension, Employment, and Road Funds. Privatization revenue is excluded.

6/ On a commitment basis. Cash expenditures differ by the change in expenditure arrears.

Table 2. Georgia: Macroeconomic Framework, Adjustment Scenario, 1996-2006

	1996	1997	1998	1999	2000 Proj.	2001	2002	2003	2004	2005	2006
	Adjustment scenario										
	(Percent change)										
Output and prices											
Real GDP	10.5	10.7	2.9	2.9	1.2	3.8	5.0	5.0	5.0	5.0	5.0
Consumer price index (end-of-period)	13.7	7.2	10.7	10.9	6.8	5.9	4.0	4.0	4.0	4.0	4.0
	(In millions of U.S. dollars)										
External sector											
Current account balance 1/	-275	-375	-389	-218	-250	-240	-225	-181	-150	-134	-127
Of which:											
Exports of goods and nonfactor services	511	661	720	739	827	908	996	1097	1202	1297	1408
Imports of goods and nonfactor services	-867	-1368	-1437	-1265	-1377	-1461	-1529	-1598	-1678	-1767	-1879
	(In percent of GDP)										
Public finances											
Overall deficit (commitment basis)	-7.4	-7.0	-6.4	-6.9	-4.6	-2.0	-0.6	-0.7	0.2	0.7	0.6
Overall deficit (cash basis)	-7.2	-6.3	-5.1	-5.1	-3.2	-3.2	-1.8	-1.2	-0.3	0.7	0.6
Privatization	0.5	0.6	1.5	1.0	0.3	1.2	0.3	0.5	0.5	0.0	0.0
Domestic financing	4.1	3.6	2.0	2.4	1.0	0.3	0.8	1.2	1.5	1.1	1.3
External financing (net)	2.5	2.2	1.5	1.2	1.8	1.7	0.7	-0.5	-1.7	-1.8	-1.8
	(In percent of GDP)										
Saving and investment 2/											
Gross domestic saving	-1.2	4.9	13.3	6.6	8.0	9.4	10.8	12.9	14.5	15.6	16.4
General government 3/	-5.4	-4.9	-4.3	-4.7	-2.9	-0.5	1.2	0.9	1.4	2.3	2.1
Non-government sector	4.2	9.8	17.6	11.3	10.9	9.8	9.6	11.9	13.1	13.3	14.4
Investment	7.9	15.6	24.4	14.6	16.1	16.5	17.0	17.5	18.0	18.5	19.0
General government	1.9	2.0	2.0	2.2	1.7	1.5	1.8	1.6	1.1	1.6	1.5
Non-government sector 4/	6.0	13.6	22.4	12.5	14.4	15.0	15.2	15.9	16.9	16.9	17.5
	(In millions of U.S. dollars; unless otherwise indicated)										
External public debt and foreign exchange reserves											
External debt, end of year	1,357	1,508	1,652	1,720	1,804	1,994	2,147	2,205	2,187	2,180	2,170
External debt service (after rescheduling)	47.2	39.7	66	99	109	91	117	193	238	229	218
External debt service/exports of GNFS (percent)	9.2	6.0	9.1	13.4	13.2	10.1	11.7	17.6	19.8	17.6	15.5
Gross official reserves											
(in millions of U.S. dollars)	158	173	118	132	136	199	247	269	253	276	343
(in months of imports of goods and services)	2.2	1.5	1.0	1.3	1.2	1.6	1.9	2.0	1.8	1.9	2.2
Memorandum items:											
External current account balance (in percent of GDP) 1/	-9.2	-10.8	-11.1	-8.0	-8.1	-7.1	-6.2	-4.6	-3.5	-2.9	-2.6
Nominal GDP (in millions of lari)	3,786	4,511	4,863	5,513	6,035	6,748	7,369	8,047	8,787	9,595	10,478

Sources: Georgian authorities; and Fund staff estimates.

1/ Including transfers: (-) means current account deficit.

2/ National accounts statistics suffer from serious methodological problems, including inconsistent adjustments for the informal economy.

3/ Total revenue and grants minus current expenditure

4/ The decline in private investment in 1999 relative to the 1998 level reflects the scaling down of imports related to the construction of the oil pipeline from Azerbaijan.

Table 3. Georgia: General Government, 1998-2001

	1998	1999	2000 - Expected outcome			2001
	Actual	Estimated outcome	Annual	H1	H2	Program
	(In millions of lari)					
Total revenue and grants	786.4	873.3	904.2	403.5	500.6	1,135.0
Total revenue	740.8	825.1	885.4	400.9	484.6	1,064.8
Tax revenue	643.6	782.3	852.2	384.5	467.7	1,005.3
Nontax revenue	97.1	42.8	33.2	16.3	16.9	59.5
Grants	45.7	48.2	18.7	2.7	16.1	70.2
Total expenditure and net lending	1,096.4	1,252.9	1,179.4	566.2	613.2	1,269.0
Current expenditure	997.3	1,132.5	1,079.0	532.9	546.0	1,151.6
<i>Of which:</i>						
Wages and salaries	176.7	190.8	184.8	93.9	90.9	168.6
Interest payments	114.8	159.0	165.6	85.0	80.6	150.2
Domestic	62.8	80.5	86.4	43.0	43.4	60.0
External	51.9	78.6	79.2	42.0	37.3	90.2
Transfer and subsidies	119.3	142.2	157.0	81.0	76.0	138.7
Capital expenditure and net lending	99.1	120.4	100.4	33.3	67.2	103.0
Budget contingency	0.0	0.0	0.0	0.0	0.0	14.4
Overall balance (commitments)	-309.9	-379.6	-275.2	-162.7	-112.5	-134.0
Adjustment to cash basis	64.0	97.6	80.4	83.3	-3.0	-80.0
Net change in expenditure arrears	64.0	95.9	80.6	78.1	2.5	-80.0
Net other cash balancing	0.0	1.7	-0.2	5.3	-5.5	0.0
Overall balance (cash)	-246.0	-282.0	-194.9	-79.4	-115.5	-214.0
Total financing	246.0	281.9	194.9	79.4	115.6	214.0
Privatization	73.4	52.7	15.5	12.1	3.4	80.0
Domestic financing	97.9	131.9	59.7	32.3	27.4	20.0
NBG	109.8	187.1	22.7	-2.1	24.8	-28.1
<i>Of which:</i> NBG recapitalization	0.0	70.3	-42.2	-42.2	0.0	-28.1
Banks and nonbanks (t-bills and deposits)	-9.7	-0.6	7.7	-4.0	11.7	20.0
Commercial banks (other)	-2.1	15.7	-12.9	-3.8	-9.1	0.0
Off-set to NBG recapitalization bond	0.0	-70.3	42.2	42.2	0.0	28.1
External financing	74.7	68.7	109.7	25.2	84.5	114.0
Disbursements	100.2	138.4	159.7	28.9	130.7	177.6
Amortization	-115.4	-182.0	-205.6	-103.1	-102.5	-291.2
Changes in arrears (-, reduction)	-73.6	112.4	143.9	87.5	56.3	-374.0
Macroeconomic support	163.5	0.0	11.8	11.8	0.0	601.6
Net US in-kind loans	0.0	28.6	10.0	9.7	0.2	0.0
	(In percent of GDP)					
Total revenue and grants	16.2	15.8	15.0	14.3	15.5	16.8
Total revenue	15.2	15.0	14.7	14.2	15.0	15.8
Tax revenue	13.2	14.2	14.1	13.7	14.5	14.9
Nontax revenue	2.0	0.8	0.6	0.6	0.5	0.9
Grants	0.9	0.9	0.3	0.1	0.5	1.0
Total expenditure and net lending	22.5	22.7	19.5	20.1	19.0	18.8
Current expenditure	20.5	20.5	17.9	18.9	17.0	17.1
Capital expenditure and net lending	2.0	2.2	1.7	1.2	2.1	1.5
Budget contingency	0.0	0.0	0.0	0.0	0.0	0.2
Overall balance (commitments)	-6.4	-6.9	-4.6	-5.8	-3.5	-2.0
Adjustment to cash basis	1.3	1.8	1.3	3.0	-0.1	-1.2
Net change in expenditure arrears	1.3	1.7	1.3	2.8	0.1	-1.2
Net other cash balancing	0.0	0.0	0.0	0.2	-0.2	0.0
Overall balance (cash)	-5.1	-5.1	-3.2	-2.8	-3.6	-3.2
Total financing	5.1	5.1	3.2	2.8	3.6	3.2
Privatization	1.5	1.0	0.3	0.4	0.1	1.2
Domestic financing	2.0	2.4	1.0	1.1	0.9	0.3
External financing	1.5	1.2	1.8	0.9	2.6	1.7
Net US in-kind loans	0.0	0.5	0.2	0.3	0.0	0.0
Memorandum item:						
Overall balance, excluding grants (in percent of GDP)	-7.3	-7.8	-4.9	-5.9	-4.0	-3.0
Primary balance (in percent of GDP)	-4.0	-4.0	-1.8	-2.8	-1.0	0.2
Nominal GDP	4,863	5,513	6,035	2,814	3,221	6,748

Sources: Georgian authorities; and Fund staff estimates and projections.

Table 4. Georgia: Accounts of the National Bank of Georgia and Monetary Survey, 1999-2001 1/
(End-of-period stocks; in millions of lari; unless otherwise indicated)

	1999			2000			2001			
	Dec.	Mar.	Jun.	Pref. Act.	Oct.	Dec.	Mar.	Jun.	Sep.	Dec.
						Program			Program	
Accounts of the National Bank of Georgia										
Net foreign assets 2/	-446.3	-452.7	-467.1	-442.7	-435.5	-427.0	-452.0	-428.3	-393.2	-365.6
Gold	1.1	1.0	1.1	1.0	1.0	1.0	1.0	1.1	1.0	1.0
Foreign exchange reserves (including Dutch account) 4/	264.8	246.0	218.3 5/	242.7	244.3	271.0	264.2	306.0	351.8	397.6
Use of Fund resources	-630.0	-616.3	-602.5	-588.8	-583.2	-601.4	-619.6	-637.8	-648.4	-666.6
Other foreign liabilities	-82.2	-83.4	-84.0	-97.6	-97.6	-97.6	-97.6	-97.6	-97.6	-97.6
Net domestic assets	754.8	753.9	762.0	780.2	776.8	775.7	795.2	787.4	764.4	757.8
Net claims on general government 3/	687.5	660.1	685.4 5/	702.7	700.1	710.2	696.1 8/	696.1	680.9	682.1
Claims on rest of economy	83.5	84.8	85.3	98.9	98.9	98.9	98.9	98.9	98.9	98.9
Claims on banks	1.9	-1.0	0.9	0.4	2.2	3.4	5.4	7.4	9.4	11.5
Other items, net 3/	-18.1	10.0	-9.6	-21.8	-24.4	-36.8	-5.2 8/	-15.0	-24.8	-34.7
Reserve money (RM)	308.5	301.2	294.9	337.5	341.3	348.7	343.2	359.1	371.2	392.2
Currency in circulation (M0)	259.8	249.2	249.0	287.5	284.7	303.4	298.6	308.8	315.5	337.3
Required reserves	29.7	33.5	32.7	38.7	38.6	36.3	35.9	42.2	43.4	46.2
Balances on banks' correspondent a/cs	19.0	18.5	13.1	11.3	18.1	9.0	8.7	8.1	12.3	8.7
Memorandum items:										
Growth of reserve money (relative to end of previous year)	18.8	-2.4	-4.4	9.4	10.7	13.0	-1.6	3.0	6.5	12.5
Foreign exchange reserves (in mlns of U.S. dollars) 4/	132.4	123.0	109.2	121.4	122.2	135.5	132.1	153.0	175.9	198.8
Monetary Survey										
Net foreign assets 2/	-452.9	-468.6	-467.3	-421.7	-428.3	-405.9	-430.9	-407.3	-372.1	-344.5
Net domestic assets	897.5	917.3	947.6	995.4	1,011.5	953.4	970.6	997.4	980.5	989.4
Domestic credit	1,092.2	1,065.6	1,133.0	1,202.4	1,218.7	1,175.4	1,163.0	1,201.5	1,196.5	1,217.2
Net claims on general government	686.2	654.7	676.2	691.8	686.5	700.0	689.9	694.0	682.7	687.9
Public borrowing from DMBs	13.3	14.7	9.4	5.0	3.6	0.0	0.0	0.0	0.0	0.0
Credit to the rest of the economy	406.0	410.9	456.8	510.6	532.1	475.3	473.0	507.5	513.8	529.3
Other items, net	-194.7	-148.4	-185.4	-207.0	-207.2	-222.0	-192.4	-204.2	-216.0	-227.9
Broad money (M3)	444.6	448.6	480.3	573.7	583.3	547.5	539.7	590.1	608.4	644.8
Broad money, excl. forex deposits (M2)	286.1	284.1	280.6	327.0	336.4	355.8	350.8	371.7	383.3	406.2
Currency held by the public	244.0	233.7	234.3	269.1	266.7	287.9	283.1	288.5	298.7	314.9
Total deposit liabilities	200.6	214.9	246.0	304.6	316.6	259.5	256.5	301.6	309.7	329.9
Memorandum items:										
Growth of broad money (relative to end of previous year)	20.6	0.9	8.0	29.1	31.2	23.1	-1.4	7.8	11.1	17.8
Growth of credit to the rest of the economy	31.8	1.2	12.5	25.8	31.1	17.1	-0.5	6.8	8.1	11.4
M3 multiplier 6/	1.4	1.5	1.6	1.7	1.7	1.6	1.6	1.6	1.6	1.6
M3 velocity 7/	13.3	12.0	12.3	11.2	...	11.8	10.9	11.3	11.9	11.2
Foreign exchange deposits in percent of total deposits	79.0	76.5	81.2	81.0	78.0	73.8	73.6	72.4	72.7	72.3

Sources: National Bank of Georgia; and Fund staff estimates.

1/ Quarterly patterns reflect the expected timing of World Bank and EU disbursements.

2/ For December 1999 onward, net international reserves are valued at the program rate of 2.00 lari/US\$ and US\$/SDR 1.35 and US\$/EURO of 1.00; from September 2000 onward the US\$/Euro rate is changed to 0.85.

3/ End-March 2000 data reflect repayment of lari 42 million of a lari 70.3 million government bond issued in March 1999 to recapitalize the NBG for losses from revaluation of its net international reserves.

4/ Includes SDR holdings and foreign currency account with Netherlands Bank which is used for debt service payments.

5/ Reflects a decrease of US\$0.8 million which was paid from the Dutch account on June 30, but was not recorded by the NBG pending confirmation from the correspondent bank.

6/ M3 divided by reserve money (RM).

7/ Annualized quarterly GDP divided by end-period M3.

8/ Reflects the repayment of recapitalization bond (lari 28 million) which lowers government loans and is offset by an increase in other items net (OIN); OIN also reflects a profit transfer to MoF of lari 15 million.

Table 5. Georgia: Summary Long-Term Balance of Payments, 1998-2006
(In millions of U.S. dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006
	Prel. Estimates		Projections						
Current account balance (excluding transfers)	-599.3	-407.3	-421.2	-419.0	-395.0	-355.4	-321.7	-304.9	-296.5
Trade balance	-685.4	-540.9	-583.9	-599.8	-599.8	-596.4	-596.7	-597.0	-611.1
Exports	478.3	477.0	521.1	570.5	622.9	679.2	740.2	807.1	879.9
Imports 1/	-1163.7	-1017.9	-1105.0	-1170.3	-1222.7	-1275.6	-1337.0	-1404.0	-1491.0
Services (net)	86.2	133.7	162.7	180.9	204.7	241.0	275.0	292.1	314.5
Transfers 2/	210.7	189.2	171.2	178.7	169.9	173.9	171.3	171.1	169.2
Of which: official	73.4	75.4	50.4	50.9	33.1	28.2	16.3	12.0	0.0
Capital account	270.6	68.4	132.4	157.3	126.1	208.3	186.0	210.7	243.3
Medium- and long-term loans	52.7	-7.6	42.6	44.1	-12.1	62.2	30.0	43.6	36.1
Disbursements	134.4	85.8	156.4	196.2	159.7	156.9	163.3	167.4	155.4
World Bank	93.6	58.3	65.1	87.3	53.1	50.8	46.7	39.1	24.5
EBRD	10.3	2.9	28.6	41.0	21.8	0.0	0.0	0.0	0.0
IFAD	1.1	1.1	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral	29.4	6.7	61.7	67.9	84.8	106.1	116.7	128.3	130.9
Other (including commercial)	0.0	16.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization 3/	-81.7	-93.4	-113.8	-152.1	-171.8	-94.7	-133.3	-123.8	-119.3
Foreign direct investment	221.0	60.0	76.8	101.2	127.6	137.1	148.4	161.2	174.6
Other (incl. commercial banks)	-3.1	16.0	13.1	11.9	10.5	9.1	7.5	5.9	32.5
Errors and omissions	-9.1	86.0	62.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	-127.1	-63.6	-55.4	-83.1	-98.7	26.4	35.8	77.4	115.9
Financing	127.1	63.6	43.2	-265.5	-80.2	-64.5	-35.8	-77.4	-115.9
Use of Fund resources, net	36.2	23.8	-26.6	-16.3	-31.6	-43.2	-51.8	-54.1	-49.1
Of which: purchases/disbursements	37.2	45.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: repurchases/repayments	1.0	21.5	26.6	16.3	31.6	43.2	51.8	54.1	49.1
Increase in reserves (-)	54.9	-14.0	-3.2	-63.2	-48.6	-21.3	16.0	-23.2	-66.8
Change in arrears (+, increase)	-91.3	53.8	73.0	-185.9	0.0	0.0	0.0	0.0	0.0
Of which: arrears to Turkmenistan 4/	59.1	53.8	73.0	-185.9	0.0	0.0	0.0	0.0	0.0
Debt and arrears rescheduling	4.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Macroeconomic support from the EU	122.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap 5/	0.0	0.0	12.2	348.6	178.9	38.1	0.0	0.0	0.0
Memorandum items									
Current account deficit, excluding transfers (In percent of GDP)	17.2	14.9	13.7	12.4	10.8	9.1	7.6	6.6	5.9
Gross international reserves	118.4	132.4	135.6	198.8	247.5	268.8	252.8	276.0	342.8
In months of imports of goods and services	1.0	1.3	1.2	1.6	1.9	2.0	1.8	1.9	2.2
Debt service (after a new rescheduling) 5/ (In percent of GNFS exports)	65.9	99.1	109.0	91.4	116.9	193.0	238.2	228.9	218.2
External debt	1652.0	1720.2	1803.9	1994.2	2147.2	2205.4	2187.1	2180.0	2170.1
NPV of debt to exports of GNFS 6/	217.1	213.2	189.8	185.0	174.7	159.6	140.5	125.7	113.7
External debt (in percent of GDP) 6/	47.3	63.1	58.8	59.1	58.9	56.3	51.6	47.3	43.5

Sources: Georgian Statistics Department; and Fund staff estimates.

1/ The large increases in imports in 1997 and 1998 were driven mainly by imports associated with the construction and refurbishment of the "early oil" pipeline connecting Azerbaijan to the Black Sea. The sharp drop in the growth rate of imports in 1999 is largely due to the slowdown in pipeline-related imports following the completion of the project in early 1999.

2/ Starting in 1997, transfers include data on the inflow of workers' remittances.

3/ Arrears from the end of 1994 and obligations to bilateral creditors falling due through end-1997 were rescheduled between 1995 and 1998. The terms of repayment differed across creditors, although the rate of interest was uniform at 4 percent.

4/ In December 1999, Georgia made a payment of US\$ 25 million to Turkmenistan as partial payment towards principal obligations falling due.

5/ The financing gap is expected to be filled by possible financial support under a new Fund arrangement, a rescheduling of arrears, and of principal payments falling due to bilateral creditors in 2001 through 2002.

6/ Includes both private and public and publicly guaranteed external debt.

Table 6. Georgia: External Debt Outstanding, 1994-1999
(In millions of U.S. dollars)

	1994	1995	1996	1997	1998	1999
					Prel.	
Total debt outstanding	1,003.9	1,216.7	1,357.4	1,507.7	1,652.0	1,720.2
By debtor						
Public and publicly guaranteed	1,003.9	1,216.7	1,357.4	1,503.9	1,640.3	1,680.9
Private non-guaranteed	0.0	0.0	0.0	3.8	11.7	39.3
By creditor						
Multilateral	193.2	364.5	520.3	651.6	776.1	839.4
World Bank	1.0	86.0	162.7	227.0	320.5	378.8
IMF	40.5	116.1	189.5	257.8	302.1	319.0
ESAF	0.0	0.0	79.0	151.6	194.3	235.2
SBA	0.0	33.2	31.6	30.3	30.1	14.2
STF	40.5	83.0	79.0	75.8	77.7	69.5
European Union	151.7	160.8	155.1	145.5	129.8	116.8
Other	0.0	1.6	12.8	21.4	23.8	24.9
Bilateral	810.7	852.2	837.2	852.3	864.2	841.5
BRO	655.9	684.3	635.4	639.2	619.5	594.5
Russia	156.3	167.1	175.4	179.3	179.3	179.3
Turkmenistan 1/	440.3	453.2	394.3	394.3	374.6	349.6
Armenia	18.1	19.7	19.6	19.6	19.6	19.6
Azerbaijan	15.0	15.7	16.3	16.3	16.3	16.3
Kazakhstan	24.1	26.7	27.8	27.8	27.8	27.8
Other	2.0	2.0	2.0	1.9	1.9	1.9
Non-BRO	154.8	167.9	201.8	213.1	244.7	247.0
Turkey	42.0	45.4	47.9	54.3	54.3	54.3
Austria	97.4	104.2	110.3	90.0	90.0	90.0
Other	15.4	18.4	43.5	68.7	100.4	102.6
Memorandum items:						
Arrears to bilateral creditors on principal payments 2/	0.0	0.0	0.0	0.0	59.1	113.0

Sources: Georgian authorities; and Fund staff estimates.

1/ Under a preliminary agreement reached in February 1995, all of Georgia's obligations to Turkmenistan, including new gas arrears from 1994 and penalties were converted into a new debt of US\$453.2 million. After a reconciliation of accounts, concluded in May 1995, this figure was reduced to US\$440 million. About US\$46 million was written off in the context of a rescheduling agreement reached in March 1996.

2/ At end-1999, Georgia was in arrears on principal payments to Turkmenistan.

Table 7. Georgia: External Debt Service Obligations, 1999-2006 1/
(In millions of U.S. dollars)

	1999	2000	2001	2002	2003	2004	2005	2006
Total debt service due								
Medium/long term	157.8	176.5	192.8	225.7	159.4	170.6	163.3	154.6
Public and publicly guaranteed	157.8	173.4	190.0	223.0	156.9	168.3	161.2	152.6
Official creditors	157.8	173.0	189.6	222.6	156.5	167.9	160.9	152.3
Multilateral	51.2	45.6	52.2	71.3	83.3	93.7	86.0	81.5
Bilateral	106.6	127.4	137.4	151.3	73.2	74.2	74.8	70.8
Private creditors	0.0	0.4	0.4	0.4	0.4	0.4	0.3	0.3
Private non-guaranteed	0.0	3.0	2.9	2.7	2.5	2.4	2.1	2.0
Short term	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Principal payments								
Medium/long term	114.9	134.4	152.1	183.6	119.3	131.2	124.0	114.4
Public and publicly guaranteed	114.9	132.6	150.3	181.8	117.5	129.4	122.2	112.6
Official creditors	114.9	132.3	150.0	181.5	117.2	129.1	121.9	112.3
Multilateral	36.0	30.2	34.1	50.2	62.9	74.8	68.4	64.6
Bilateral	78.9	102.0	115.9	131.3	54.2	54.3	53.5	47.7
Private creditors	0.0	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Private non-guaranteed	0.0	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Short term	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest Payments								
Medium/long term	42.9	42.1	40.7	42.1	40.1	39.5	39.4	40.2
Public and publicly guaranteed	42.9	40.8	39.6	41.2	39.4	38.9	39.0	40.1
Official creditors	42.9	40.7	39.5	41.2	39.3	38.8	39.0	40.0
Multilateral	15.1	15.4	18.1	21.2	20.3	18.9	17.7	16.9
Bilateral	27.8	25.3	21.5	20.0	19.0	19.9	21.3	23.1
Private creditors	0.0	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Private non-guaranteed	0.0	1.3	1.1	0.9	0.7	0.6	0.4	0.2
Short term	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Debt service (in percent of exports of GNFS)	21.4	21.3	21.2	22.7	14.5	14.2	12.6	11.0
Arrears on principal payments to bilateral creditors 2/	113.0	183.5	...	...	...	...	...	...

Sources: Georgian authorities; and Fund staff estimates.

1/ Based on bilateral rescheduling agreements with creditors in 1995 through 1997.

2/ Through September 2000, Georgia was in arrears on principal payments to Turkmenistan and Russia.

Table 8. Georgia: Indicators of Fund Credit, 1998-2006
(In percent; unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	2004	2005	2006
		Projections							
Outstanding Fund Credit (In millions of SDRs)	215.8	233.3	222.7	246.7	259.6	255.1	217.6	178.6	143.3
In percent of:									
Exports of goods and nonfactor services	40.6	43.2	36.4	36.9	35.6	31.9	25.0	19.1	14.2
Total public debt	17.7	18.5	16.7	16.8	16.5	15.9	13.7	11.4	9.2
Gross official reserves	247.1	240.9	222.2	168.4	143.2	130.3	118.8	89.7	58.3
GDP	8.4	11.7	9.8	9.9	9.7	8.9	7.1	5.4	4.0
Quota	194.4	155.2	148.2	164.1	172.7	169.8	144.8	118.8	95.4
Repurchases / Repayments and charges due (In millions of SDRs)	5.0	19.4	22.9	15.1	25.9	33.8	38.7	40.1	36.0
In percent of:									
Exports of goods and nonfactor services	0.9	3.6	3.8	2.3	3.5	4.2	4.5	4.3	3.6
Total public debt	5.2	15.7	16.1	9.2	13.5	23.6	22.5	24.1	22.9
Gross official reserves	5.8	20.1	22.9	10.3	14.3	17.2	21.5	20.2	14.7
GDP	0.2	1.0	1.0	0.6	1.0	1.2	1.3	1.2	1.0
Quota	4.5	12.9	15.3	10.1	17.2	22.5	26.1	26.7	24.0

Source: Fund staff estimates.

Table 9. Georgia: Projected Payments to the Fund as of September 30, 2000, 2000-2009
(Purchases under obligation schedule, in millions of SDRs; unless otherwise indicated)

	Overdue	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Obligations from existing drawings											
1. Principal											
a. Repurchases	0.0	4.4	9.3	9.3	9.3	9.3	4.6	0.0	0.0	0.0	0.0
b. PRGF/SAF Repayments	0.0	0.0	2.8	13.9	22.2	27.8	34.4	31.6	20.5	12.2	6.7
2. Charges and interest 1/											
a. On Fund credit	0.0	1.1	3.0	2.4	1.8	1.2	0.6	0.3	0.1	0.1	0.0
b. On use of SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total obligations 2/	0.0	5.5	15.0	25.6	33.3	38.2	39.6	31.9	20.7	12.3	6.7
(In percent of quota)	0.0	3.6	10.0	17.0	22.1	25.4	26.3	21.2	13.8	8.2	4.4
Obligations from prospective drawings											
1. Principal											
a. Repurchases	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
b. PRGF/SAF Repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.6	10.8	18.0	21.6
2. Charges and interest 1/											
a. On Fund credit	0.0	0.0	0.1	0.3	0.5	0.5	0.5	0.5	0.5	0.4	0.3
b. On use of SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total obligations 2/	0.0	0.0	0.1	0.3	0.5	0.5	0.5	4.1	11.3	18.4	21.9
(In percent of quota)	0.0	0.0	0.1	0.2	0.3	0.4	0.4	2.8	7.5	12.3	14.6
Cumulative (existing and prospective)											
1. Principal											
a. Repurchases	0.0	4.4	9.3	9.3	9.3	9.3	4.6	0.0	0.0	0.0	0.0
b. PRGF/SAF Repayments	0.0	0.0	2.8	13.9	22.2	27.8	34.4	35.2	31.3	30.2	28.3
2. Charges and interest 1/											
a. On Fund credit	0.0	1.1	3.1	2.7	2.3	1.7	1.1	0.8	0.6	0.5	0.3
b. On use of SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total obligations 2/	0.0	5.5	15.1	25.9	33.8	38.7	40.1	36.0	32.0	30.7	28.6
(In percent of quota)	0.0	3.6	10.1	17.2	22.5	25.8	26.7	24.0	21.3	20.4	19.0

Source: Treasurer's Department.

1/ Projections are based on current rates of charge, including burden-sharing charges where applicable, for purchases in the GRA, and on current interest rates for SAF, PRGF, and Trust Fund. The current SDR interest rate is assumed for net use of SDRs.

2/ Overdue obligations (if applicable) will be settled in full at close of business October 01, 2000.

GEORGIA: FUND RELATIONS

(As of October 31, 2000)

I. Membership Status: Joined 05/05/1992; Article VIII

II. General Resources Account:	SDR Million	Percent Quota
Quota	150.30	100.0
Fund holdings of currency	194.24	129.2
Reserve position in Fund	0.01	0.0

III. SDR Department:	SDR Million	% Allocation
Holdings	2.38	...

IV. Outstanding Purchases and Loans:	SDR Million	%Quota
Systemic transformation	43.94	29.2
ESAF arrangements	172.05	114.5

V. Financial Arrangements:

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR million)</u>	<u>Amount Drawn (SDR Million)</u>
ESAF	02/28/96	08/13/99	172.05	172.05
Stand-by	6/28/95	2/28/96	72.15	22.20

VI. Projected Obligations to Fund: (SDR million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	(10/31/00)	2000	2001	2002	2003	2004
Principal		2.3	12.0	23.1	31.4	37.0
Charges/interest		<u>1.1</u>	<u>3.1</u>	<u>2.5</u>	<u>1.9</u>	<u>1.2</u>
Total		3.4	15.1	25.6	33.3	38.2

VII. Exchange Arrangements:

The currency of Georgia is the lari, which became the sole legal tender in October 2, 1995. The lari replaced the coupon, which was introduced in April 1993. Since April 29, 1993, the Tbilisi Interbank Currency Exchange (TICEX), established by the NBG and a group of commercial banks, has conducted periodic auctions to determine the exchange rate of the

domestic currency. On June 14, 1993, the NBG authorized the establishment of foreign exchange bureaus that are allowed to buy and sell foreign currency bank notes.

The frequency of the TICEX auctions was increased from weekly to twice weekly in late September 1994, to thrice weekly in April 1995, and to daily from January 1, 1996. The rate established at the TICEX on October 31, 2000 was lari 1.960 per U.S. dollar.

From September 1994 until December 7, 1998 intervention was a major factor in the evolution of the exchange rate. However, the difference between the TICEX rates and those at foreign exchange bureaus has become smaller over time. Since December 7, 1998, the NBG has only intervened to purchase foreign exchange, to bolster the international reserves.

VIII. Article IV Consultation:

- (a) Georgia is on a 12-month consultation cycle.
- (b) The 1999 Article IV consultation was concluded on April 21, 2000.

IX. Technical Assistance:

See Table 1 of this appendix.

X. Resident Representative

The third resident representative, Mr. Lane, took up the post as resident representative on April 10, 1999, replacing Mr. Monroe. Mr. Monroe took up his post as resident representative on November 23, 1996, replacing Mr. Wang.

XI. National Bank of Georgia:

Ms. Vance, an MAE peripatetic banking supervision advisor to the NBG, commenced a series of visits to Tbilisi at the end of September 1997. Mr. Nielsen, an MAE advisor, provided technical assistance to the NBG during May 1998. Mr. Viksnins was an MAE peripatetic advisor to the NBG president starting in October 4, 1999. Mr. Fish, resident advisor on banking supervision, began his assignment on August 10, 1999. Mr. Bernard Thompson provided peripatetic technical assistance in accounting and internal audit in March and August 2000.

XII. Ministry of Finance Resident Advisors:

The late Mr. Sharma was an FAD resident advisor and assisted the authorities in the development of a Treasury. He assumed duties on May 1, 1997. Mr. Sainsbury, an FAD advisor, assisted the Ministry of Finance from June 1998 to November 1999.

Table 1. Georgia: Fund Technical Assistance Missions: 1997-00			
Subject	Type of Mission	Timing	Counterpart
Fiscal Affairs Department (FAD)			
Tax Policy	Taxation of Agricultural land, presumptive taxation of small businesses, and excises on alcoholic beverages	February 3-17, 1998	Ministry of Finance, Ministry of Economy, and Tax Inspectorate of Georgia
Tax Administration	Advisory	January 20-27, 1999	Ministry of Finance
Public Expenditure Management	Advisory	January 27-February 9, 1999	Ministry of Finance
Fiscal Federalism	Advisory	March 16-30, 1999	Ministry of Finance
Tax Administration	Large Tax Payer Inspectorate	March 27-April 14, 2000	Ministry of Finance
Customs Reform	Customs Administration	October 10-25, 2000	Ministry of Revenues (State Customs Department)
Monetary and Exchange Affairs Department (MAE)			
Central Bank	Follow-up assistance	July 13-23, 1998	National Bank of Georgia
Exchange Rate Developments, Banking Supervision and Banking System Restructuring	Advisory	December 9-17, 1998	National Bank of Georgia
Monetary Operations, Treasury Bill Markets and Banking Supervision	Follow-up assistance	October 5-15, 1999	National Bank of Georgia
Accounting, banking, supervision and monetary operations	Advisory	October 10-20, 2000	National Bank of Georgia
IMF Institute (INS)			
Macroeconomic and financial policies	Course	Sep. 30-Oct. 11, 1996	Ministry of Finance, Ministry of Economy, National Bank of Georgia
Statistics Department (STA)			
National Accounts	Technical Assistance	December 8-18, 1998	State Department of Statistics
Money and Banking Statistics	Technical Assistance	January 14-27, 1999	National Bank of Georgia
Balance of Payments Statistics	Technical Assistance	April 27-May 21, 1999	State Department of Statistics
National Accounts	Follow-up Assistance	July 5-16, 1999	State Department of Statistics
Money and Banking	Follow-up Assistance	September 16-29, 1999	National Bank of Georgia
National Accounts	Follow-up Assistance	December 17-24, 1999	State Department of Statistics
Balance of Payments Statistics	Technical Assistance	April 27-May 15, 2000	State Department of Statistics

Table 1. Georgia: Fund Technical Assistance Missions: 1997-00			
Subject	Type of Mission	Timing	Counterpart
Legal Department (LEG)			
Tax Code	Follow-up Assistance	March 2-7, 1997	Ministry of Finance, Tax Inspectorate of Georgia ¹
Tax Code	Follow-up Assistance	April 20-May 10, 1997	Ministry of Finance, Tax Inspectorate of Georgia
Tax Code	Follow-up Assistance	August 1997	Ministry of Finance, Tax Inspectorate of Georgia

¹ Prior to 1997, the official name of the Tax Inspectorate of Georgia was the State Tax Service.

RELATIONS WITH THE WORLD BANK
(As of October 31, 2000)

Georgia joined the World Bank in August 1992 and the International Development Association (IDA) in August 1993. Through end-October 2000, the World Bank has approved 19 investment and technical assistance credits and five adjustment operations, all with standard IDA terms, totaling SDR 399.1 million. A resident mission was opened in Tbilisi in August 1996.

A third Structural Adjustment Credit (SAC III) and an Energy Sector Adjustment Credit (ESAC), equivalent to SDR 44.3 million and SDR 18.1 million, respectively, were approved by the World Bank Executive Board on June 29, 1999. SAC III supports implementation of the government's reform program, including measures to: strengthen fiscal performance, ensure budgetary provisions for core social expenditures, improve the legal and regulatory framework for the private sector, and complete the process of ownership change and market liberalization. Key reform objectives supported by ESAC include, enhancing the financial sustainability and management of the energy sector, supporting privatization, as well as lessening the impact on the socially most vulnerable by increasing the poverty benefit. The first tranches of SAC III (SDR 14.7 million) and ESAC (SDR 9.05 million) were released on effectiveness of the credits, on July 27, 1999. A Structural Reform Support project (SDR 12.2 million) was approved on the same date to provide technical assistance to support these reform measures, and included an investment component to support the Government's Hospital Restructuring program in Tbilisi.

Recently, a Roads project (SDR 29.8 million) was approved (May 25, 2000) to reduce road transport costs and improve access, provide funding for road maintenance, and strengthen the State Department of Roads. On May 11, 2000, an Agriculture Research, Extension and Training project (SDR 5.5 million credit and SDR 1.8 million GEF grant) was approved to promote the adoption of technologies to increase sustainable agricultural production and reduce pollution of natural resources. A Judicial Reform project (SDR 9.9 million credit) was approved on June 29, 1999 to assist in the development of an independent and professional judiciary. The project provides support to develop a new court administration and case management system, rehabilitation of selected court infrastructure, as well as provide public information on the role of the judiciary and the reforms being implemented.

To date, IFC has approved 9 projects with total financing of US\$87 million. Among these, IFC approved a US\$30 million loan to the recently privatized electricity distributor of Tbilisi (AES/Telasi) to strengthen its electricity distribution network and to install new meters to improve collections. Also, four investments in the banking sector were approved: (i) US\$3 million credit line and a 10 percent stake in TBC Bank; (ii) a US\$0.75 million equity investment to purchase a 20 percent stake in a new microfinance bank, the Microfinance Bank of Georgia; and (iii) a US\$3 million credit line to TbilComBank; and (iv) a US\$3 million credit line in the Bank of Georgia to support mortgage-based financing for renovation and acquisition of residential and commercial real estate. IFC is also planning a technical assistance program in Georgia, as part of the recently instituted Private Enterprise Partnership. Georgia was added to IFC's Outreach Program in 1998, allowing the IFC to open a representative office, co-located with the World Bank.

GEORGIA RELATIONS WITH THE EBRD
(As of May 2000)

Since mid-1998, the EBRD has added a number of new projects to its portfolio, raising the total number of signed projects to sixteen and its commitments to \$186 million. The total value of projects supported to date is \$696.4 million. In July 1998, the EBRD provided a convertible loan to Bank of Georgia and by the end-1998 two large public infrastructure operations were signed. One is part of a regional project to rehabilitate the Trans-Caucasian railway, linking the ports of Poti and Batumi to Baku port in Azerbaijan. The second operation involves the rehabilitation of the Enguri Hydro Power plant, the country's most important source of primary energy

In September 1999 the EBRD signed a loan with Georgian Wines and Spirits company to promote Georgian exports to the CIS and Western Europe. In May 1999, a private sector project with a glass factory was signed. In December 1999, another private sector project was signed with AES-TELASI to modernize Tbilisi Electricity Distribution.

In March 2000, the EBRD gave a loan to Microfinance Bank of Georgia to encourage micro enterprise development in the country. This was followed by equity participation in Frontera Resources Georgia Transaction.

The pace and composition of portfolio growth in Georgia has varied significantly from year to year. While in 1994 and 1995 public infrastructure projects were launched, the portfolio in the following years was diversified, including projects principally in the financial sector, consistently increasing the private sector share in the EBRD's portfolio in Georgia. With the signing of the two new public sector projects in 1998, the private sector share of the portfolio declined to 35 percent. However, this increased to 55 percent, after several private sector transactions were signed.

Projects are in preparation in the energy and industrial sector, as well as in the rehabilitation and upgrade of facilities in Poti port. The Bank is also considering to participate in the privatization of Georgian telecoms.

EBRD PROJECT COMMITMENTS
(in millions of USD)

Project Name	Date of Agreement	Commitment Amount	Total project cost
State Projects			
Power Rehabilitation Project	December 1994	18.1	19.2
Tbilisi Airport Refurbishment	July 1995	11	12.3
Enguri Hydro Power Plant	December 1998	38.75	138
Georgian Rail Link Project	December 1998	20	33
Private Projects			
IBSB Georgia	September 1996	1	5
Georgia SME Credit Line	December 1996	12	12
Absolute Bank	March 1997	5	5
Borjomi	June 1997	10	24
United Georgian Bank	November 1997	10	10
Tbilisi Business Center - TBC Bank	March 1998	1.9	1.9
Bank of Georgia Convertible loan	July 1998	7	7
Ksani Glass Packaging Factory	May 1999	8.4	26
Georgian Wines and Spirits	September 1999	5	9
Microfinance Bank	March 2000	3	3
AES-Telasi	December 1999	30	141
Frontera Resources	September 2000	5	250
Total		186.15	696.4

1 Euro = 1.0046 Dollars, as of December 31 1999.

December 6, 2000

Dear Mr. Köhler:

Georgia is continuing to implement a comprehensive economic reform program aimed at completing the transition towards a market economy. With the support of the IMF and the World Bank, the country has maintained financial stability and economic growth since 1995. Following an exchange rate adjustment in the wake of the Russian crisis, inflation has been under control and the exchange rate stable. Georgia's accession to the World Trade Organization (WTO) in June 2000 is testament to our commitment to economic reform.

Despite these considerable achievements, Georgia faces a number of daunting economic and financial challenges. The state has not been able to consolidate its finances sufficiently, partly due to problems with corruption. Tax collection, as a share of GDP, is among the lowest in the CIS. The country is facing severe difficulties in meeting its external financial obligations and is pursuing a round of debt rescheduling at the Paris Club. The shortfall in public funds is particularly serious for the country's poor, as spending on health, education, and the social safety net remains severely constrained. In addition, the recent drought has slowed down growth and enhanced the need for external assistance.

The attached Memorandum of Economic and Financial Policies outlines our key macroeconomic objectives and policies for 2001 to 2003, which are designed to address these challenges. At the center of the program is a sizeable fiscal adjustment that will be supported by structural reforms, in particular efforts to improve public sector administration and reduce corruption. The memorandum describes our initiatives to strengthen fiscal and financial institutions. The interim Poverty Reduction and Economic Growth strategy paper, which was prepared by a number of working groups and has been discussed with international institutions and representatives of civil society, lays out our broader structural reform efforts aimed at poverty reduction and economic growth. In addition, we will begin the implementation of our strategy to combat corruption, which was published in a report prepared by the anti-corruption commission in November.

In support of our economic reform program, Georgia requests a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) in an amount equivalent to SDR 108 million (about 72 percent of quota).

I am confident that the policies and measures described in the attached memorandum are adequate to achieve the objectives of the program. The government and the National Bank of Georgia will take any other measures that may become appropriate for this purpose. In the period of the PRGF arrangement, the government of Georgia will regularly consult with the Fund concerning additional measures that may become appropriate and will provide the Fund with such information as the Fund requests in connection with the progress of Georgia in implementing the policies and reaching the objectives of the program supported by the PRGF arrangement. Moreover, after the period of the arrangement, and while Georgia

has outstanding financial obligations to the Fund from loans and earlier arrangements, the government will consult with the Fund on Georgia's economic and financial policies from time to time, at the initiative of the government or at the request of the Managing Director. Georgia will conduct with the Fund the first semi-annual review of its program before May 15, 2001, as described in the attached memorandum.

Sincerely yours,

/s/

Eduard Shevardnadze
President of Georgia

Attachment: Memorandum of Economic and Financial Policies

Mr. Horst Köhler
Managing Director of the International Monetary Fund
Washington, D.C.
U.S.A.

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2001–2003

I. INTRODUCTION

1. Georgia is continuing to implement a comprehensive economic reform program aimed at completing the transition towards a market economy. With the support of the IMF and the World Bank, the country has restored price stability and economic growth since 1995. After severe output losses in the early 1990s, the economy has started to recover, with an average growth rate of 6 percent between 1995 and 1999. Following an exchange rate adjustment in the wake of the Russian crisis, inflation has been brought back down to below 10 percent per annum and the exchange rate has been stable. Substantial progress has been made in privatization, liberalization, and other structural reforms. Georgia's accession to the World Trade Organization (WTO) in June 2000 is testament to our commitment to economic reform.

2. Despite these achievements, Georgia faces a number of daunting economic and financial challenges. The state has not been able to consolidate its finances, largely due to problems with governance and corruption. Tax collection, as a share of GDP, is among the lowest in the CIS. The country is facing severe difficulties in meeting its external financial obligations and is pursuing a round of debt rescheduling at the Paris Club. The shortfall in public funds is particularly serious for the country's poor, as spending on health, education, and the social safety net remains severely constrained. The situation is exacerbated by public expenditure arrears, including in the social sector. In addition, despite progress in energy sector reform, there continue to be frequent interruptions of energy supply. The small banking sector has not yet provided sufficient financial intermediation to support sustainable growth, while dollarization remains high.

3. It is against this background that we are launching our economic program for 2001–2003, for which we are seeking support from the IMF under the poverty reduction and growth facility (PRGF). It is based on continued monetary stability and on a sizeable fiscal adjustment, in order to establish orderly internal and external payments. A comprehensive agenda of institutional and structural reforms, with a focus on improving governance, will lay the foundations for sustained economic growth and poverty reduction. The recently prepared interim poverty reduction strategy paper (I-PRSP) sets out the main elements of the wider structural program, while this memorandum focuses on those policies and reforms that are crucial for the success of a macroeconomic program that could be supported by the IMF under the PRGF.

II. PERFORMANCE DURING 2000

4. While **inflation** remains under control, **growth prospects** for 2000 have been dimmed by the adverse impact of a severe drought. Output losses in the vital agricultural sector are substantial, offsetting a positive growth trend for the rest of the economy. Annual consumer price inflation has picked up a little in recent months, reflecting an upturn in food

prices associated with the drought, though it is expected to remain below 10 percent for the year as a whole.

5. **Fiscal performance** deteriorated markedly in the first half of 2000, with total revenues and grants of the general government falling to 14¼ percent of GDP, compared with 15¼ percent for the full year of 1999. The fiscal deficit, on a commitments basis, remained high at 5¼ percent of GDP, and public expenditure arrears continued to accumulate. In light of these difficulties, parliament approved a revised budget in early July incorporating strong fiscal adjustment measures for the remainder of the year including substantial cuts in expenditure commitments. At the same time, in response to determined efforts by the tax collection agencies, tax collections recovered sharply in the third quarter and exceeded revenues in the previous year by 12 percent. The weakest performance continues to be in excise collections, whereas profit taxes, VAT, customs taxes, and social contributions are up in real terms relative to 1999. After rapid accumulation of public expenditure arrears in the first half of 2000, arrears have stabilized since end-June.

6. **Monetary policy** in 2000 has underpinned low inflation and a stable exchange rate, with very little extension of net credit to the government from the National Bank of Georgia (NBG). Reserve money growth in the twelve months to October 2000 was 7¼ percent, while broad money growth was 27¼ percent, partly reflecting a two percentage points decrease in reserve requirements and a significant increase in deposits. Treasury bill yields have eased to about 10 percent. Net foreign assets of the NBG were well above expectations, partly reflecting purchases of foreign exchange by the NBG, amounting to US\$52 million in the five months to October. Notwithstanding these sizeable purchases, the exchange rate has remained stable. Gross international reserves of US\$122 million at the end of October amounted to about one month of imports of goods and services.

7. The **balance of payments** position remains precarious, with large current account imbalances, low official reserves, arrears on external debt payments, and a large hump in external debt servicing in the near future. The current account deficit excluding transfers amounted to 15 percent of GDP in 1999 and little improvement is expected in 2000, given the adverse effect of the recent drought and high oil prices. Georgia continues to experience difficulties in servicing its external debts. While remaining current on all external interest obligations, Georgia has accumulated arrears on principal payments to Turkmenistan since 1998 and to Russia since the first quarter of 2000. In an effort to resolve this problem, the government is seeking a comprehensive debt rescheduling from bilateral creditors.

III. POLICIES FOR 2001–2003

8. At the center of the economic program for 2001–2003 is a sizeable fiscal adjustment that will be supported by efforts to improve governance and reduce corruption. Improved tax collection will help reduce public expenditure arrears and free resources to fight poverty and improve the social safety net. A comprehensive rescheduling of external debt will underpin Georgia's return to full solvency. Macroeconomic policies will continue to focus on low inflation. A comprehensive set of institutional and structural reforms will be aimed at

strengthening governance, by improving the transparency and effectiveness of public institutions, particularly in the fiscal and financial sphere.

A. Macroeconomic prospects

9. The implementation of the economic program for 2001–2003 will allow Georgia to achieve sustainable growth and reduce external vulnerabilities. A lower budget deficit will support an increase in domestic savings and investment, raising medium-term growth prospects. Combined with the elimination of public expenditure arrears and strengthened public finances, sustained growth averaging 5 percent per year would help reduce poverty significantly over the medium term. Fiscal adjustment will also make the external debt burden more manageable and help reduce the large current account deficit. This will allow official reserves to grow over time, with the medium-term goal of covering 3 months of imports. Foreign direct investment will be attracted by macroeconomic stability and by improvements in the investment climate, including measures to strengthen governance.

B. Fiscal policies

10. A substantial **fiscal adjustment** is required to bring the budget back onto a sustainable path. Our short-term fiscal objective is to reduce the commitments deficit of the general government to 2 percent of GDP in 2001 from an estimated 4½ percent of GDP in 2000. This adjustment will be achieved through a combination of improved revenue collections and reduced expenditure commitments as a percentage of GDP. The program includes floors on tax revenues and ceilings on the cash deficit and expenditure arrears, which are consistent with the 2001 budget, and are set out in Table 1.

11. Low **revenue collections** are primarily the result of weak administrative capacity and governance problems, including corruption, in the revenue raising agencies. A comprehensive reform package aimed at strengthening the tax and customs agencies and improving tax compliance (see Section E) should ensure a consolidation of the recent upturn in tax collections through 2001 and beyond. Tax collections by the general government (including extrabudgetary revenue) are targeted to increase to 15 percent of GDP in 2001, from an estimated 14 percent of GDP this year. This will include revenues of lari 161 million from petroleum and cigarettes, two areas where governance problems have hindered tax collection in the past.

12. The necessary fiscal adjustment can only be achieved if higher revenues are combined with a containment of **public expenditures**. Total expenditure and net lending of the general government is planned at 18¾ percent of GDP, compared to 19½ percent of GDP in 2000. The adjustment in expenditures will involve a reallocation of resources among spending units, with a view to protecting social expenditures and allocating sufficient budgetary funds for the reform of revenue raising agencies.

13. The steady accumulation of **expenditure arrears** over the last few years has undermined the credibility of economic policies and deepened poverty. The stock of arrears on pensions and wages is estimated at 3¼ percent of GDP at the end of August 2000. The

economic program for 2001 aims to begin the process of clearing arrears, particularly in the social sphere. To this effect, the budget for 2001 envisages a repayment of pensions, wages, and other social arrears (including payments to refugees) of lari 80 million (1¼ percent of GDP). The repayment will follow a publicly announced monthly schedule and will be fully budgeted. The medium-term objective is to eliminate all wage, pension and other social sector arrears within about 3 years. The Ministry of Finance will develop a strategy during 2001 to settle the existing stock of arrears to suppliers, including possibly through securitization.

14. Total **budgetary financing** is assumed to be 3¼ percent of GDP in 2001, around the level in 2000. This will include net external financing of 1¼ percent of GDP (reflecting disbursements from the World Bank and other donors, as well as the impact of assumed debt rescheduling by bilateral creditors), and privatization revenues of 1¼ percent of GDP (lari 80 million). There will be no net credit from the NBG. In the event that programmed external financing is delayed, a program adjuster will allow additional short-term credit from the NBG, up to a limit, to finance external payments on a timely basis. Such credit will be repaid when the external financing is disbursed. Privatization proceeds will be used to repay debts to the National Bank of Georgia, which will subsequently issue new credit to the government for the purpose of repaying budgetary arrears, according to the agreed schedule. Any excess in privatization proceeds will be used for additional repayment of debt to the NBG and additional reduction of budgetary arrears, in consultation with IMF staff.

C. Monetary and exchange rate policies

15. Monetary policy will be aimed at maintaining price stability over the medium term. A prudent monetary program will be maintained, with the aim to increase international reserves and keep annual inflation in the range 4–6 percent. Significant deviations from this range would signal a need to adjust monetary policy, in consultation with IMF staff.

16. The **monetary program for 2001** will be consistent with projected GDP growth and our inflation target, as well as continued financial development. The program assumes a moderate decline in velocity and an increase in the money multiplier. The ceilings on net credit to the general government and on net domestic assets of the NBG (Table 1) are consistent with our fiscal program for 2001. Adjustments to these targets will be made if balance of payments support, debt rescheduling, and privatization proceeds deviate from expectations.

17. The **floating exchange rate regime**, adopted in the aftermath of the Russian crisis, will be maintained. The NBG will not intervene to defend the exchange rate, but will purchase foreign exchange to augment its reserves, in line with program targets for reserves accumulation (Table 1). Gross international reserves of the NBG are targeted to reach at least 1½ months of imports of goods and services by end-2001, up from a projected 1¼ months at the end of 2000.

D. External policies

18. Georgia's balance of payments and external debt position remain very difficult. With a limited capacity to service external debt obligations, arrears continue to accumulate on principal payments to Turkmenistan, and new arrears have arisen in 2000 on principal obligations to Russia. To resolve the external debt servicing problems and obtain adequate financing for an economic program that could be supported by an IMF arrangement, Georgia will seek debt rescheduling from bilateral creditors. As a first step, prior to Board consideration of the program, the government will inform bilateral creditors about the progress it has made in securing Fund support for an economic adjustment program that would form the basis for debt restructuring, and seek their agreement to participate in rescheduling discussions.

19. In light of the difficulties encountered with the previous round of debt rescheduling in 1995-97, which was conducted on a bilateral basis with little attention being paid to uniformity in treatment of creditors, Georgia will seek to carry out the proposed rescheduling in a multilateral framework, preferably under the aegis of the Paris Club. In the event that some creditors are not willing to participate in a Paris Club round, Georgia will seek to negotiate debt rescheduling with those creditors on a bilateral basis, on terms comparable to any Paris Club agreement.

20. In order to contain the accumulation of external debt and alleviate the debt service burden over the next few years, the central government, the local authorities, and the NBG will neither contract nor guarantee any new non-concessional external debt commitments during the period of the arrangement. Moreover, the Georgian government and NBG will not accumulate any new external arrears.

21. Georgia will continue to maintain its liberal trade and payments system and will adhere to the commitments made to the WTO in further liberalizing the trade and investment regime. Tariff rates are relatively low by international standards. Most import, export, and exchange restrictions, the state orders system, and capital controls have been eliminated.

E. Institutional and structural reforms

22. At the center of the economic program for 2001-2003 is a comprehensive strategy aimed at improving the transparency and effectiveness of fiscal and financial institutions in Georgia. The weaknesses in tax collection, the accumulation of expenditure arrears, and the fragility of the financial sector require a bold effort to improve governance and reduce corruption. Such institutional reforms are not only critical for macroeconomic stability and sustained growth, but will also directly improve living conditions for the socially most vulnerable and are therefore at the heart of our poverty reduction strategy. In particular, the reforms will enable the state to meet its current social obligations, while also enhancing its capacity to strengthen the social safety net over the medium term.

23. The strategy to strengthen governance includes measures to enhance the capacity of fiscal institutions for raising tax collection and controlling expenditures. It also includes the

implementation of a medium-term anti-corruption strategy and safeguards against misuse of multilateral resources. Another set of measures is aimed at strengthening the financial sector institutions, by improving central bank supervision and the capacity to liquidate insolvent banks. Continued reform of the energy sector is aimed at enhancing transparency in the sector and improving its financial viability.

Reform of fiscal institutions

24. The fiscal adjustment required to bring public finances back on a sustainable path can only be achieved if it is supported by strong structural improvements in the fiscal area, on both the revenue and expenditure side. Institutional reform has already begun at the state tax department (STD) headquarters, through downsizing, salary increases, and computerization. The reform program, with support from USAID, will be completed by mid-2001. The program includes further reforms to increase tax collections, particularly in the large taxpayer inspectorate (LTI) and the state customs department. The accumulation of expenditure arrears will be contained by implementing a realistic budget supported by a new budget system law, and through better expenditure management and control. This comprehensive package of fiscal measures will contribute significantly to improving governance and reducing corruption in Georgia.

25. In order to strengthen the **collection, enforcement, and audit performance in the LTI**, the following actions will be taken in line with IMF technical assistance recommendations:

- a. eliminating the social funds department within the LTI and integrating its activities within the functional areas of the LTI by January 1, 2001;
- b. improving the selection process for identification of large taxpayers by April 1, 2001;
- c. implementing a system that properly controls filing and payment obligations by April 1, 2001;
- d. implementing an audit strategy applying standard audit practices by July 1, 2001; and
- e. implementing a strategy for recovering overdue taxes by October 1, 2001.

26. In order to strengthen customs collections, a reform strategy for the state customs department (SCD) developed with IMF technical assistance will be implemented in 2001. Prior to Board discussion of the program a two-year action plan will be adopted by presidential decree and a reform committee will be appointed. In addition, the following specific measures will be taken:

- a. a code of conduct for tax and customs officials will be adopted by April 1, 2001;

- b. a unit in the Ministry of Revenues responsible for monitoring and controlling exemptions will be established by April 1, 2001;
- c. the procedures for granting exemptions, supported by amendments to legislation and regulations, will be improved by July 1, 2001; and
- d. the processing and control of transit cargo will be strengthened by October 1, 2001.

27. In order to pay VAT refunds in a timely manner, while protecting the revenue collections from fraudulent claims, a **simplified VAT refund system** will be put in place (efforts in this regard will be assisted by the recent increase in the exempt turnover threshold to lari 24,000). This will involve, by April 1, 2001:

- a. a requirement to carry forward unused credits for up to 6 months and offset them against VAT payments, with the only exception being for exporters and large investors;
- b. rules for distinguishing claimants according to their compliance record; and
- c. the Ministry of Revenues setting up a system to monitor refunds claimed and refunds paid, and reporting these on a regular basis.

28. To improve revenue collections and reduce distortions in the economy, **tax policy** will aim to broaden and simplify the tax system. Measures to be implemented with the 2001 budget include:

- a. revenue-raising measures, including possible changes to excise rates;
- b. a simplification and modest increase in the progressivity of the personal income tax;
- c. no new tax exemptions, unless required by an international treaty ratified by parliament; and
- d. no extension of existing tax incentives granted under the law on foreign investment.

29. The commission on tax policy reform established in August 2000, is preparing a comprehensive medium-term reform plan, in close consultation with the fiscal affairs and legal departments of the IMF, and will present it to parliament early in 2001. Over the medium term, the government, including the active participation of the ministry of finance, will seek to ensure that a significant share of revenues from oil and gas pipelines accrue to the budget.

30. To reduce the amount of **tax arrears**, the government will review ways to facilitate the seizure of financial assets from nonpayers on an administrative basis, subject to rules that ensure equal treatment and transparency of the process. The government will also review the

possibility of establishing rules for repaying tax arrears in installments. The government will refrain from applying tax amnesty and from conducting offset transactions.

31. To reverse the accumulation of **expenditure arrears**, a realistic budget is essential. In addition, it is paramount to introduce a proper commitments control and accounting system. To this end, by July 1, 2001:

- a. an audit of expenditure arrears will be undertaken, involving the verification of all unpaid bills by line ministries, which will help prevent fraudulent claims from suppliers when an arrears repayment program is initiated; and
- b. the treasury will introduce a system of commitments recording in respect of (i) purchase orders of goods, services and contract above lari 5,000; and (ii) wages, pensions, debt service payments and other transfers.

These steps will be facilitated by the early appointment of a new resident FAD treasury advisor.

32. To further strengthen **expenditure control and management**, all central treasury functions will be fully consolidated in the Ministry of Finance. This will require:

- a. transferring the sub-treasury accounts in the ministries of defense and interior to the Ministry of Finance, prior to IMF Board consideration of the program;
- b. reflecting all off-budget accounts in the 2001 budget law to be approved by parliament prior to IMF Board consideration of the program; and
- c. applying standard expenditure control procedures to expenditures from these accounts from January 1, 2002.

33. An **improved expenditure control framework** will be fully implemented to facilitate the execution of the 2001 budget. This will include the following components from January 1, 2001:

- a. the preparation of monthly cash inflow forecasts jointly by the Ministry of Finance and the National Bank of Georgia;
- b. the preparation by the Ministry of Finance of projected cash availability on a weekly basis;
- c. the issuance by the budget department of quarterly guidelines on a rolling basis with monthly distribution by spending units and major economic categories; and
- d. based on this information, the issuance by the treasury of four different cash limits for prioritized categories of expenditure items.

34. The Ministry of Finance will refrain from issuing **loan guarantees** within the domestic banking system or any similar type of commitment.

Reform of financial institutions

35. Further reforms in the financial sector will involve efforts to strengthen the banking system, broaden the opportunities for investment, and develop the capital markets. Taken together, these institutional reforms will significantly contribute to strengthening transparency in the financial sector, reducing systemic risks, and mobilizing domestic savings.

36. The NBG will implement the following measures to **strengthen the banking system**:

- a. raise the minimum capital requirements of existing banks to lari 5 million by January 1, 2001;
- b. improve the legal and regulatory framework for bank supervision and resolution, including by issuance of new asset classification regulations for commercial banks (December 2000); issuance of conflict of interest regulations for banks (March 2001); and amending legislation so as to establish the primacy of banking law in bank-related matters (by June 2001); and
- c. implement international accounting standards in commercial banks comprising 80 percent of total banking sector assets by September 2001.

37. In addition, during 2001, the NBG will vigorously enforce prudential requirements in line with the **supervisory action framework**, including by revoking licenses of banks that fail to meet the requirements. The NBG will also continue to adapt its regulations to changes in the financial sector and strengthen the skills of banking supervision staff through training. The NBG will also seek to make regulations more transparent and easily understood by commercial banks.

38. Over the medium term, the authorities will **foster financial development** by facilitating the entry of foreign banks to promote competition; reducing interest rates by limiting government borrowing and repaying debt; improving banks' ability to assess risk, including providing access to training; and removing legal obstacles to using collateral (including land) for lending. Capital market growth will be enhanced by the development of the secondary **treasury bill market**, including through the securitization of government debt to the NBG. This will broaden the treasury bill market to non-banks and allow the NBG to utilize open market operations more effectively. The Ministry of Finance will also aim to steadily increase the maturity of treasury bills. We will also encourage the development of the nascent Georgian Stock Exchange (GSE) and strengthen the newly established and independent National Securities Commission.

39. The NBG will continue to enhance transparency and will comply with IMF standards for safeguarding the IMF's financial resources. To this end, as in previous years the NBG will publish an **audit, undertaken by an international accounting firm, of its full financial statements** for 2000 by June 30, 2001. It will continue to take a cautious approach to profit distribution, and in particular will not distribute profits associated with revaluation gains.

Energy sector reform

40. Georgia's dependence on imported energy and its strategic location for energy transportation imply that the sector is highly relevant for macroeconomic stability and growth. It is critical that the accumulated debt of the electricity sector, estimated at over US\$500 million at September 1, 2000 (excluding government debt to donors), is resolved without transferring it to the central government. The lack of a reliable energy supply places additional costs on businesses and undue hardship on the population, especially on the socially vulnerable.

41. We have therefore given high priority to the restructuring of the energy sector, supported by multilateral and bilateral partners, including the World Bank. Georgia is committed to cooperating with the World Bank and others to restore the sector's financial viability and economic efficiency over the medium run. The highest priority measure is the enhancement of private sector participation in the distribution and transmission of electricity as well as the management of the wholesale electricity market, to eliminate nonpayments and prevent the further accumulation of debt.

42. As part of these wider reform efforts in the energy sector, an approach to restructuring the existing energy debt has been agreed with the World Bank. Audits of the energy debts have already been carried out by international auditors (funded by USAID) and the Georgian government agencies (including the Energy Debt Commission and the Chamber of Control). The government recognizes that the time for action has now arrived. The economic program for 2001 therefore includes the following short-term measures to address the risks from the **high debts and arrears of the energy sector**, as well as to increase transparency and reduce corruption:

- a. submission to parliament of amendments to the Energy Law to allow a debt surcharge on the electricity tariff, prior to Board consideration of the program;
- b. the Energy Debt Commission will outline its preferred debt restructuring terms, and negotiations will commence on this basis with creditors by March 31, 2001; and
- c. introduction of a debt surcharge on the electricity tariff beginning on June 1, 2001 (at an initial level of 0.3–0.7 tetri/kWh). The proceeds of the surcharge will be put in an escrow account to be used exclusively for debt service payments, to be managed by the Wholesale Electricity Market Administration as settlement agent. Biannual

adjustments in the debt surcharge will be made subsequently depending on the outcome of debt restructuring negotiations.

Anti-corruption strategy

43. Combating corruption requires a multi-pronged strategy. The measures aimed at strengthening fiscal and financial institutions described above are a key component of the strategy to address the wider governance problem in Georgia. In addition, we have recently taken a number of specific steps to address the problem of corruption, including:

- a. establishment of a presidential anti-corruption commission that has prepared a comprehensive medium-term anti-corruption strategy; and
- b. the examination of tax administration officials to test their competence, resulting in a significant number of dismissals (about two-thirds of those tested).

44. The medium-term strategy we have developed is broad based and will address corruption through actions in the following main areas:

- a. liberalization of the business environment (including transparency in licensing, simplicity of tax rules, improvements in registration and certification procedure);
- b. strengthening of public finances (including improving transparency in the budgetary and procurement systems, internal audit procedures, management of state assets and liabilities);
- c. strengthening the civil service (including ethical codes, financial disclosure, conflicts of interest rules, and adequate incentives for employees); and
- d. strengthening law enforcement and the judiciary (including streamlining functions, ethical codes).

45. The anti-corruption strategy paper and the list of short-term anti-corruption measures of the government, endorsed by the president, has been published.

46. Progress in tackling corruption will be monitored by an Anti-Corruption Coordination Council under the president with NGO's and civil society representatives. With a new IMF-supported program, it would also be monitored indirectly through program revenue targets for excisable goods, as well as through meeting our commitments on the reform of fiscal and financial institutions. A program review in mid-2001 will assess progress in implementing the near-term measures identified in the anti-corruption strategy paper.

Poverty reduction strategy

47. We have prepared an I-PRSP, with support from the World Bank, the IMF, and other donors. This paper reflects the work of several working groups (social sector, fiscal and

monetary policy, agriculture and environmental protection, infrastructure, and management and state administration reform), which have been established to develop policies to tackle poverty.

48. The World Bank will play an integral role in supporting our poverty reduction strategy. SAC III includes measures to strengthen fiscal performance, ensure budgetary provisions for core social expenditures, improve the legal and regulatory framework for the private sector, privatization, and market liberalization. Reform of secondary education is also being assisted by the World Bank. The Energy Sector Adjustment Credit (ESAC) supports efforts to enhance financial sustainability of the energy sector. In the first half of 2001, the World Bank will prepare a public expenditure review. A fourth SAC is expected in 2001 and will provide wide-ranging reform measures in public sector governance, agriculture, energy, and privatization.

49. The IMF will also play a vital role in this process, by advising on macroeconomic policy and on key institutional reforms in the fiscal and financial areas. An IMF-supported program under the PRGF will be critical for maintaining macroeconomic stability, improving prospects for sustainable growth, and improving governance. Apart from the indirect impact of sustainable growth on poverty reduction, the program will, through its marked improvement in public finances, address poverty directly by reducing public expenditure arrears in the social sphere and freeing public resources for social sector programs.

IV. PROGRAM MONITORING

50. Our commitment to move towards a sustainable fiscal policy and strengthen governance will be underscored by a number of measures that are to be implemented prior to the consideration of the program for 2001–2003 by the IMF Board of Executive Directors (Annex A).

51. The new PRGF arrangement will involve quarterly monitoring and disbursements, as well as semi-annual reviews. The first review will be completed before May 15, 2001 and will focus on an assessment of progress in implementing the near-term anti-corruption measures. The second review, to be completed before November 15, 2001, will focus on progress in strengthening the banking sector and energy debt restructuring.

52. The proposed IMF-supported program under the PRGF will include fiscal, monetary, and external performance criteria. The quantitative performance criteria and indicative targets through the end of 2001 are specified in Table 1. Technical definitions, adjustment mechanisms, and reporting requirements are provided in the supplementary Technical Memorandum of Understanding (TMU).

- a. In the fiscal area, the quantitative performance criteria will be ceilings on the cash deficit of the general government and on expenditure arrears, and floors on total tax revenues.

- b. In the monetary sphere, the quantitative performance criteria will be a ceiling on net domestic assets of the NBG, a ceiling on net credit of the banking system to the general government, and a floor on net international reserves of the NBG.
- c. Regarding external debt, there will be ceilings on contracting and guaranteeing new non-concessional external debt by the public sector.

53. The proposed IMF-supported program also includes continuous performance criteria. During the period of the arrangement, the general government and the NBG will not accumulate any new external payment arrears; will not impose or intensify restrictions on payments and transfers for current international transactions; will not introduce multiple currency practices; will not conclude bilateral payments agreements that are inconsistent with Article VIII; and will not impose or intensify import restrictions for balance of payments purposes.

54. The proposed IMF-supported program also includes structural benchmarks (Annex B), with an emphasis on strengthening governance by improving fiscal and financial institutions. Further structural reforms aimed at poverty reduction are laid out in the I-PRSP and will be implemented with assistance from the World Bank and other multilateral and bilateral partners.

ANNEX A: ACTIONS PRIOR TO IMF BOARD CONSIDERATION

In line with the above discussion, the following actions will be taken prior to the consideration of the program for 2001–2003 by the IMF’s Board of Executive Directors:

1. Satisfactory macroeconomic performance relative to agreed quantitative targets through end-November (excluding expenditure arrears for November, data for which will not be available until early January 2001);
2. Adoption and passage by parliament of a 2001 budget fully consistent with the economic program described in this memorandum, including associated revisions to the tax code;
3. Securing appropriate financing assurances from external creditors;
4. Elimination of the sub-treasury accounts in the ministries of defense and interior and transfer of their functions to the central treasury at the Ministry of Finance;
5. Recording of off-budget accounts of line ministries in the 2001 budget law.
6. Publication of the anti-corruption strategy paper, including a list of short-term anti-corruption measures, endorsed by the president.
7. Submission to parliament of amendments to the Energy Law to allow a debt surcharge on the electricity tariff.
8. Issuance of a presidential decree adopting a two-year action plan for Customs reform and appointing a reform committee.

ANNEX B: STRUCTURAL BENCHMARKS

	Deadline
A. Fiscal measures	
1. Adoption of a code of conduct for tax and customs officials.	April 1, 2001
2. Amend legislation and regulations to strengthen control on procedures for granting customs exemptions.	July 1, 2001
3. Implement simplified VAT refund system and monitor refunds claimed and paid.	April 1, 2001
4. Audit the stock of expenditure arrears.	July 1, 2001
5. Introduce commitments recording and strengthen commitments control.	July 1, 2001
6. Apply standard expenditure control procedures to off-budget accounts outside the treasury.	January 1, 2002
B. Financial sector	
7. Amend legislation to establish primacy of banking law in bank-related matters.	June 30 2001
8. Issue new asset classification regulations for commercial banks.	Dec. 31, 2000
9. Issue conflict of interest regulations for banks.	March 31, 2001
10. Implement IAS in commercial banks comprising 80 percent of total banking sector assets.	Sept. 30, 2001
C. Energy sector	
11. Impose debt surcharge of 0.3-0.7 tetri/kWh on the electricity tariff.	June 1, 2001

Table 1. Georgia: Quantitative Performance Criteria and Indicative Targets, 1999-2001 1/

	Stocks		Cumulative change from end-September 2000				
	end-Dec. 1999	end-Sep. 2000	end-Dec. 2000	end-March 2001	end-June 2001	end-Sept. 2001	end-Dec. 2001
	Actual	Prelim.	Performance criteria			Indicative targets	
(In millions of lari)							
1. Quantitative targets 2/							
Floor on general govt. tax revenue (including special funds) 3/	n.a.	n.a.	231.4	458.9	714.7	974.8	1,236.7
Ceiling on cash deficit of the general govt. 4/	n.a.	n.a.	72.3	110.4	152.4	221.1	286.4
Ceiling on domestic expenditure arrears of the general govt.	n.a.	n.a.	0.0	-8.8	-27.2	-50.0	-80.0
Ceiling on net credit of the banking system to the general govt. 3/ 5/ 6/	615.9	663.7	8.2	26.2	30.3	19.0	24.2
Ceiling on net domestic assets of the NBG 5/	754.8	780.2	-4.5	15.0	7.2	-15.8	-22.4
(In millions of U.S. dollars)							
Floor on total net international reserves of the NBG 5/	-223.2	-221.3	7.9	-4.6	7.2	24.8	38.6
Ceiling on contracting or guaranteeing							
1. short-term external debt (less than one year)	n.a.	n.a.	0.0	0.0	0.0	0.0	0.0
2. nonconcessional medium- and long-term external debt							
Maturities above 1 year	n.a.	n.a.	0.0	0.0	0.0	0.0	0.0
<i>Of which:</i> Maturities from 1 to 5 years	n.a.	n.a.	0.0	0.0	0.0	0.0	0.0
(In millions of lari)							
2. Indicative targets							
Reserve money	308.5	337.5	11.2	5.7	21.6	33.7	54.7
Cigarette and petroleum revenues	n.a.	n.a.	49.0	89.3	129.6	169.9	210.2
(In millions of U.S. dollars)							
3. Adjusters							
Net external non-project financing	n.a.	n.a.	7.3	1.2	15.7	39.6	54.1
Privatization	n.a.	n.a.	0.0	0.0	0.0	30.0	30.0
World Bank SAC & ESAC	n.a.	n.a.	32.5	32.5	52.5	52.5	72.5
less: amortization 7/	n.a.	n.a.	25.2	31.3	36.8	42.9	48.4
(In millions of lari)							
External project financing	n.a.	n.a.	39.9	66.4	92.9	119.4	145.9

Sources: Fund staff estimates.

1/ Section 1 of this table lists quantitative performance criteria. Some ceilings and floors are subject to possible adjustment, as indicated in footnotes 4 and 5, based on deviations from projections of external financing, reported in Section 3 of the table. Indicative targets are shown in Section 2. Continuous performance criteria are described in paragraph 53 of the MEFP.

2/ Based upon accounting exchange rates 2 lari/US\$ and 1.35 US\$/SDR.

3/ Special state funds include the Pension, Employment, and Road Funds. Privatization receipts are excluded.

4/ As described in the TMU, the macroeconomic program includes an adjuster for deviations from expected disbursements of external project finance (Section 3). The ceiling for the cash deficit of the general government for the end of a quarter will be adjusted upward (downward) by the full amount of the cumulative excess (shortfall) of external project financing, subject to a cap on cumulative upward adjustment of lari 80 million.

5/ As described in the TMU, the macroeconomic program includes an adjuster for deviations from expected net external non-project financing (Section 3), defined as the sum of all foreign-currency denominated privatization receipts and net disbursements under the World Bank's SAC and ESAC programs, minus government debt amortization payments. The ceilings for net credit of the banking system to the general government and net domestic assets of the NBG will be adjusted upward (downward) by the full amount of the cumulative shortfall (excess) of net external non-project financing, subject to a cap on upward adjustment of lari 65 million for the end-December 2000 ceiling and lari 40 million for the end-quarter ceilings in 2001, while the floor on net international reserves will be shifted downward (upward) by the full amount, subject to a cap on downward adjustment of US\$ 32.5 million.

6/ The stock excludes the recapitalization bond issued by the government to cover NBG losses in 1998.

7/ Amortization reflects principal repayments to bilateral creditors and EBRD after the proposed rescheduling.

INTERNATIONAL MONETARY FUND

GEORGIA

Technical Memorandum of Understanding (TMU)

December 6, 2000

1. This memorandum sets out the understandings between the Georgian authorities and the IMF staff regarding the definitions of quantitative performance criteria and indicative targets for the arrangement supported under the Poverty Reduction and Growth Facility (PRGF) reported in Table 1 of the associated Memorandum of Economic Financial Policies (MEFP), as well as respective reporting requirements. It also provides definitions and reporting requirements for the continuous performance criteria described in paragraph 53 of the MEFP.
2. The quantitative performance criteria (ceilings and floors) and indicative targets listed in Table 1, Sections 1 and 2, of the MEFP are defined as cumulative changes from end-September 2000. Some floors and ceilings are adjusted by cumulative deviations of certain external financing flows from projections (Table 1, Section 3, of the MEFP), converted at an accounting exchange rate of lari 2 per U.S. dollar.¹ The program relies on adjusters that are symmetric and allow the substitution of net external non-project financing for net domestic credit to government (and net domestic assets of the NBG). However, any resulting increases in net domestic credit to government and net domestic assets of the NBG are subject to a cap. The program also allows for an automatic adjustment to the cash deficit target in case of deviations of external project financing from expectations, subject to a cap on upward adjustment.
3. While the adjustment mechanism is designed to accommodate unanticipated, temporary fluctuations in external financing, the caps imply that significant shortfalls in financing will require policy changes, including tighter fiscal policy, which would need to be considered in the context of a program review.

¹ For instance, if a disbursement of \$10 million originally projected to accrue in the first quarter of 2001 is delayed until the second quarter of 2001, then an adjuster of \$10 million (lari 20 million) would apply to end-March 2001 targets, but not to end-June 2001, when net external financing would have returned – on a cumulative basis – to the originally projected level. In practice, this means that a delay in external financing inflows can be compensated temporarily by higher domestic credit, but not permanently, implying a repayment to the NBG once the delayed disbursement accrues.

**QUANTITATIVE PERFORMANCE CRITERIA, INDICATIVE TARGETS, AND CONTINUOUS
PERFORMANCE CRITERIA: DEFINITIONS AND REPORTING STANDARDS**

A. Floor on Tax Revenues

4. **Definition:** Tax revenues are defined as total tax collections by the State Tax Department and the State Customs Department, including tax revenues from the central government, local governments, and extrabudgetary funds. The tax revenues are recorded when these are paid into the treasury's revenue account(s) in the National Bank of Georgia (NBG). The tax revenues exclude the amounts retained by the revenue agencies for bonus payments.
5. **Adjustment clauses:** Once a change is made in accounting practices so that the bonus payments to the revenue agencies are included in the treasury's revenue account(s), the revenue targets will be adjusted upward by the applicable bonus share.
6. **Supporting material:** The Ministry of Finance (treasury) will provide data showing a detailed breakdown of tax revenues paid into the NBG revenue accounts (form 412) on a monthly basis within two weeks of the end of each month. The local budget department in the Ministry of Finance will provide additional information on revenue collections of local governments. The authorities will also provide data on any offset transactions on a monthly basis.

B. Indicative Target for Revenues from Cigarettes and Petroleum

7. **Definition:** This is defined as the total of customs duties, excise duties, and VAT collected by the State Tax Department and the State Customs Department on the domestic production and imports of cigarettes and petroleum products.
8. **Adjustment clauses:** None.
9. **Supporting material:** The Ministry of Finance will provide data with a break-down into the main categories of products on a monthly basis within two weeks of the end of each month.

C. Ceiling on Expenditure Arrears

10. **Definition:** Expenditure arrears are defined as a subset of arrears incurred by the general government on the following expenditure items: wages, pensions, assistance to refugees and internally displaced persons, healthcare state programs, invalid assistance state programs, and scholarships. Once sufficient progress is made on introducing commitments recording in the treasury, the measurement of arrears will be strengthened by applying the following principles for recording expenditure arrears: (a) the goods and services have been received; (b) these have been certified to conform to the order of the contract; (c) the bill for payment has been received; and (d) the bill has remained unpaid beyond the normal or agreed period of credit. Until then, the net change in arrears will be estimated as the

difference between actual cash spending and the monthly cash limits issued to spending units prior to the beginning of the month.

11. **Adjustment clauses:** None.

12. **Supporting material:** The Ministry of Finance (treasury) will provide monthly data, with a detailed break-down by economic and organizational category, on cash spending and commitments made by the central government, and/or cash limits issued to the spending units. The information on cash limits and spending commitments will be provided within two weeks from the beginning of each month. The information on cash spending will be provided within four weeks of the end of each month. The local budget department in the Ministry of Finance will provide information on monthly spending by the local budgets, and the extrabudgetary funds will provide information, through the Ministry of Finance, on their monthly expenditures.

D. Ceiling on the Cash Deficit of the General Government

13. - **Definition:** The cash deficit of the general government will be measured from "below-the-line", equal to the total financing (domestic and external, plus privatization proceeds) received by the general government.² Privatization receipts consist of all gross proceeds received by the central and local governments. Domestic financing consists of all bank and non-bank financing to the general government. External financing is defined as the total of disbursements, macroeconomic support, net change in arrears, minus amortization. This include all project financing (capital expenditure and net lending) and balance of payments support (excluding grants) received by the budget.

14. **Adjustment clauses:** The ceiling will be adjusted to reflect cumulative deviations from program assumptions about **external project financing** for capital expenditure or net lending (see Table 1, Section 3, of the MEFP). The ceiling at the end of a quarter will be adjusted upward (downward) by the full amount of the cumulative excess (shortfall) of external project financing. There will be a cap on cumulative upward adjustment of lari 80 million.

15. **Supporting material:** Data on privatization receipts will be provided by the Ministry of Finance (treasury) on a monthly basis within two weeks of the end of each month. The data will be consistent with the revenue account(s) in the NBG (form 412). Data on domestic financing (bank and non-bank) will be provided by the NBG. Until further improvements in the NBG accounts, the treasury will provide information on Ministry of Finance guaranteed loans (including guaranteed amount, principal repayment schedule, and actual principal and interest payments). Data on external project financing will be provided by the Ministry of

² Modest differences between the recorded financing and the cash deficit, calculated as expenditures plus net lending minus revenues and grants, can be attributed to check-float and smaller errors and omissions.

Finance in a table on project and grant disbursements by creditor, on a monthly basis within two weeks of the end of each month.

E. Ceiling on Net Credit of the Banking System to the General Government

16. **Definition:** Net credit of the banking system to the general government includes net credit to the general government from the NBG and the deposit money banks. General government is defined in this context as the central government, local government, and extrabudgetary funds. Credit to the government includes: all loans to the general government, all treasury bills issued by the general government (including those purchased by the central bank), as well as all government-guaranteed loans from the banking system to other entities. Net credit to the government is credit to the government less deposits of the general government in the banking system. In addition, any accrued government interest obligations to the NBG would be reflected in net credit to the government. Government bonds issued to cover NBG losses are excluded from net credit to the government.

17. **Adjustment clauses:** The ceiling on net credit of the banking system to the general government will be adjusted to reflect cumulative deviations from program assumptions on **net external non-project financing** (see Table 1, Section 3, of the MEFP), which is defined as the sum of all foreign-currency denominated privatization receipts and net disbursements under the World Bank's SAC and ESAC programs, minus government debt amortization payments. The ceiling at the end of a quarter will be adjusted upward (downward) by the full amount of the cumulative shortfall (excess) of net external non-project financing, subject to a cap on cumulative upward adjustment of lari 65 million for the end-December 2000 ceiling and lari 40 million for the end-quarter ceilings in 2001.

18. **Supporting material:** The NBG will provide the monetary survey on a monthly basis within two weeks of the end of each month. The NBG will also provide information on the activities of the treasury bill market. The necessary information on net external non-project financing will be provided in a table on the NBG's foreign exchange flows (which includes details on inflows, outflows, and net international reserves) on a monthly basis within a week of the end of each month. The Ministry of Finance will provide additional information on the repayment of principal and interest on government-guaranteed loans from commercial banks on a monthly basis.

F. Ceiling on Net Domestic Assets of the NBG

19. **Definition:** Net domestic assets of the NBG are defined as the difference between net foreign assets and reserve money. Net domestic assets include net claims on government (including loans and treasury bills purchased by the NBG, accrued government interest obligations to the NBG, less deposits of the government with the NBG.), claims on banks, claims on the rest of the economy (including the KfW loan), and other items net (including the NBG capital accounts, net unclassified assets, counterpart funds and exchange rate revaluation).

20. **Adjustment clauses:** The ceiling on net domestic assets of the NBG will be adjusted to reflect cumulative deviations from program assumptions on **net external non-project financing** (see Table 1, Section 3, of the MEFP), which is defined as the sum of all foreign-currency denominated privatization receipts and net disbursements under the World Bank's SAC and ESAC programs, minus government debt amortization payments. The ceiling at the end of a quarter will be adjusted upward (downward) by the full amount of the cumulative shortfall (excess) of net external non-project financing, subject to a cap on cumulative upward adjustment of lari 65 million for the end-December 2000 ceiling and lari 40 million for the end-quarter ceilings in 2001.

21. **Supporting material:** The NBG will provide data on its balance sheet, which includes data on its net domestic assets, on a monthly basis within one week of the end of each month. The necessary information on net external non-project financing will be provided in a table on the NBG's foreign exchange flows (which includes details on inflows, outflows, and net international reserves) on a monthly basis within one week of the end of each month.

G. Floor on Net International Reserves of the National Bank of Georgia (NBG)

22. **Definition:** Net international reserves (NIR) of the NBG in U.S. dollars are calculated on the basis of assets and liabilities of the NBG, using program assumptions of bilateral exchange rates (2 lari per U.S. dollar and 1.35 U.S. dollar per SDR). NIR of the NBG are defined as liquid, convertible currency claims of the NBG on nonresidents that are readily available. Pledged or otherwise encumbered assets, including but not limited to assets used as collateral (or guarantee for third party external liabilities) are excluded from reserve assets. Reserve liabilities include the use of Fund resources and any other liabilities of the NBG. The stock of NIR in period t is calculated as the stock of NIR in period $(t-1)$ plus the net inflow of foreign exchange in period t , the change in the value of gold stock at market prices in period t , and the change in the stock of liabilities to the IMF and other creditors in period t .

23. **Adjustment clauses:** The floor of net international reserves will be adjusted to reflect cumulative deviations from program assumptions on **net external non-project financing** (see Table 1, Section 3, of the MEFP), which is defined as the sum of all foreign-currency denominated privatization receipts and net disbursements under the World Bank's SAC and ESAC programs, minus government debt amortization payments. For a shortfall (excess) of net external non-project financing, the floor will be adjusted downward (upward) by the full amount, subject to a cap on cumulative downward adjustment of US\$32.5 million.

24. **Supporting material:** Data on net international reserves and data on net external non-project financing will be provided in a table on the NBG's foreign exchange flows (which includes details of inflows, outflows, and net international reserves) on a monthly basis within the week following the end of the month.

H. Ceiling on Contracting or Guaranteeing New Non-Concessional Medium- and Long-term External Debt by the Public Sector (with original maturity of 1 year or more)

25. **Definition:** The public sector consists of the central government, the National Bank of Georgia (NBG), and local authorities. Concessional external loans are defined as loans with a grant element of at least 35 percent of the value of the loan. The grant element is to be calculated by using currency-specific discount rates reported by the OECD (CIRRs).³ For maturities of less than 15 years, the grant element will be calculated based on six-month averages of commercial interest rates. For maturities longer than 15 years, the grant element will be calculated based on 10-year averages. The term “debt” includes all current liabilities, which are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require the public sector (obligor) to make one or more payments in the form of assets (including currency), at some future point(s) in time to discharge principal and/or interest liabilities incurred under the contract. In effect, all instruments that share the characteristics of debt as described above (including loans, suppliers’ credits, and leases) will be subject to the ceiling. The term “debt” also applies to commitments contracted or guaranteed for which value has not been received.

26. **Adjustment clauses:** None.

27. **Supporting material:** Details of all new commitments and government guarantees for external borrowing, with detailed explanations, will be provided by the Ministry of Finance on a monthly basis within two weeks of the end of each month.

I. Ceiling on Contracting or Guaranteeing Short-Term External Debt by the Public Sector (with original maturity of 1 year or less)

28. **Definition:** The public sector consists of the central government, the National Bank of Georgia (NBG), and local authorities. The term “debt” includes all current liabilities, which are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require the public sector (obligor) to make one or more payments in the form of assets (including currency), at some future point(s) in time to discharge principal and/or interest liabilities incurred under the contract. In effect, all instruments that share the characteristics of debt as described above (including loans, suppliers’ credits, and leases) will be subject to the ceiling. The term “debt” also applies to commitments contracted or guaranteed for which value has not been received.

29. **Adjustment clauses:** None.

³ An electronic spreadsheet file that shows the relevant discount rates reported by the OECD (CIRRs) will be provided on a periodic basis by Fund staff.

30. **Supporting material:** Details of all new commitments and government guarantees for external borrowing, with detailed explanations to be provided by the Ministry of Finance on a monthly basis within two weeks of the end of each month.

J. Non-accumulation of External Arrears

31. **Definition:** During the period of the arrangement, the general government and the NBG will not accumulate any new external payment arrears. Official arrears on external debt service obligations include any non-payment of interest and/or principal *in full and on time* falling due to all creditors, including the Fund, the World Bank, and other official creditors. Exemptions under the continuous performance criterion on arrears, in the context of reaching an agreement on rescheduling debt to bilateral creditors with whom Georgia has undertaken a debt rescheduling in the past, will have to be agreed with the IMF.

32. **Adjustment clauses:** None.

33. **Supporting material:** Details of official arrears accumulated on interest and principal payments to creditors will be reported within one week from the date of the missed payment.

K. Non-introduction of exchange and trade restrictions

34. **Definition:** During the period of the arrangement the general government and the NBG will not impose or intensify restrictions on payments and transfers for current international transactions; will not introduce multiple currency practices; will not conclude bilateral payments agreements that are inconsistent with Article VIII; and will not impose or intensify import restrictions for balance of payments purposes.

35. **Adjustment clauses:** None.

36. **Supporting material:** The government and NBG will inform the Fund about any changes to the exchange and trade regime.

L. Indicative Target for Reserve Money

37. **Definition:** Reserve money is defined as currency in circulation and required reserves of deposit money banks and balances on banks' correspondent accounts.

38. **Adjustment clauses:** None.

Supporting material: The central bank balance sheet is to be transmitted on a monthly basis, within one week of the end of the month.

INTERNATIONAL MONETARY FUND

GEORGIA

Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Supplementary Information

Prepared by European II and Policy Development and Review Departments

Approved by John Odling-Smee and Anthony Boote

January 8, 2001

1. This supplement provides information on developments since the staff report was issued.¹ These developments do not change the thrust of the staff appraisal.
2. Consumer price inflation in November was lower than expected, and the 12-month inflation rate declined to 5¼ percent, well below the end-year target of 6¾ percent. The one-month treasury bill rate fell further to under 8 percent in November. The lari remained stable in November and December, and the central bank purchased US\$16 million in the foreign exchange market during this period. Nonetheless, gross international reserves declined to around US\$110 million (1 month of imports of goods and services) at end-December, mainly on account of a payment of US\$22 million to clear debt-service arrears to Russia.
3. The status of prior actions is summarized in Table 1. **The staff considers that all the measures have been implemented.**
4. **Macroeconomic performance relative to agreed monthly targets through end-November has been satisfactory**, with end-November monetary, external debt, and overall tax revenue targets all met, most with comfortable margins (Table 2). There continue to be some shortcomings in the fiscal area, notably shortfalls in tax collections from cigarettes and tobacco, and an increase in expenditure arrears in October and November. The increase in arrears since end-June amounts to lari 14 million, much less than the lari 80 million accumulated in the first half of 2000. Had the authorities fully utilized the margin under the net credit to government ceiling, resulting from an increase in government deposits, there would have been no increase in expenditure arrears since end-June.² These developments highlight the problems in the area of expenditure control and management that are to be

¹ EBS/00/258, December 6, 2000.

² Tax revenues are typically high in the last few days of each month, leading to a temporary rise in deposits before the money is spent.

addressed through measures under the program (paragraph 33 of the Memorandum of Economic and Financial Policies (MEFP)). The authorities have already taken steps to improve the management of government deposits and short-term credit facilities to better utilize available resources. As a result, they expect to observe the end-December performance criterion for expenditure arrears under the new program by reversing the October and November increases during December. Data for arrears at end-December will not be available until early February.

5. **The 2001 budget and associated tax code amendments have been approved by parliament, broadly in line with understandings reached with the staff.** Tax amendments include extensions of existing excise tax rates, with minor adjustments, and the introduction of a new petroleum product excise. Parliament was unwilling to approve some excise tax increases initially proposed by the government, but the resulting gap in the budget was closed, mainly by a reduction in the size of the incentive fund for the state tax and customs departments. This change was in line with advice of the staff and other external advisers—which the authorities had previously declined to accept—that the fund was larger than necessary. The staff considers that the resources available for the revenue departments under the approved budget will be sufficient to finance their reform programs. Parliament postponed consideration of amendments, estimated to be revenue neutral, to simplify personal income taxes. These will now be considered in the context of the comprehensive tax reform plan currently being prepared (MEFP, paragraph 29). In line with the MEFP (paragraph 28), the budget included no new tax exemptions nor any extension of existing tax incentives.

6. **Staff and management consider that adequate financing assurances are in place from Georgia's external creditors.** Paris Club creditors discussed a possible nonconcessional rescheduling for Georgia on December 13, 2000. The Russian authorities indicated that they would only be prepared to consider a rescheduling when Georgia had cleared its arrears to Russia and had ratified the agreement on the settlement of external public debts and assets of the Soviet Union (known as the "zero option" agreement). As Georgia has now cleared its arrears to Russia and submitted legislation to parliament to ratify the zero option agreement, the Russian authorities have indicated to the staff their support for a PRGF arrangement, and their willingness to discuss a rescheduling of Georgia's debts in the framework of the Paris Club, once the zero option agreement has been ratified by the Georgian parliament. Other Paris Club creditors have also indicated their support. The Paris Club Secretariat is currently consulting its members and will confirm its willingness to invite Georgia to a rescheduling meeting by January 10, 2001. The staff will inform the Board of the outcome of this consultation prior to the Board discussion. The Georgian authorities have received indications from a number of non-Paris Club creditors, including Turkey, Armenia, Azerbaijan, and the Islamic Republic of Iran, of their willingness to reschedule bilaterally on terms comparable to those provided by the Paris Club, and discussions are continuing with other creditors (Turkmenistan, Kazakhstan, and Uzbekistan).

Table 1: Georgia: Status of Prior Actions

	Measure	Status
1.	Satisfactory macroeconomic performance relative to agreed quantitative targets through end-November.	Cumulative end-November targets for NIR and NDA of the central bank, net credit to government from the banking system, total tax revenues, and contracting and guaranteeing of external debts were all observed. Cumulative tax revenues from cigarettes and petroleum remained below target at end-November, while expenditure arrears rose further and continued to exceed the target.
2.	Adoption and passage by parliament of a 2001 budget fully consistent with the financial program described in the memorandum, including associated revisions to the tax code.	Done. Parliament approved the 2001 budget law on December 13, 2000. Associated tax code amendments were approved on December 29, 2000. Amendments to simplify personal income tax will be considered by parliament at a later date.
3.	Securing appropriate financial assurances from external creditors.	Paris Club creditors are expected to agree prior to the Board meeting to discuss a rescheduling for Georgia. Georgia has received positive indications from several (though not all) of its creditors that are not participants in the Paris Club of their willingness to reschedule Georgia's debts on terms that are comparable to those of the Paris Club.
4.	Elimination of the sub-treasury accounts in the ministries of defense and interior and transfer of their functions to the central treasury at the ministry of finance.	Done. Presidential decree signed on December 12, 2000.
5.	Recording of off-budget accounts of line ministries in the 2001 budget law.	Done. Annex 10 of the 2001 budget law lists the revenues and expenditures of special funds by ministry.
6.	Publication of the anti-corruption strategy paper, including a list of short-term anti-corruption measures, endorsed by the President.	Done. Published in the government newspaper "Republic of Georgia" on November 1, 2000, including a list of short-term measures and foreword by the president which strongly endorses the paper.
7.	Submission to parliament of amendment to the Energy Law to allow a debt surcharge on the electricity tariff.	Done. Submitted to parliament on December 12, 2000.
8.	Issuance of a presidential decree adopting a two-year action plan for Customs reform and appointing a reform committee.	Done. Presidential decree signed on December 12, 2000.

Table 2. Performance at end-November 2000

	Cumulative Changes from end-May to end-November	
	Target	Outturn
	(In millions of lari)	
Ceiling on net credit of the banking system to the general government	37.0	3.3
Ceiling on net domestic assets of the NBG	42.6	-8.8
Floor on general government tax revenue	446.3	468.0
Of which: cigarette revenue	39.5	26.8
petroleum revenue	50.0	36.8
Domestic expenditure arrears of the general government	7.7	30.3
	(In millions of U. S. dollars)	
Floor on net international reserves of the NBG	-12.5	27.7
Ceiling on contracting and guaranteeing of:		
Short-term debt	0.0	0.0
Nonconcessional medium and long-term debt	0.0	0.0

Statement by the IMF Staff Representative
January 12, 2001

The following information has become available since the issuance of the staff report for Georgia's request for an arrangement under the Poverty Reduction and Growth Facility (EBS/00/258, December 6, 2000, and Supplement 1, January 8, 2001).

The Paris Club Secretariat, following consultation with its members, has now confirmed its willingness in principle to negotiate a rescheduling of Georgia's debt to bilateral creditors.



Press Release No. 01/4
FOR IMMEDIATE RELEASE
January 12, 2001

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves US\$ 141 Million PRGF Loan for Georgia

The Executive Board of the International Monetary Fund (IMF) today approved a three-year loan under the Poverty Reduction and Growth Facility (PRGF)¹ in an amount equivalent to SDR 108 million (about US\$141 million) to support the government's economic program. The first disbursement of SDR 9.0 million (about US\$12 million) under the new program will become available immediately.

Following the IMF Executive Board discussion, Shigemitsu Sugisaki, Deputy Managing Director said:

"Georgia's economic program for the next three years aims to lay the foundation for faster growth and poverty reduction, while addressing the problem of the country's large external debts. To achieve these objectives, the program focuses on the maintenance of macroeconomic stability, through continued prudent monetary policy and a sustained fiscal consolidation, together with structural and institutional reforms to strengthen governance and tackle corruption. Improvements in tax and customs administration and expenditure control are crucial, as governance problems in these areas in the past have undermined investment, economic growth, and fiscal policy. The budget for 2001, recently approved by parliament, provides a sound basis for the necessary fiscal adjustment, with a projected increase in revenues, a reduction in the fiscal deficit, and a repayment of budgetary arrears, particularly wage and pension arrears.

"Given Georgia's large external debts and debt service payments, Directors noted the authorities' efforts, in conjunction with their macroeconomic policies, to reach agreements on debt

¹ On November 22, 1999, the IMF's concessional facility for low-income countries, the Enhanced Structural Adjustment Facility (ESAF), was renamed the Poverty Reduction and Growth Facility (PRGF), and its purposes were redefined. It was intended that PRGF-supported programs will in time be based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. At this time for Georgia, pending the completion of a PRSP, a preliminary framework has been set out in an interim PRSP, and a participatory process is under way. It is understood that all policy undertakings in the interim PRSP beyond the first year are subject to reexamination and modification in line with the strategy that is to be elaborated in the PRSP. Once completed and broadly endorsed by the Executive Boards of the IMF and World Bank, the PRSP will provide the policy framework for future reviews under this PRGF arrangement. PRGF loans carry an annual interest rate of 0.5%, and are repayable over 10 years with a 5½-year grace period in principal payments.

rescheduling with bilateral creditors, which the authorities are pursuing at the Paris Club. They urged Georgia and its bilateral creditors to pursue discussions in a cooperative spirit. Success in reducing the large debts of the energy sector would have a strong beneficial effect on the fiscal and external financing positions as well as on the stability of energy supplies.

“The authorities have outlined their strategies for reducing poverty and fighting corruption in an interim Poverty Reduction Strategy Paper (PRSP) and an anti-corruption strategy paper. The former provides a sound basis for the development of a full PRSP and the further specification of policies, and for concessional support from the Fund under the Poverty Reduction and Growth Facility. The publication of these papers is an important step toward an open and inclusive process of developing and implementing structural and institutional reforms. The sustainability of macroeconomic stability and growth will depend largely on the success of these reforms,” Mr. Sugisaki said.

ANNEX

Program Summary

Georgia's fiscal performance began deteriorating in mid-1999, however this was halted in mid-2000 as the newly appointed government revised the budget, incorporating a strong fiscal adjustment. Since then, tax revenue collections have increased and the balance of payments position has strengthened, despite a recent drought affecting the agriculture sector which accounts for about a quarter of GDP.

Georgia's new economic program for 2001-2003 focuses on policies that would help the country achieve sustainable economic growth and reduce poverty. The centerpiece of the authorities' program is fiscal consolidation, to put the economy on a path to fiscal sustainability, establish the ability of the government to meet its commitments, and underpin efforts to resolve the large external debt burden. Under the program, real GDP growth is projected to reach 3 ¾ percent in 2001, compared to 1 ¼ percent in 2000; end-year inflation is expected to be 6 percent in 2001 and international reserves are programmed to reach the equivalent of 1 ½ months of imports of goods and services by the end of the year.

The **fiscal program** for 2001 will target a reduction in the commitments deficit to 2 percent of GDP, from 4 ½ percent in 2000. The primary deficit will be effectively reduced to zero, compared with 1 ¾ percent of GDP in 2000. Fiscal performance is expected to improve in 2001 with a containment of expenditure commitments, in line with the revised budget of 2000, toward more realistic levels that should arrest the accumulation of budgetary arrears. On the revenue side, plans are to increase tax collections by accelerating reforms in tax and customs administration.

The National Bank of Georgia has committed itself to maintaining a prudent **monetary policy** in order to support price stability under a floating exchange rate regime. The economic program is designed to continue the low inflation and stable exchange rate achieved in 2000.

At the heart of Georgia's medium-term policy agenda are plans for a comprehensive set of **structural reforms**, in particular institutional reforms to strengthen governance and combat corruption, which has undermined both fiscal policy and economic growth. To this end, the economic program includes measures to promote the effectiveness and transparency of fiscal and financial institutions, particularly in the tax collecting agencies. Another priority is to address the problem of energy sector debts.

The government's interim Poverty Reduction Strategy Paper has laid out structural reforms in five main areas to reduce poverty and stimulate economic growth: (i) social sector reforms to improve allocation of benefits to better target the poor; (ii) supportive macroeconomic policies, such as tax and customs administration, to raise fiscal revenues while reducing the budget deficit; (iii) public administration reform based on recommendations of the anti-corruption

commission; (iv) private sector development to foster investment in infrastructure as well as other areas; and, (v) agricultural reform.

Georgia became a member of the IMF on May 5, 1992; its quota² is SDR 150.3 million (about US\$197 million), and its outstanding use of IMF credit currently totals SDR 211 million (about US\$276 million).

² . A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its allocation of SDRs.

Table 1. Georgia: Selected Economic and Financial Indicators, 1996-2001

	1996	1997	1998	1999	2000	2001
					Projection	Program
					1/	2/
(Percentage change relative to previous year; unless otherwise indicated)						
National income and prices						
Nominal GDP	55.0	19.1	7.8	13.4	9.5	11.8
GDP at constant prices	10.5	10.7	2.9	2.9	1.2	3.8
Nominal GDP (in millions of lari)	3,786	4,511	4,863	5,513	6,035	6,748
Consumer price index, period average	39.3	7.0	3.6	19.1	4.3	7.6
Consumer price index, end-of-period	13.7	7.2	10.7	10.9	6.8	5.9
General government						
Total revenue (excl. grants)	145	42	13	11	7	20
Total expenditure and net lending	78	21	12	14	-6	8
External sector 3/						
Exports	15	18	-3	0	9	9
Imports	10	37	11	-13	9	6
Money and credit (end-of-period)						
Reserve money	36	33	-6	19	13	12
Credit to enterprises and households (banking system)	-15	38	38	33	17	11
Broad money (including forex deposits)	42	46	-1	21	23	18
Velocity, level 4/	14.8	12.1	13.2	12.4	11.0	10.5
Money multiplier, level	1.23	1.35	1.42	1.44	1.57	1.64
Gross international reserves						
In months of imports of goods and services	2.2	1.5	1.0	1.3	1.2	1.6
In millions of U.S. dollars	158	173	118	132	136	199
Exchange rate, lari/U.S. dollar						
Period average	1.26	1.30	1.39	2.02	1.97	...
End-of-period	1.27	1.30	1.79	1.96	...	...
(In percent of GDP; unless otherwise indicated)						
General government						
Total revenue and grants	14.0	14.8	16.2	15.8	15.0	16.8
Tax revenue 5/	10.8	13.0	13.2	14.2	14.1	14.9
Tax revenue (in percent of current expenditure)	55.6	65.9	64.5	69.1	79.0	87.3
Total expenditure and net lending 6/	21.4	21.8	22.5	22.7	19.5	18.8
Current expenditure	19.5	19.7	20.5	20.5	17.9	17.1
Fiscal balance, commitment basis	-7.4	-7.0	-6.4	-6.9	-4.6	-2.0
Fiscal balance, cash basis	-7.2	-6.3	-5.1	-5.1	-3.2	-3.2
External sector						

Trade balance	-11.7	-16.1	-19.6	-19.8	-19.0	-17.8
Current account balance						
Excluding transfers	-13.9	-16.5	-17.2	-14.9	-13.7	-12.4
Including transfers	-9.2	-10.8	-11.1	-8.0	-8.1	-7.1

Sources: Georgian authorities; and Fund staff estimates.

1/ Projection as of December 2000. Reflecting output losses due to the drought, and assuming disbursements by the IMF and the World Bank in the fourth quarter of 2000.

2/ Scenario based on an economic program that could be supported under the IMF's PRGF facility.

3/ Goods only; in US\$ terms.

4/ Annual GDP divided by end-period M3.

5/ Includes general government tax revenue and special state funds. The latter include the Pension, Employment, and Road Funds. Privatization revenue is excluded.

6/ On a commitment basis. Cash expenditures differ by the change in expenditure arrears.