

Georgia: Selected Issues and Statistical Appendix

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**International Monetary Fund
Washington, D.C.**

INTERNATIONAL MONETARY FUND

GEORGIA

Selected Issues and Statistical Appendix

Prepared by a team comprising Paulo Neuhaus (head), Patricia Brukoff, Jonathan Dunn, Wojciech Maliszewski, and Bert van Selm (all EU2), Lisandro Abrego (PDR), Edward Frydl (MFD), and Alejandro Hajdenberg (FAD)

Approved by the European II Department

September 17, 2003

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I. INFLATION IN GEORGIA¹

A. Macroeconomic Developments

1. Georgia experienced one of the highest inflation rates among the BRO countries after the creation of a national currency—the *coupon*—in April 1993.² A stabilization program in mid-1994 brought an end to hyperinflation, and introduction in October 1995 of a new currency (the *lari*) replacing the coupon boosted demand for money. Since then, the National Bank of Georgia (NBG) has conducted a prudent monetary policy, focusing on maintaining price stability. The lari was pegged de facto to the U.S. dollar between October 1995 and December 1998 and price stability helped to remonetize the economy somewhat, although monetization has remained low and dollarization high.

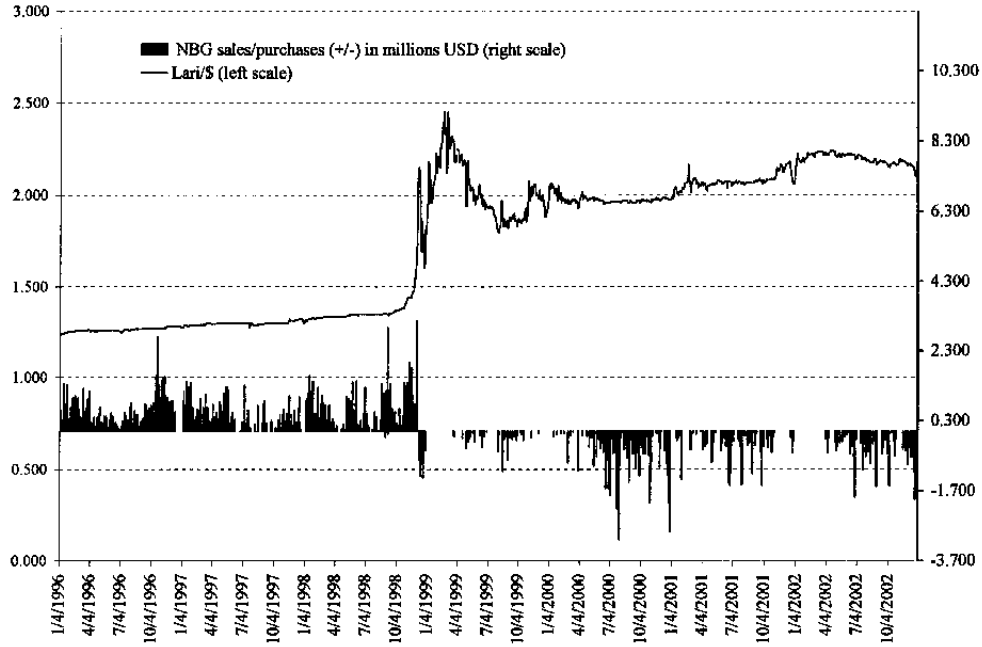
2. In the final months of 1998, the onset of the Russian crisis and widespread public concern regarding domestic budgetary problems led to a sharp decline in the demand for lari (broad money declined by 25 percent in nominal terms from August to November) and growing pressure on the pegged exchange rate. To defend the lari, the NBG intervened heavily in the foreign exchange market (Figure I-1), increased banks' reserve requirements, withdrew liquidity through interbank auctions, and suspended automatic intra-month budget financing. The attempt was unsuccessful, and after running foreign reserves down to the equivalent of 3 weeks of imports, the NBG allowed the lari to float on December 7, 1998. The lari/dollar exchange rate immediately dropped by 20 percent and monthly inflation soared to 12 percent (Figure I-2).

3. After the depreciation, the NBG further tightened monetary policy by limiting credit to the government, but the continued weakness of the fiscal position forced an increase in direct financing in the last months of 1999 and in the first half of 2000. This once again exerted downward pressure on the currency. As the fiscal position improved in the second part of 2000, the NBG was able to restrain the growth in net domestic assets. Moreover, it controlled reserve money growth sufficiently to offset a rebuilding of foreign reserves at the end of the year, which was permitted by favorable balance of payments developments. When the exchange rate began to appreciate at the end of 2002, the NBG intervened by stepping up foreign exchange purchases. Aside from these episodes, the exchange rate has remained largely stable and inflation low throughout the post-crisis period.

¹ Prepared by Wojciech Maliszewski.

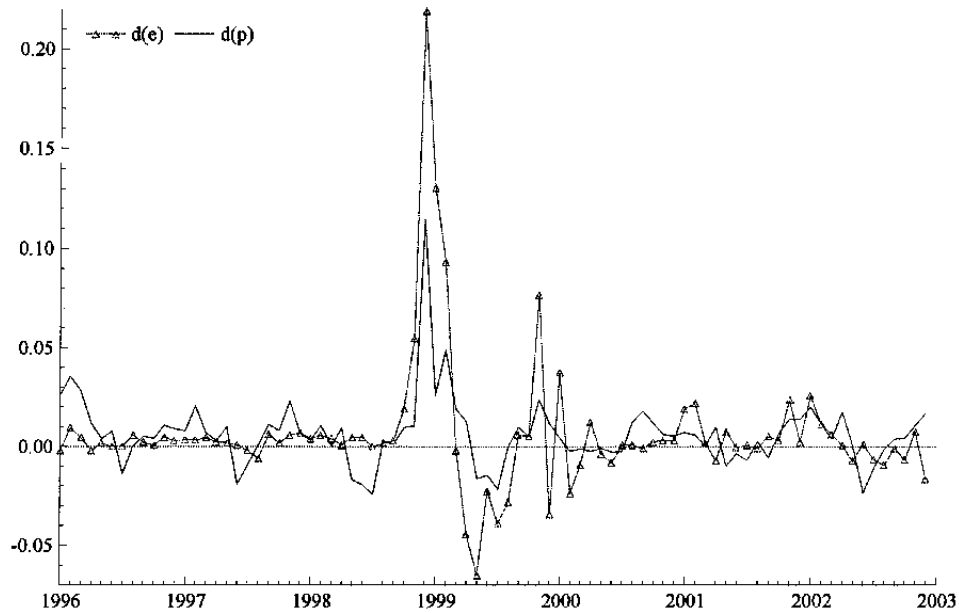
² The BRO group includes the Baltics, Russia, and other former Soviet Union countries.

Figure I-1. Lari/U.S. Dollar Exchange Rate and NBG Interventions at the Tbilisi Interbank Currency Exchange



Source: Georgian authorities.

Figure I-2. Georgia: Logarithmic Changes in Price Level $d(p)$ and Lari/U.S. Dollar Exchange Rate $d(e)$



Source: Georgian authorities.

B. Model of Inflation

4. Long-term price level behavior is assumed to be governed by the balance between aggregate demand and supply of goods and services. Equation (1), derived under this assumption in Appendix I, links the logarithm of price level (p) with logarithms of the money supply (m), exchange rate (e) and aggregate supply of goods (y):

$$p = \beta_1 m + \beta_2 e - \beta_3 y \quad (1)$$

The equation is suitable for estimation and testing in the cointegration framework (the estimation procedure is discussed in Appendix II).³ After restricting parameters β_1 and β_2 to sum to one, the following estimates of the parameters have been obtained (with standard errors of unrestricted parameters reported in parentheses):

$$p = 0.38 m + 0.62 e - 1.27 y$$

(0.07) (0.02)

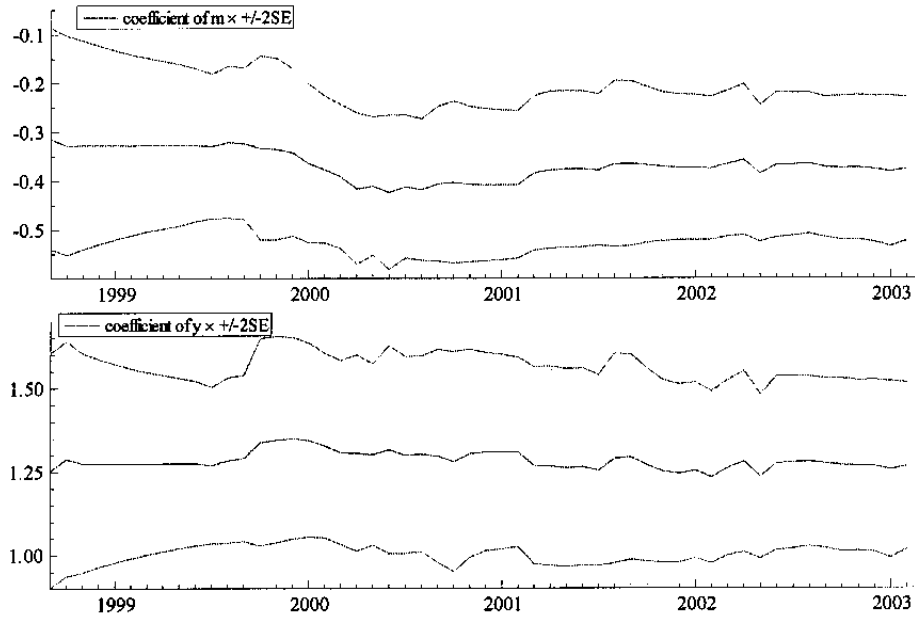
The exchange rate coefficient is higher than that of money, but they are both close to one-half.

5. As suggested in the theoretical discussion in Appendix I, estimates of equation (1) can be stable, even if there are persistent disequilibria in the money and foreign exchange markets. Persistent pressure on the exchange rate before the Russian crisis may be an example of a disequilibrium of this type. In the theoretical model, disequilibrium in the foreign exchange market in this period would imply that the money market was also out of equilibrium. The shift in real money holdings during the crisis gives some support to this hypothesis. A recursive estimation of equation (1) coefficients (reported in Figure I-3) shows that the parameters are stable even if persistent disequilibria in the money and foreign exchange markets had been present in the sample.

6. Short-run price dynamics are modeled in a single-equation, error-correction mechanism. After testing the assumption that changes in the logs of money and the exchange rate are exogenous to inflation, inflation is determined by these two variables and lagged deviations from the long-run relationship. The exact form of the short-run relationship (lag structure) is determined by application of the general-to-specific methodology as discussed in Appendix II. In addition to these variables which enter the long-run relationship, percentage changes in relative prices of fruits and vegetables and percentage changes in oil import prices also affect short-run price dynamics. The two variables proxy for supply shocks stemming from the agricultural sector and from input prices. In addition, a dummy variable is used for December 1998, the month of a de facto regime change, when the lari started floating against the dollar.

³ Non-stationary variables are cointegrated if some of their linear combinations are stationary.

Figure I-3. Georgia: Recursive Estimates of Long-Run Coefficients of the Price Equation



Source: Fund staff estimates.

7. Estimates of the final specification of the inflation equation are reported in Table I-1. Figure I-4 shows actual and fitted values, together with residuals. The equation shows that inflation is strongly affected by exchange rate changes and that the pass-through is fast. Changes in money also have a significant impact on inflation, but this effect takes longer to work its way through the economy than exchange rate changes. The adjustment of prices is also affected by the error-correction term, which is highly significant. This suggests that the price level adjusts to its long-run equilibrium, which is a function of the levels of money, exchange rate and output. Lagged inflation terms do not appear in the final specification of the short-run dynamics, indicating that—conditioning on the behavior of exchange rate, money, and relative prices—inflation persistence is very low. Supply shocks originating in agriculture have a high and significant short-term impact on inflation. Changes in oil import prices have a smaller, but also significant impact.

Table I-1. The Error-Correction Equation for Inflation 1/

$$\Delta p_t = 0.4633 + 0.0935 \Delta e^{\text{USD}}_t + 0.0973 \frac{1}{3} (\Delta m_t + \Delta m_{t-1} + \Delta m_{t-2}) + 0.0589 \text{ECM}_{t-1}$$

(0.1078)
(0.0274)
(0.0253)
(0.0137)

$$+ 0.1322 \Delta(p_t^{\text{food}} - p_t) + 0.0287 \Delta p_t^{\text{oil}} + 0.0872 \text{D1298}$$

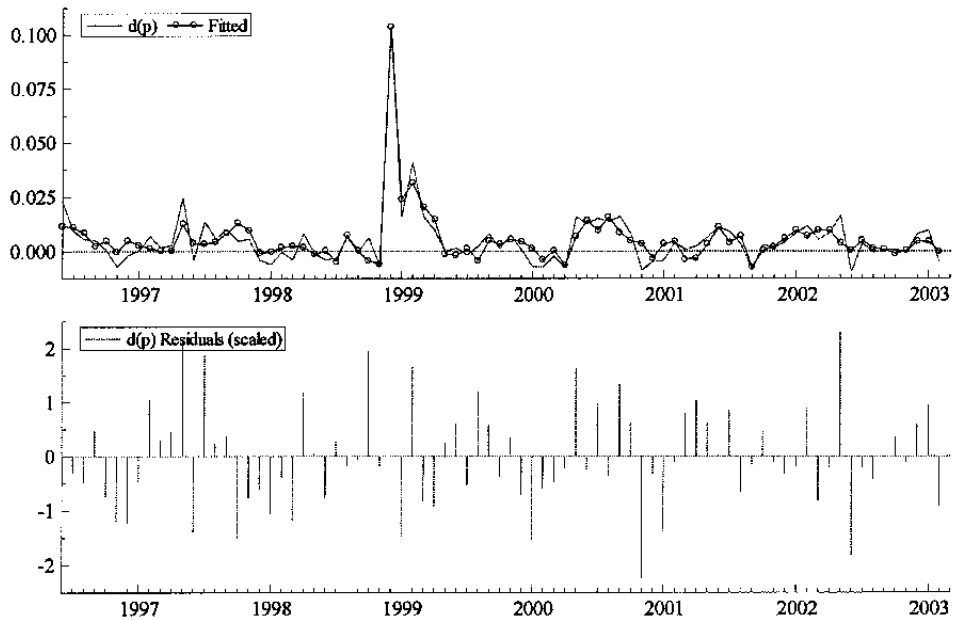
(0.0225)
(0.0076)
(0.0081)

$R^2 = 0.8583$
Sample: 1996.6 – 2003.2
 Equation standard error: 0.0054
 Number of observations: 81
 DW = 2.18

Source: Fund staff estimates.

1/ ECM (error-correction mechanism) denotes deviations from the estimated long-run relationship in equation (1). Δ indicates first difference. D1298 is one for December 1998, zero otherwise. Standard errors reported in parentheses

Figure I-4. Δp : Actual Values, Fitted Values and Residuals from the Error-Correction Model



Source: Fund staff estimates.

C. Conclusions

8. The econometric results show that it is feasible to estimate robust price and inflation equations for Georgia. The long-run price equation expresses prices as a function of money, the exchange rate, and real income, and may be interpreted as portraying equilibrium in the goods market. Short-run dynamics of inflation are strongly affected by current exchange rate changes, money growth, and changes in relative prices of foodstuffs and oil. The estimated long- and short-run relationships are stable, and may be useful as a tool for policy formulation and evaluation. Estimation of a separate money demand equation turns out to be more difficult, pointing to a longer and more complicated adjustment mechanism governing the behavior of real money balances. Inflation in Georgia exhibits very low persistence, possibly due in part to the use of relatively short-term nominal wage contracts (a legacy of the hyperinflationary period), which may prevent inflation from becoming entrenched after a shock.

9. The results suggest that the NBG faces serious challenges when conducting monetary policy. Public memory of hyperinflation is still fresh, and any external or internal shock quickly exerts strong pressure on the exchange rate. Because the stock of foreign exchange reserves remains small, the NBG has no scope for leaning against downward pressure on the lari, especially when budget financing needs complicate monetary tightening. Yet even when faced with these challenges, the NBG has enjoyed substantial success in keeping inflation low and relatively stable. Looking ahead, further accumulation of foreign reserves and development of indirect monetary control instruments, such as a deeper treasury bill market, would increase the capacity of the NBG to respond to shocks.

DERIVATION OF THE LONG-RUN PRICE EQUATION

10. The aggregate demand for goods and services is a function of real money supply (M/P) and the real exchange rate (E/P). In log-linear form (denoted by lower-case letters), the aggregate demand is written as:

$$y^D = \alpha_1 (m - p) + \alpha_2 (e - p) \quad (\text{A1})$$

The aggregate supply is exogenously given and in equilibrium is equal to aggregate demand and real income (Y):

$$y = y^S = y^D \quad (\text{A2})$$

It is assumed that the goods market is always in equilibrium and therefore equation (A2) always holds.

11. Flow demand for foreign exchange (current account deficit) is assumed to be a function of real exchange rate and real income. Real income is fixed at the level of aggregate supply, the available foreign financing is exogenously given, and the real exchange rate tends to equilibrate the foreign exchange market. Money demand is assumed to be a function of real income. Similarly, since real income—the only variable entering the real money demand function—is exogenous, real money balances tend to equilibrate the money market.⁴

12. If the three markets are on average in equilibrium, it is likely that two unique long-run cointegrating vectors emerge between non-stationary nominal variables in equation (A1) (treating “ y ” as exogenous). The two cointegrating vectors describe equilibrium at any two of the three markets and equilibrium at the omitted market is described by a linear combination of the two unique cointegrating vectors. It is also possible that the money and foreign exchange markets are persistently out of equilibrium (adjustments towards equilibrium may be very slow or non-linear) and that only the goods market is—by assumption—always in equilibrium. In this case, only one cointegrating vector can be found in the data, corresponding to the equilibrium described by equation (A1). Re-normalizing this equation by expressing price level as a function of money, the exchange rate and income gives equation (1) in the text, with $\beta_1 = \alpha_1/(\alpha_1 + \alpha_2)$, $\beta_2 = \alpha_2/(\alpha_1 + \alpha_2)$ and $\beta_3 = 1/(\alpha_1 + \alpha_2)$.

⁴ A typical formulation of the Cagan-style money demand function expresses the demand for real money balances (M/P) as a function of expected inflation and real income. This formulation is not well suited to modeling the long-run behavior of money balances in Georgia. Tests for stationarity of the series—discussed below—suggest that after 1996, inflation became a stationary series, while real money balances remained non-stationary.

ESTIMATION AND TESTING OF THE MODEL

Sources, transformations and statistical properties of the data

13. The model is estimated on monthly data for the post-stabilization period (January 1996-December 2002). Domestic CPI and GDP (a measure of income) are available from the Georgian State Department of Statistics (SDS). The available quarterly GDP series has been interpolated under the assumption that a monthly series follows a unit root process. The exchange rate is measured by average lari/U.S. dollar exchange rate, and money is measured by M2, both available from the NBG.⁵ Fruit and vegetable prices are obtained from disaggregated CPI data and are divided by the total CPI to obtain relative values. Average oil prices are from the IMF's WEO database. All series are in logs and are seasonally adjusted using a version of the X-12 procedure. Tests for stationarity (ADF) suggest that logs of M2, CPI and the lari/U.S. dollar exchange rate are all order-one integrated. The log of GDP is order-one integrated by construction.

Testing and estimation of cointegrating vectors

14. The Johansen procedure is used to test for the number of cointegrating vectors and estimate their coefficients. The procedure starts by selecting a set of endogenous and exogenous variables and choosing an appropriate lag structure for the VAR system of the endogenous variables. Prices, the exchange rate and money are modeled as endogenous variables. Real GDP is exogenous and restricted to enter only the long-run (cointegrating) relationship. Two other exogenous variables, namely relative food prices and changes in oil import prices—proxies for supply shocks—enter only the short-run dynamics of the system. In addition, two dummy variables are used: for December 1998, the month of a de facto regime change when the lari began to float against the dollar, and for September 1998, the first month after the Russian crisis. The VAR is estimated with six lags of each endogenous variable.

15. Results of the tests suggest that there is only one cointegrating vector between prices, money, the exchange rate and output (Table I-2). After normalizing the parameter of the log of price level to unity, a hypothesis that coefficients of money and exchange rate sum up to one (homogeneity restriction) is tested, together with exogeneity restrictions. The homogeneity restriction is not rejected at the 5 percent significance level. The weak exogeneity of the exchange rate and inflation is not rejected at the 5 percent level, while the weak exogeneity of prices is strongly rejected. The equation with imposed restrictions of homogeneity and weak exogeneity of money and exchange rate is reported in the main text and chosen for further analysis.

⁵ Estimation of the model using M3 instead of M2 yields very similar results.

Table I-2. Georgia: Tests for the Number of Cointegrating Vectors between p, m, e and y 1/

Rank	λ_{\max}		λ_{\max} using T - nk		λ_{trace}		λ_{trace} using T - nk	
0	39.25	[0.003]**	28.38	[0.003]**	30.53	[0.041]*	22.07	[0.035]*
1	10.87	[0.223]	9.09	[0.285]	8.46	[0.425]	7.07	[0.489]
2	1.78	[0.182]	1.78	[0.182]	1.38	[0.239]	1.38	[0.239]

Source: Fund staff estimates.

Specification of an error-correction equation

16. Since the weak exogeneity of the exchange rate and money is not rejected, it is valid to condition on these two variables in a single-equation inflation model. The “general-to-specific” methodology is followed in searching for the final form of the short-run dynamic inflation equation. The specification search begins from estimation of a relatively unrestricted model. The unrestricted inflation equation includes five lags of inflation; five lagged and current values of changes in the log of money and in the log of the exchange rate; the lagged error-correction term from the long-run price equation; changes in relative prices of fruits and vegetables and of oil prices; and the dummy variables discussed above. In the next steps, restrictions imposed on the model are tested against the unrestricted alternative. Restrictions imposed on the general specification leading to the final equation reported in Table I-2 cannot be statistically rejected, and the final inflation equation easily passes all standard specification and stability tests.

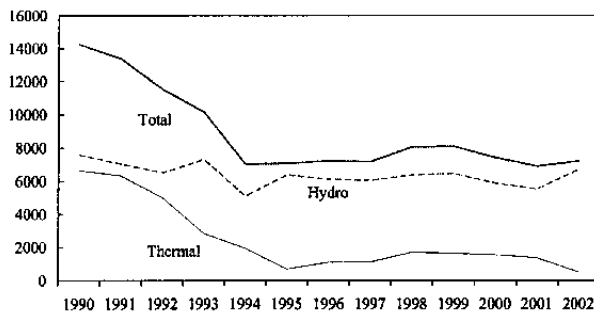
II. ENERGY SECTOR REFORMS IN GEORGIA⁶

A. Overview of Reforms

17. A review of Georgia's experience with energy sector reform shows that the country has significantly changed the structure of the sector, in line with donor recommendations. Nevertheless, further progress is needed to achieve the ultimate goals of these reforms—reliable energy supply and financial stability. Moreover, the analysis below indicates continued weakness in the areas of governance and transparency stemming from interference by strong vested interests. This has undercut the potential benefits that could be derived from the reform measures already taken, leading to the acute technical and financial difficulties currently plaguing the energy system.

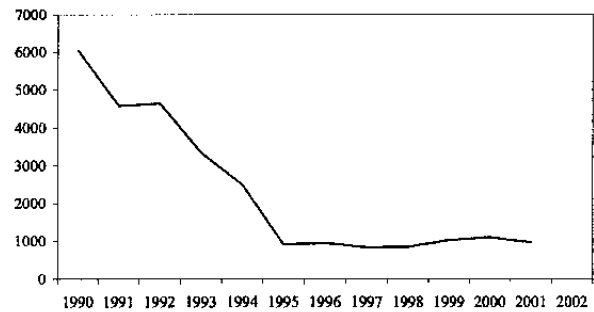
18. Since independence, Georgia has experienced frequent power cuts and limited supply of gas and electricity during the winter. The increase in energy import prices led to a six-fold decrease in gas imports and rendered thermal energy generation uneconomical, causing overall electricity generation to fall by more than half (Figures II-1 and II-2). The country now relies largely on hydro-electric stations for its power supply, but the largest one by far—Enguri—lies in territory partially controlled by the breakaway region of Abkhazia, and more than a third of Enguri's electricity production is consumed by Abkhazia without any payment. Collection rates on electricity that finds its way to domestic consumers have been low, especially outside Tbilisi. Collection rates on gas consumption have been low throughout the country. As a consequence, energy infrastructure has been poorly maintained and the sector has accumulated significant external debts. The recent EBRD and World Bank Business Environment and Enterprise Performance Survey (BEEPS II) shows that firms in Georgia on average lose more than 60 business days per year due to power outages.

Figure II-1. Georgia: Electricity Production
(In million kWh)



Source: Ministry of Fuel and Energy.

Table II-2. Georgia: Natural Gas Consumption
(In million m³)



Source: Georgia International Gas Corporation.

⁶ Prepared by Wojciech Maliszewski and Bert van Selm. Thanks are due to Richard Podpiera, whose work on Georgia's energy sector contributed to this text.

19. **This situation persists despite the fact that reforms have largely followed World Bank advice to demonopolize and privatize the electricity sector.** In 1996 the government separated Sakenergo—a vertically integrated power company—into generation, transmission and dispatch, and distribution companies. Attempts to improve performance through better state management failed, leading the government to privatize the main segments of the sector. In December 1998 AES, a major international utility, acquired a 75 percent stake in Tbilisi’s electricity distribution network for US\$25.5 million. In addition AES bought two thermal power generating units at Tbilisresi, the country’s largest thermal power plant, for US\$5 million in April 2000.⁷ Finding buyers interested in other parts of the country’s energy system proved much more difficult. As an alternative to privatization, financial assistance from international donors was used to put in place private management contracts for the Georgian Wholesale Electricity Market (GWEM) in February 2002, for transmission and dispatch company (Georgian State Electric System, GSE) in December 2002 and for distribution outside Tbilisi (Georgian United Distribution Company, GUDC) in May 2003.

20. **Reforms in the gas sector have followed a similar path, although they have been slower than in the power sector and—because domestic production of natural gas is very small—confined to the transmission and distribution system.** In 1997, Georgian Gas International Corporation (GGIC) was established to manage the high-pressure transmission network, ensure supplies and promote supply diversification and foreign investments in the sector. Due to its strategic importance, there have been no privatization plans for the high-pressure network, although the Russian utility Gazprom appears to have acquired significant control over the network through a recent cooperation agreement. Privatization of gas distribution started in 1998; almost the entire system was bought by the private Russian trading company Itera (through its subsidiary Sakgas), with the exception of the distribution company in Tbilisi, Tbilgazi.

Tariffs, collection rates, and quasi-fiscal subsidies

21. **Energy tariffs have been gradually increased to cost recovery levels since 1997, but a significant reversal took place in early 2003 with a considerable reduction in electricity prices, which was, in turn, reversed in September 2003.** The 1997 Law on Electricity established the independent Georgian National Energy Regulatory Commission (GNERC), a body responsible for setting wholesale and retail electricity tariffs and issuing licenses for electricity generation. GNERC was able to raise prices for electricity to cost recovery levels in a series of price increases from 1997 to 2002. At end-2002, retail electricity tariffs stood at 6.4 U.S. cents per kWh in Tbilisi and 4.0 U.S. cents per kWh in the rest of the country. However, in February 2003, GNERC reduced electricity sector tariffs across the board following a Constitutional Court ruling. The reduction was deeper for the Enguri

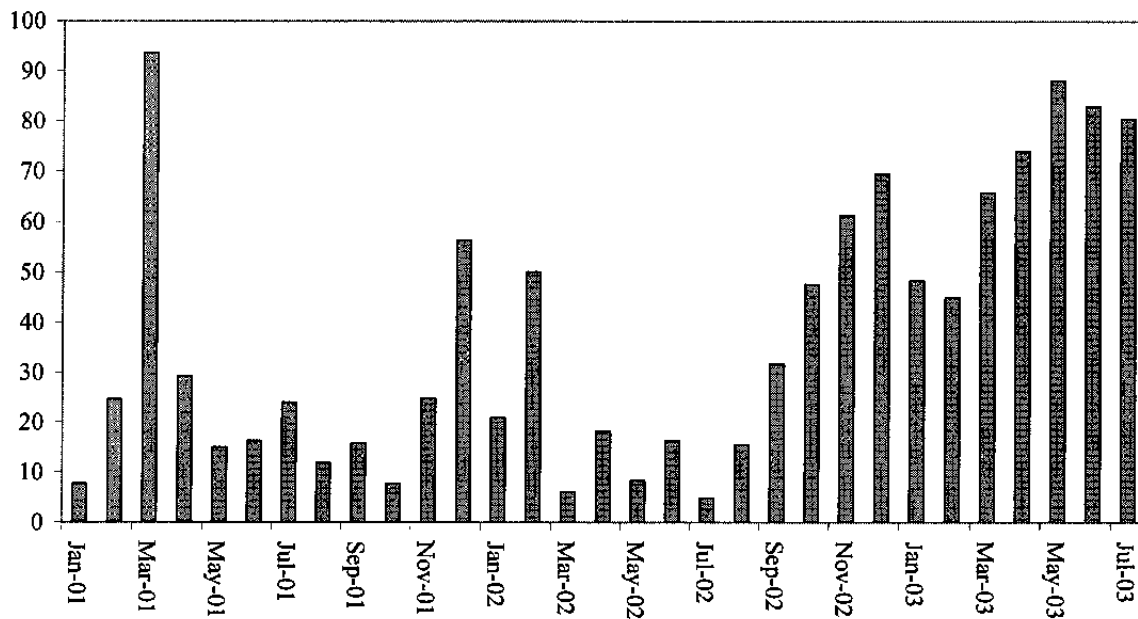
⁷ AES’s assets in Georgia were sold to the Russian electricity distributor UES in July 2003.

hydropower plant (30 percent) and the company filed a case against the tariff decision in a district court. Following another court ruling, GNERC issued a resolution increasing the tariffs to their previous level effective December 1, 2003.

22. **Gas tariffs have been gradually increased to import cost levels since 1999, when GNERC took over responsibility for regulating the gas sector.** Prices currently stand at GEL 0.27 per m³ for residential customers in Tbilisi and GEL 0.30 per m³ in other cities. The tariffs cover the cost of importing gas from Russia (approximately US\$60 per 1000 m³), transmission and distribution charges.

23. **Reforms in the wholesale electricity market have led to a gradual, but slower than expected increase in collection rates.** An April 1999 amendment to the Law on Electricity of Georgia established GWEM to replace Sakenergo as the buyer of electricity from domestic and foreign generators and supplier to distribution companies and large enterprises. GWEM was tasked to improve payment discipline by issuing orders to disconnect nonpaying customers, and to allocate the cash it received among generators equitably and transparently. However, technical problems, political pressures, social concerns, and corruption have often outweighed the market operator's legal right to issue disconnection orders, limiting any improvement in payment discipline. Nevertheless, GWEM has raised collection rates considerably since late 2002, with an average collection rate of 69 percent in the first seven months of 2003 (Figure II-3).

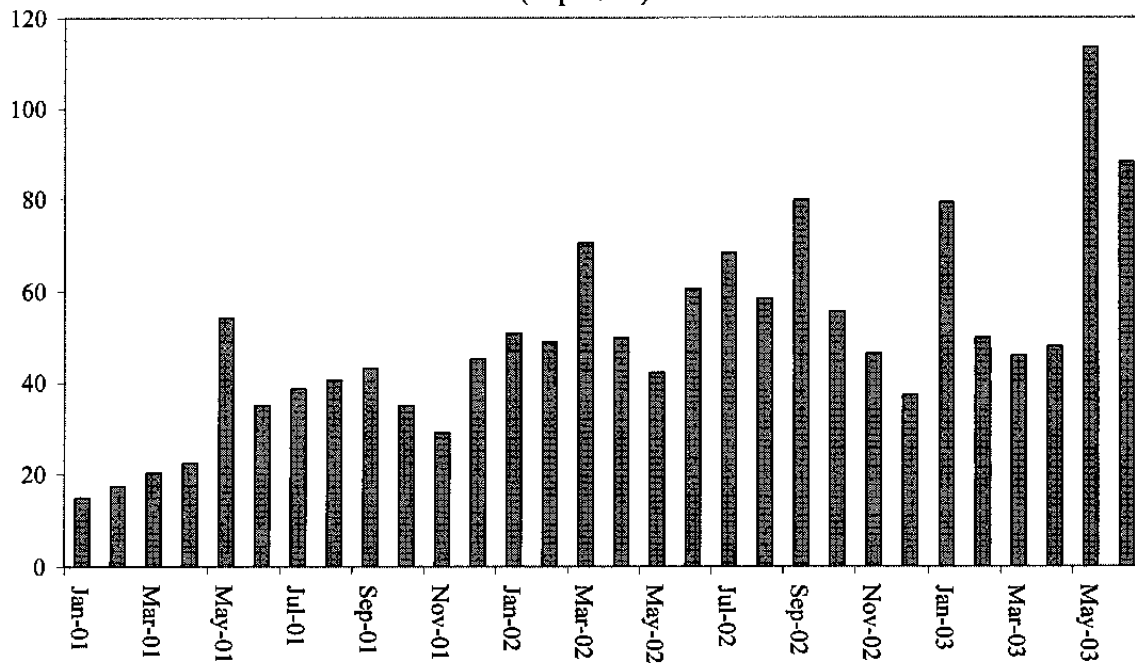
Figure II-3. Georgia: Collection Rates from Direct Customers of the Wholesale Electricity Market
(In percent)



Sources: GWEM; Ministry of Fuel and Energy; and Fund staff estimates.

24. **On the retail level, collection rates in Tbilisi improved following the sale of Tbilisi’s distribution network to AES, but non-payment outside the capital remains pervasive.** The increase in collection rates in Tbilisi has been fast, but AES Telasi managed to reduce its commercial losses (theft of electricity) only in 2003. Figure II-4 shows that—taking into account the commercial losses—the improvement in payment discipline has been gradual. The government has been slow to bring distribution outside Tbilisi under private ownership or management. Initially, distribution outside Tbilisi was handed over to municipalities, which did little to improve payment discipline. Municipal distribution companies were subsequently merged into the Georgia United Distribution Company (GUDC), but collection rates have remained weak, hovering around 25 percent. The authorities expect a recent drive to cut off non-paying customers—initiated in June 2003 under the new private management—to improve collection rates.

Figure II-4. Georgia: AES Collection Rates
(In percent)



Sources: AES Telasi; and Fund staff estimates.

25. **Collection rates for gas consumption in Tbilisi have remained low.** In 2002 the municipally-owned Tbilgazi collected only 28 percent of billings, prompting the local government to finance gas imports using commercial bank credits. Plans for the privatization of gas distribution in Tbilisi have failed, due to lack of interest from foreign investors. In March 2003, a tender for the management contract for Tbilgazi was won by a company formed by GIGC employees (“New Management”), but the contract has not been signed yet.

26. **Poor payment discipline is reflected in large quasi-fiscal losses in the energy sector, which amounted to 5.9 percent of GDP in 2002.** Table II-1 below presents the underlying calculation, conducted under the assumption that actual tariffs set by the regulatory commission correctly reflect costs of electricity production. Quasi-fiscal losses in the power sector declined in 2002, as payments from direct wholesale customers (large enterprises) and payments collected by AES increased. A considerable improvement is expected in 2003 on the basis of higher collection rates outside Tbilisi and budgetary subsidies to cover the unpaid consumption by Abkhazia. Quasi-fiscal losses in 2003 could have been reduced by additional 0.5 percent of GDP if the electricity tariffs in 2003 had not been affected by the Constitutional Court ruling.

Table II-1. Georgia: Energy Sector Quasi-Fiscal Losses

	2001	2002	2003 forecast
<i>Power sector</i>			
Quantity delivered (million kWh) 1/	6443.4	6942.7	6942.7
Cost price (US cents)	4.1	4.0	4.3
Tariff (US cents)	4.1	4.0	3.9
Collection rate (percent) 2/	22.6	30.7	51.5
Generation cost (US\$ million)	262.2	280.4	300.7
Billed amount (US\$ million)	262.2	280.4	271.3
Collected amount (US\$ million)	60.2	96.6	145.2
Total losses (US\$ million)	202.0	183.8	155.5
<i>Of which:</i> price effect (US\$ million)	0.0	0.0	29.4
<i>Of which:</i> non payment effect (US\$ million)	202.0	183.8	126.1
Total losses (percent of GDP)	6.3	5.4	4.2
<i>Tbilgazi</i>			
Total losses (US\$ million)	...	15.6	15.6
Total losses (percent of GDP)	...	0.5	0.4
<i>Energy sector (power sector + Tbilgazi)</i>			
Total losses (US\$ million)	...	199.4	171.1
Total losses (percent of GDP)	...	5.9	4.7
GDP (US\$ million)	3200.9	3395.9	3677.0

Source: Fund staff calculations, based on data provided by the GWEM and the AES.

1/ Quantity produced and imported minus 10 percent normative losses.

2/ GUDC collection rates are based on Fund staff estimates.

B. Energy Sector External Debt and Payment Arrears

27. **Poor payment discipline in the energy sector has led to significant accumulation of external debt.** A large part of the external debt accumulated by the energy sector is related to natural gas imports used primarily to supply the Tbilisresli plant with fuel and for distribution to households in Tbilisi. The total stock of external debt accumulated by the energy and gas sector at end-2002 is estimated at US\$693.7 million, or 20.4 percent of GDP (Table II-2).

Table II-2. Georgia: External Debt of the Energy System, end-2002

	US\$ Million	Percent of GDP
Electricity and fuel oil deliveries		
Azerbaijan	1.6	0.0
Russia	46.0	1.4
Turkey	52.7	1.6
Anglo Oil	28.5	0.8
Gas deliveries		
Turkmenistan	324.0	9.5
Itera	56.6	1.7
Other	1.8	0.1
International institutions and donors		
World Bank	77.4	2.3
EBRD	56.7	1.7
KfW	48.5	1.4
Total	693.7	20.4

Source: Fund staff estimates based on data from the Ministry of Fuel and Energy, and the Ministry of Finance.

28. **Low collection rates have also led to the accumulation of cross-agency debts in the power sector** (Table II-3). Sakenergo's debt to generation companies amounts to 3.1 percent of GDP. Although the private management contract for GWEM has led to a gradual improvement in collection rates, GWEM's debt to generation companies reached 7.2 percent of GDP at the end of 2002. Distribution companies owe Sakenergo and GWEM an equivalent of 19.5 percent of GDP.⁸ Trade in these debts reduces the transparency of payments in the sector, since payments are partially made in debt rather than cash.

⁸ The difference between receivables and payables of Sakenergo and GWEM covers debts to suppliers outside the energy sector, and gas and electricity import.

Table II-3. Georgia: Cross-Agency Debt of the Electricity System, end-2002

	US\$ Million	Percent of GDP
Sakenergo		
Receivables from distribution companies	93.7	6.1
Payables to generation companies	48.6	3.1
GWEM		
Receivables from distribution companies	207.1	13.4
Payables to generation companies	111.9	7.2

Source: Fund staff estimates based on data from the Ministry of Fuel and Energy.

29. **International donors active in the power sector agree that there is an urgent need to create a debt resolution agency that would take over all cross-agency debts of the electricity sector accumulated before a certain date.** Despite support from the Ministry of Fuel and Energy, no steps have been taken so far to make the proposed agency operational.

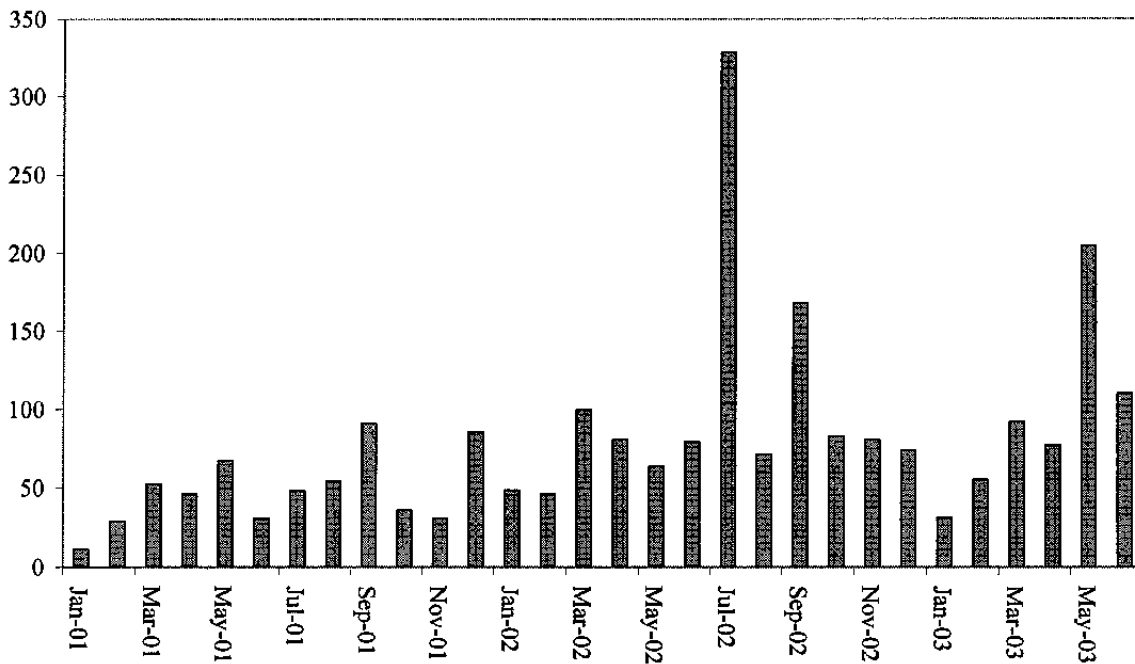
C. Taxation and Budgetary Allocations for the Power Sector

30. **Taxes paid by energy sector companies are an important source of revenue for the general government, but—due to widespread non-payment for energy consumption—calculation of taxes on an accrual basis has created a heavy burden for the sector.** Under pressure from AES, the tax code was modified in October 2001 to levy VAT for all distribution companies on final cash billings to consumers, rather than on an accruals basis. At that time, the tax code was also modified so that VAT would not be charged on electricity sold to distribution companies but stolen before final delivery. This latter decision was reversed in June 2002. Thus, VAT obligations are currently calculated based on all electricity delivered to distribution companies, i.e., the tax is paid also on technical and commercial losses. Similarly, profit taxes and dividends (in the case of state-owned companies) are computed on an accruals basis without provision for write-offs, creating a burden especially for generation and for transmission and dispatch activities, due to low payments from downstream companies. Rapidly accruing penalties on overdue taxes exacerbate these problems. The difficulties faced by electricity companies stemming from the payment of taxes on an accruals basis, without any provision for accruing and writing off losses, as well as from payment of taxes on technical and commercial losses, provide substantial justification for modifying the tax code to address these problems consistently.

31. **On the expenditure side, the 2003 budget includes GEL 96 million (1.2 percent of GDP) for various energy sector commitments,** including GEL 22.7 million to pay for Abkhazia's current use of electricity and clearance of GWEM claims for unpaid electricity

use in previous years.⁹ While this amount has been agreed between the Ministry of Finance and the Ministry of Fuel and Energy, there is currently a disagreement between the two ministries on the actual subsidies needed to cover the consumption of the breakaway region and some other subsidies granted by parliament in 2002. The 2003 budget includes GEL 30 million for electricity consumed by budgetary organizations. Payments by budgetary organizations for their electricity use met the 70 percent target set under the PRGF program in the first six months of 2003 (Figure II-5).

Figure II-5. Georgia: Collection Rates from Budgetary Organizations
(In percent)



Sources: AES Telasi; Ministry of Fuel and Energy; and Fund staff estimates.

D. Experience of Other Transition Countries

32. While most transition countries have deregulated their energy sectors, the speed of reforms has varied even among countries starting from similar initial conditions.¹⁰

⁹ The energy sector debt strategy that the authorities prepared in June 2002 put the stock of debt related to previous unpaid energy consumption by Abkhazia at GEL 87 million; it proposed to clear this debt over a ten-year period.

¹⁰ A useful overview is provided in *Central and Eastern Europe: Power Sector Reforms in Selected Countries*, Report No 196/97, July 1997, Joint WB-UNIDO Energy Sector

(continued)

Under communism, the electricity sectors in Hungary, Poland and Ukraine had much in common and operated under a single grid system. In all three countries, market reforms brought about de-monopolization and commercialization of state-owned enterprises (SOEs) operating in the sector, as well as substantial price increases and changes in the tariff structure. However, each of the three countries opted for a different speed and sequencing of reforms. While Hungary quickly privatized most of the state-owned generation and distribution companies, Poland proceeded relatively slowly with privatization. Ukraine initially privatized only a small share of the sector under a voucher privatization scheme. Moreover, Hungary and Ukraine introduced far-reaching changes to the energy system laws much earlier than Poland. Despite a slower pace of reforms in Poland, restructuring of SOEs active in the sector—combined with a hardening of budget constraints for energy consumers—has improved the efficiency and the financial position of the sector. Fast and decisive reforms have also created an efficient and financially viable energy system in Hungary. In contrast, in Ukraine payments for electricity consumption have plummeted, hampering operation of the reformed system and generating a substantial quasi-fiscal deficit. Despite rapid changes, the reforms failed because of powerful vested interests benefiting from the quasi-fiscal subsidies and extracting rents from the power system.

33. Armenia—a country facing initial conditions similar to Georgia—opted for a single-buyer market model when energy sector reforms started in 1997. The new energy law broke the vertically-integrated monopoly into distribution, transmission and dispatch, and generation companies. An independent regulatory agency was established, SOEs operating in the sector were commercialized, and private ownership was allowed. Despite the reforms, until 1999 the system generated annual quasi-fiscal deficits of over 4 percent of GDP due to excess technical losses, theft, tariffs set below cost-recovery levels, low collection rates, and barter transactions impairing transparency of the system. A concerted effort by the government to improve the situation in the energy sector has led to higher collection rates, but the quasi-fiscal deficit has remained around 2-3 percent of GDP.

34. Cross-country comparisons and Georgia’s own experience indicate that—while changes in the structure of the energy sector may be important—good governance, transparency, and resistance to vested interests are the keys to successful reform of the energy sector. Continued weakness in these areas has led the Georgian energy system to the current stage of technical and financial dilapidation. To avert collapse, the government needs to deal with corruption in the sector, ensure timely payments for electricity consumed by budget organizations and state-owned enterprises, clearly state its support for cutting off non-paying customers and regions, prohibit barter and offset operations to settle energy bills, restructure old debts, and rationalize its tax policy towards the sector.

Management Assistance program (ESMAP). The EBRD’s 2001 Transition Report presents a more recent analysis.

III. BANKING SECTOR REFORMS AND FINANCIAL DEVELOPMENTS IN GEORGIA¹¹

A. Summary and Introduction

35. The Georgian banking system was last closely analyzed in the context of the October 2001 Financial System Stability Assessment (FSSA). This chapter seeks to update the analysis, providing a new assessment of progress made and identifying the challenges that remain.

36. The 2001 FSSA indicated that financial intermediation was under-developed, dominated by banks, and faced significant vulnerabilities to exchange rate and credit risks. It noted that, while considerable progress had been made to strengthen banking supervision, important weaknesses remained to be addressed. The report also indicated that many of these weaknesses would be remedied by legal reforms under consideration at that time. The report cited the main risks to the financial system as coming from the relatively high fiscal deficit and external debt, which could lead to pressures on the exchange rate, prices, and output, with repercussions on the banking system. At the same time, weaknesses identified in the banking system and the quasi-fiscal costs of dealing with insolvent banks were viewed as potential triggers to a deterioration in the macroeconomic environment.

37. The picture that emerges now indicates that Georgia's banking system is more robust and less vulnerable than at the time of the 2001 assessment. This has largely been the result of significant progress by the National Bank of Georgia (NBG) in introducing key reforms in the legal and regulatory frameworks for banking supervision, and in strengthening its capacity for implementation of these measures. However, if macroeconomic conditions continued to be unsupportive and domestic capital markets remained under-developed, then future growth of the banking system could be constrained and remain a source of risk to the system. And while strengthened banking supervision has reduced systemic risk, the quasi-fiscal costs of dealing with insolvent banks could still have a substantial adverse effect on macroeconomic conditions.

B. Structure of the Banking System

38. The Georgian financial sector remains small by international standards and by comparison with other countries in the region. Total assets of the banking system have risen since 2001 but still amounted to only 15 percent of GDP at end-June 2003. Monetization, as measured by the ratio of broad money (M3) to GDP has risen steadily, from 10.2 percent as of end-2001 to 11 percent as of end-June 2003. Foreign currency deposits have been by far the most dynamic segment of M3. Growth of M2 excluding foreign currency deposits has consistently lagged behind that of M3 since 1997. M2 (excluding foreign currency deposits)

¹¹ Prepared by Patricia Brukoff, Edward Frydl, and Eka Galdava (IMF office in Tbilisi).

in Georgia remains among the lowest in the world, at 6 percent of GDP, compared to Kazakhstan at about 13 percent, and Poland at approximately 42 percent as of end-June 2003.

Table III-1. Georgia: Share of Broad Money (M2) to GDP
(In percent)

	December			June 2003
	2000	2001	2002	
Armenia	7.3	7.1	9.1	7.5
Georgia	6.4	6.1	6.2	5.5
Kazakhstan	9.6	9.7	10.8	13.8
Lithuania	23.4	26.5	22.1	28.9
Moldova	15.7	18.2	20.5	21.3
Poland	43.5	44.6	42.2	40.1
Slovak Republic	66.9	68.7	65.5	62.0

Sources: Economic Database Sharing System, IMF; EBRD Transition Report; central bank reports; and Fund staff estimates.

1/ Simple average of Armenia, Georgia, Kazakhstan, Lithuania, and Moldova.

39. The size and regional characteristics of the Georgian banking system have changed little over the past two years. The banking system still comprises resident regional small and medium-sized banks, five large banking institutions with branch networks throughout the country, and two foreign banks. Consolidation has continued, with the number of banks falling from 29 at end-March 2001 to 25 at end-June 2003. While this is sharply down from the peak of 229 banks in 1994, Georgia remains over-banked relative to the size of the population and the economy. Recognizing the need for further sectoral consolidation, the NBG's Banking Supervision Department (BSD) is strengthening its supervisory actions aimed at smaller banks playing little or no role in financial intermediation. While these banks are not systemically important, the NBG and other commercial banks feel that the sector's public reputation continues to suffer somewhat from their continued operation. At the same time, the NBG is creating incentives for mergers and acquisitions among domestic banks by increasing the minimum required capital to €5 million, in line with European standards.

40. While this approach may lead to further reductions in the total number of banks, it is also likely to increase the concentration of assets that has accompanied sectoral consolidation. At end-June 2003, the five largest banks in the country held about two-thirds of the system's total assets and loans and about three-fourths of deposits. This has implications for competition and market discipline in the sector that will have to be monitored closely by the BSD in evaluating banks' proposals for mergers and acquisitions.

Table III-2. Georgia: Licensed Banks, June 30, 2003

	Number	Total Assets (Lari-millions)
Active banks—domestic	23	1,229
Temporary administration	0	0
Branches of foreign banks	2	13
Licenses revoked still operating	0	0
Total	25	1,242

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

Table III-3. Georgia: Number of Banks per Million People

	Annual		
	2000	2001	2002
Armenia	8.2	8.7	7.3
<i>Of which: foreign-owned</i>	1.3	1.4	1.3
Georgia	5.9	5.4	5.9
<i>Of which: foreign-owned</i>	2.0	1.7	1.5
Kazakhstan	3.2	3.0	2.6
<i>Of which: foreign-owned</i>	1.1	1.1	0.7
Lithuania	4.0	3.7	3.7
<i>Of which: foreign-owned</i>	0.9	1.1	0.9
Moldova	...	4.4	3.7
<i>Of which: foreign-owned</i>	...	...	...
Poland	19.5	18.4	17.2
<i>Of which: foreign-owned</i>	1.2	1.2	1.2
Slovak Republic	4.4	4.1	3.9
<i>Of which: foreign-owned</i>	3.0	2.8	3.1

Sources: Economic Database Sharing System, IMF; EBRD Transition Report; and central bank reports.

1/ Simple average of Armenia, Georgia, Kazakhstan, Lithuania, and Moldova.

41. Georgia's formerly state-owned banks inherited an extensive branch network, which imparts some advantage relative to the other domestic banks. However, they have also had to contend with poor management, over-staffing, a challenging transition to Western banking practices, and inefficiencies that the country's successful private banks have not faced. As sectoral consolidation proceeds, most observers expect to see more mergers and acquisitions aimed at exploiting synergies between these two groups of banks. This trend has already become apparent in the context of bidding on government tenders held in 2003 for the

distribution of various social payments, which prompted a number of banks to assemble and bid as consortia rather than as individuals.

42. There are no legal or regulatory barriers impeding foreign investment in the Georgian banking system. Although only two wholly foreign-owned banks operate currently, this does not fully capture the extent of foreign investment and involvement in the country's banking system. Foreign investment in commercial banks is carried out both by participation in the share of bank capital, with approximately one-third of the authorized capital of commercial banks now composed of foreign capital. Additional foreign involvement in the sector results from the allocation of various types of targeted loans by international financial institutions (IFIs). These external credit lines accounted for approximately 16 percent of total banking system liabilities at end-June 2003. Extension and replenishment of these credit lines depends on the Georgian banks' ability to demonstrate that the money has been used to provide credit to targeted borrowers, and that the loans are being properly managed and serviced. This system has provided participating banks with critical oversight and transfer of best practices. On-lending has typically been focused on the country's small and medium enterprise sector, with new credit lines now planned to support development of the mortgage lending market. In the past, these credit lines carried government guarantees, some of which were ultimately called and became budgetary liabilities when the banks involved were no longer able to service them. However, these guarantees are now being unwound, and planned new projects will no longer have this feature.

Table III-4. Georgia: Banking Ownership by Type and Number of Institutions, June 30, 2003

	Ten Largest	All Other	Total
Domestic owned (100%)	4	6	10
Foreign owned			
Majority interests (>50%)	3	1	4
Minority interests (<50%)	3	6	9
Foreign branches	-	2	2
Total	10	15	25

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

C. Banking System Operations and Recent Developments

43. Total deposits of commercial banks have grown over the past four and a half years by an annual average of 32 percent, with a particularly steep increase (39 percent) in foreign exchange-denominated deposits (Table A-18).

44. Commercial bank credit to the government over the past two years has been minimal, consisting of relatively small purchases of government securities in 2001, 2002, and the first

half of 2003. By contrast, bank credit to the rest of the economy has grown steadily since 2000, by an annual average of 22 percent through end-June 2003. Official data suggest the distribution of credit is quite concentrated. The trade and industrial sectors dominate, absorbing upwards of 70 percent of total loans by economic activity.

Table III-5. Georgia: Banking System Balance Sheet, June 30, 2003

(In millions of GEL)

Assets	Amount	Percent	Liabilities & Capital	Amount	Percent
Cash & due from banks	341	27	Deposits	695	56
Loans (net)	682	55	Borrowing	185	15
Other assets	218	18	Other liabilities	36	3
			Subtotal	916	74
			Capital	325	26
Total	1,241	100		1,241	100

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

45. Average spreads between deposit and lending rates have been broadly steady at 22-23 percent since end-2001 (Table A-20). However, this average conceals divergent trends in the foreign currency interest rate spreads, which have fallen from 22 percent to 18 percent, and domestic currency interest rate spreads, which have risen from 22 percent to 27.7 percent over the same period. Spreads remain high for a number of reasons, including: (i) uncertainty regarding future macroeconomic developments and associated limited public confidence in the government's economic policies; (ii) continued inefficiencies in the management and branch structure of some banks that keep lending rates high; (iii) continued high reserve requirements; and (iv) lingering difficulties in enforcing property rights and seizing collateral.

D. Dollarization of the Banking System

46. Georgian officials and representatives of the banking system indicate that price and exchange rate stability have increased public trust toward the lari and expanded its usage. Additionally, strengthened supervision has promoted increased public confidence in the banking sector. However, these factors have not been sufficient to offset depositor concerns about fiscal performance and country and currency risk. Consequently, dollarization has been increasing over the past few years. The share of foreign currency deposits in total deposits, which had peaked at 86 percent at end-2001, fell slightly in 2002, but has risen once again to 86 percent at end-June 2003. As indicated above, the asset side of Georgian banks' balance sheets is also highly dollarized, with foreign currency-denominated loans making up 86 percent of total loans at end-June 2003. (See paragraph 51 below for a discussion of prudential measures taken this year to address this source of foreign exchange risk.) As a

result, the NBG's influence over monetary transmission mechanisms and interest rate formation is highly constrained.

47. The NBG has extensively analyzed trends in dollarization and taken a number of steps aimed at stimulating lari demand. The frequency of interbank credit auctions has been increased to daily sessions. An overnight credit facility has been introduced, with preliminary announcement of the interest rate offered. Provided the fiscal position is significantly strengthened, government securities could be a promising direction for tapping into domestic demand for safe, liquid, lari-denominated assets; however, the Ministry of Finance has not yet taken the necessary steps to improve the functioning of the primary dealer system and secondary market for these instruments.

48. In an attempt to reduce dollarization, the authorities have recently introduced a differentiation of mandatory reserve requirements according to currencies. This is intended to strengthen banks' incentives to attract lari deposits and reduce the relative role of dollar deposits in the banking system. Previously, reserve requirements comprised 13 percent on both domestic and foreign currency deposits, of which one percentage point could be fulfilled from balances in correspondent accounts with the NBG, calculated on an average basis over a period of 10 business days. The revised requirements reduce the reserve requirements on deposits in Georgian lari (GEL) to 8 percent. In addition, 4 percentage points of this requirement can now be fulfilled from balances in correspondent accounts with the NBG (on a 10-day average basis), further reducing the effective reserve requirement on lari deposits. Reserve requirements on foreign-currency deposits remain at 13 percent. The NBG is also contemplating an increase in the remuneration on GEL deposits from 4.5 percent to 5 percent and a reduction in the rate on foreign currency deposits from 4.5 percent to 2 percent, with implementation tentatively planned for later this year. An increase in the allowance for averaging of requirements on foreign currency deposits is planned for some time in 2004. By increasing banks' incentives to attract lari-denominated deposits, the NBG hopes to induce a similar reallocation on the lending side of banks' balance sheets toward more lari-denominated lending.

49. The differentiation of reserve requirements seems to offer both advantages and disadvantages. Regarding the former, it would appear to be a minimally disruptive way to increase the lari-denominated share of the money supply over which the NBG can exert influence, thereby tightening monetary control. (Past international experience with differential reserve requirements shows that they have tended to undermine monetary control, but these were typically differentiated on the basis of whether deposits had internal or external use. In those cases, regulatory arbitrage produced financial innovations that worked to support the internal use of deposits with the lower reserve requirement cost.) By contrast, the uncertainty about shifts associated with regulatory arbitrage worked to lessen monetary control. This policy may also render the design of Georgia's monetary program more complex, since the introduction of differential reserve requirements complicates the task of making robust assumptions regarding the overall money multiplier.

E. Banking System Soundness and Vulnerability

50. The prudential condition of the banking system in Georgia has, on balance, improved since the 2001 FSAP. The nonperforming loans ratio has fallen from 11.6 percent at end-2001 to 7.4 percent at end-June 2003 (Table A-21). The liquidity ratio remains at a relatively high level of 44.4 percent in June 2003. The capital adequacy ratio (CAR) has declined noticeably from 33.1 percent at end-2001 to 20.1 percent at end-June 2003. This decline, however, does not reflect a significant loss of net worth but rather an increase in risky assets.

51. The 2001 FSAP highlighted the vulnerability of Georgian banks to indirect foreign exchange risk, stemming from the fact that many borrowers had little foreign exchange earnings with which to repay foreign exchange loans. To address this risk, the NBG introduced regulations in September 2002, requiring foreign currency-denominated loans to carry a 200 percent risk weight unless borrowers have a demonstrated source of foreign currency earnings. Given the high and growing share of dollar loans on Georgian bank books (the share of loans made in foreign currency rose from 82 percent at end 2001 to 87 percent at end-June 2003), the imposition of this requirement led to a significant decline in the CAR from earlier reported levels. Still, the near 20 percent CAR under current risk classifications represents a strong capital position.

52. Updated stress tests conducted by the NBG indicate that the system is well able to absorb a range of shocks. This largely results from improvements made in risk identification, monitoring, and management practices. The principal vulnerability remains, as indicated in the FSAP stress tests, the potential indirect credit risk from a large depreciation. The increased risk weighting on such exposures was meant precisely to address this problem. Additional stress tests also revealed that the earnings of a few of the small banks are vulnerable to disruptions to the servicing of T-bill debt.

Table III-6. Georgia: Stress Test for Depreciation Shock /1
(As of May 2003)

For Ten Largest Banks	Baseline	After Shock
Number of banks with:		
CAR < 0	0	0
0 < CAR < 6	0	1
6 < CAR < 12	1	5
CAR > 12	9	4
Percentage share of total banking system assets:		
CAR < 0	0	0
0 < CAR < 6	0	8.1
6 < CAR < 12	8.1	60.9
CAR > 12	79.0	18.1

1/ Shock assumes the combined effects of a 15 percent depreciation, a 5 percentage point increase in interest rate levels, and a resultant downgrading of loans as follows: for standard loans, 20 percent downgrade to classified; for each category of (non-loss) classified loans, 10 percent downgrade to the next lowest category.

53. Macroeconomic indicators point in different directions with respect to banking system vulnerability. Since 2001, two key achievements of Georgian macroeconomic policy have been the maintenance of low inflation and broad exchange rate stability. These factors have contributed to the steady growth of deposits and credit observed over the past few years. However, GDP growth remains slower than in the pre-1998 period; real interest rates remain high; foreign exchange reserves are low; and the fiscal situation remains fragile with a high level of domestic expenditure arrears. Output growth has begun to accelerate, but any further setbacks could limit the increase in profitable lending opportunities and constrain borrowers' ability to repay. The weak fiscal situation poses a continued threat to macroeconomic stability, with potentially negative effects on banks' solvency and liquidity.

F. Regulatory and Prudential Framework

54. The NBG has acted on the majority of recommendations made by the 2001 FSSA and by the January 2003 MFD technical assistance mission aimed at strengthening the legal and regulatory framework for banking supervision. Having made these key changes, the NBG now considers the framework for effective supervision to be complete.

55. The revised "fit and proper" amendment to the law on commercial banks was resubmitted to parliament and signed by the president in December 2002. Although the revisions explicitly denied the NBG the power to amend the criteria for ownership by regulation and constrained the NBG to applying the criteria only at the time of appointments, the limited terms of directors have given supervisors a good deal of practical flexibility. As a result, the NBG to date has rejected renewals of directors six times. Another banking law amendment provides supervisors with legal protection against liability arising from carrying out their responsibilities.

56. Anti-money laundering legislation was approved by the parliament in June 2003, and a Financial Monitoring Service has been established under the auspices of the NBG. Addressing a major concern, the law clearly demarcates the reporting process from tax evasion investigations. Most enabling amendments to other legislation necessary to provide an effective enforcement mechanism were approved by parliament in July 2003, including those related to property confiscation for violators. One final element related to certification still require parliamentary approval, which the Council of Europe has asked the authorities to secure by April 2004.

G. Banking Supervision

57. In addition to introducing necessary legal and regulatory reforms, the NBG has successfully implemented key operational recommendations of the 2001 FSSA aimed at increasing the effectiveness of supervisory efforts.

58. The NBG has begun to employ progressively stronger measures for several problem banks, including formal orders and memoranda of understanding. At the same time, the NBG has opted to follow a more informal approach to problem bank resolution in a number of

instances. This has entailed operating under private understandings and confidential letters with bank owners, rather than under formal MOUs and temporary administration. On balance, this approach, while risky in terms of moral hazard, appears to have worked well. Problem banks have often been put under stricter supervisory monitoring, replaced management, and been recapitalized or downsized. In this way, the NBG has made good progress in streamlining the organization, reporting, implementation, and conclusion of bank liquidation procedures.

59. Although the NBG has not obtained the authority to set conditions on the choice of banks' external auditors, it has noted that most of the larger banks in Georgia utilize funds from donors that require external audits by major international firms. The potential negative repercussions of this limitation are largely mitigated by the fact that the NBG has at times adopted a more conservative attitude on asset classification and other accounting issues than international auditors. Nevertheless, the NBG has indicated that it will continue to push for this additional authority over banks' external audits.

60. Policies regarding the approval and frequency of on-site inspections have been amended to increase flexibility in scheduling inspections and the frequency of inspection of problem banks. Full on-site inspections for banks with CAMEL ratings of 3-5 are now conducted every 6 months.¹² Banks rated 1-2 get a full examination every 18 months, but may be subject to occasional targeted inspections.

61. In keeping with the increased emphasis on risk-based supervision, the NBG has changed the organizational structure of BSD and created a dedicated team tasked with analyzing systemic risks, including through regular stress testing. The unit has updated earlier FSSA stress tests and tested banks' liquidity and exposure to T-bills. It also analyzes banking system trends, potential resolution and merger strategies, and the effects of regulatory changes on the banking system. Members of BSD have been receiving additional training both from visiting experts and through participation in international programs to strengthen skills in loan classification procedures. However, the main area in which the NBG continues to encounter difficulty regarding organizational change is in increasing the staffing levels and compensation for NBG staff engaged in banking supervision, to reflect the increasing size and complexity of their workload and to slow the outflow of trained staff to the commercial banks.

¹² A key product of an on-site bank exam is a supervisory rating of the bank's overall condition, commonly referred to as a CAMEL rating. The acronym "CAMEL" refers to the five components of a bank's condition that are assessed: *Capital adequacy, Asset quality, Management, Earnings, and Liquidity*. Ratings from 1 to 5 are assigned for each component in addition to the overall rating of a bank's financial condition. Banks with ratings of 1 or 2 are considered to present few, if any, supervisory concerns, while banks with ratings of 3, 4, or 5 present moderate to extreme degrees of supervisory concern.

62. Outreach and cooperation efforts have advanced. The NBG has improved contacts with bankers and draft regulations are now submitted for comment to the Bankers' Association. The NBG is negotiating MOUs of cooperation with supervisors in Azerbaijan, Greece, and Turkey, whose banks operate in Georgia. Cooperation with other domestic financial supervisors has not yet been formalized.

63. Going forward, the NBG plans to develop further the credibility and predictability of banking supervision and encourage further sector consolidation, by increasing banks' required minimum capital to the equivalent of €5 million, in line with EU standards. Once this process is completed in the next 2-3 years, the NBG plans to move ahead with the introduction of a deposit insurance scheme, the modalities of which are now being discussed between the NBG and the Georgian Bankers' Association. BSD staff view this as a key step for reducing macroeconomic vulnerabilities that could stem from problems emanating from the banking sector.

H. Non-Bank Financial Institutions

64. Credit unions are the largest non-bank deposit-taking institutions in Georgia. Regulatory provisions allowing the creation of credit unions were approved in the context of the 2002 law "On non-bank deposit-taking institutions." Since the adoption of this law, the NBG has licensed (and currently supervises) 42 credit unions, with total assets equivalent to GEL 1 million. There are no investment banks or leasing companies operating in Georgia.

I. Agenda for Financial Development and Reform

65. As the discussion above indicates, the authorities have made significant progress toward putting the country's banking system on sounder footing, including through implementation of most recommendations of the 2001 FSAP, although additional effort will be needed to implement the few recommendations that remain outstanding. These include securing authority for setting conditions on the choice of banks' external auditors, and increasing staffing levels and compensation for NBG staff engaged in banking supervision.

66. Key challenges that Georgia's banking supervisors will face going forward include:

- Adapting supervision to changing conditions brought on by further consolidation of the banking system, particularly with respect to increase in size (and systemic importance) of individual banks.
- Facilitating the development of deeper, broader capital markets to increase diversity of opportunities for financial intermediation and to increase diversity and competition in the sector.
- Maintaining their current conservative approach to supervision in order to compensate for likely continued macroeconomic uncertainties.

IV. GEORGIA: SUMMARY OF THE TAX STRUCTURE AS OF JULY 31, 2003¹³

Nature of Tax	Rates	Special Rules, Exemptions, Allowances and Deductions
A. Personal Income Tax		
<p>Payers of the income tax are residents and non-resident physical persons. Residents pay taxes on worldwide income, non-residents on income from domestic sources. The definition of income includes monetary and in-kind compensation from employment and non-employment sources.</p>	<p>Up to GEL 200 = 12 percent.</p> <p>GEL 201 to 350 = GEL 24 + 15 percent of the amount in excess of GEL 200.</p> <p>GEL 351 to 600 = GEL 46.5 + 17 percent of the amount in excess of GEL 350.</p> <p>Over GEL 600 = GEL 89 + 20 percent of the amount in excess of GEL 600.</p>	<p>Exemptions:</p> <p>a) income of a non-resident employee of diplomatic or equalized organizations; b) gifts and inheritances; c) grants, state stipends, and state benefits; d) alimony; e) one-time payments and material assistance provided from the budget, as well as assistance provided from the budget during a natural calamity; f) self-produced farm production produced in a private enterprise before its industrial processing; g) surplus received by a physical person from the sale of tangible assets, with the exception of surplus received from the sale of assets used for entrepreneurial activity; h) monetary compensation of the cost of clothes of special form for employees of budget-funded organizations; i) amount to be paid to physical person (donor) for food in compensation for his blood; j) necessary means for labor protection given to employed physical persons as well as food and aerated salted water within the norm stipulated for workers working under harmful conditions and in foundries; k) monetary and other types of bonuses received from the budget for winners of Olympic Games, world and European championships and their coaches; l) excess received from the sale of T-bills; m) the part of salary and/or 30 percent of income from economic activity, but not more than GEL 1,200 annually, that is used for non-state pension and voluntary medical insurance implementation. In case of taking back this amount earlier than the period of purpose this amount is taxed at the source according to active legislation.</p>
<p>15 percent of tax proceeds go to the central government and 85 percent to the territorial units where the tax was collected with the exception of Adjara and Abkhazia which are entitled to 99 percent of the revenue.</p>	<p>The presumptive tax varies from GEL 10 to GEL 150 monthly based on the type of activity and the size of the population where the enterprise is located.</p>	
<p>Tax on gross wage income is collected at the source of payment through withholding from wage, salary, dividend and interest income.</p>		
<p>Resident physical persons who receive income from entrepreneurial activities make current tax payments three times per year with an annual adjustment by April 1 of the following year.</p>		
<p>Small enterprises with turnover up to GEL 24,000 pay presumptive tax instead of income tax.</p>		<p>Income up to GEL 3,000 in a year from the following physical persons is not subject to taxation:</p> <p>a) invalids from childhood and invalids in blindness; b) participants in World War II and military operations for the integrity of Georgia; c) recipients of the honorary title of "Mother of Georgia;" d) single mothers; e) persons who adopted a child, within one year from adoption; f) persons, who adopted a child for upbringing; g) inhabitants of mountainous regions with three or more children and income of less than GEL 3,000, for those with one or two children the tax is reduced by 50 percent.</p>

¹³ Prepared by Alejandro Hajdenberg.

Nature of Tax	Rates	Special Rules, Exemptions, Allowances and Deductions
B. Profits Tax		
<p>Payers of the tax on profits are Georgian and foreign enterprises, the latter with respect to its gross income from Georgian sources.</p>	20 percent on profits.	<p>Exemptions: a) sale by the Patriarchy of Georgia of objects used for religious purposes; b) budget-funded and charitable organizations except for profit from economic activity; c) grants, membership fees and donations received by an organization; d) profile activities of prosthetic and orthopedic enterprises; e) production of technical means for disabled people; f) international organizations, except for economic activity; g) the National Bank of Georgia; h) navigation enterprises established by non-residents of Georgia sailing under the Georgian flag; i) generation and realization of renewable energy sources, consumer appliances and energy saving equipment; j) part of the profit of the enterprises located in mountainous regions from activities carried out in that territory; k) sale of treasury obligations; l) profits of hotels under certain conditions.</p>
<p>Profits are defined as gross income minus all authorized deductions specified in the tax code.</p>	10 percent on dividends.	
<p>Losses can be carried forward for a period of up to five years.</p>	10 percent on interest.	
<p>15 percent of tax proceeds go to the central government and 85 percent to the territorial units where the tax was collected with the exception of Adjara and Abkhazia which are entitled to 99 percent of the revenue.</p>		
<p>Current tax payments are made three times per year with an annual adjustment by April 1 of the following year.</p>		<p>Deductions: a) outlays connected with the receipt of income; b) doubtful debts; c) allocations to reserve funds; d) expenditures on scientific research, project design and experimental work design; e) depreciation charges and repair of fixed assets; f) expenses on insurance payments; g) expenditures on geological surveying and work to prepare for the extraction of natural resources; h) expenditures on intangible assets.</p>
C. Value-Added Tax		
<p>The credit-invoice method is applied to goods and services within the country as well as imports.</p>	20 percent flat.	<p>Exemptions: The tax code lists multiple goods and services exempted from VAT under 32 different categories. The main categories include: a) financial services; b) supply of national or foreign currency and securities; c) imports of gold to be transferred to the NBG; d) supply of state property under privatization procedure; e) rent for an apartment; f) immovable property except newly constructed residential buildings; g) medical services under state health care programs; h) services to sick, disabled and elderly people; i) some pharmaceutical raw materials and substitutes with foreign economic activity; j) scientific literature, school books, children's literature; k) newspapers, magazines and literature; l) provision of educational services; m) urban and inter-urban public transportation; n) imports of inputs for production of export goods; o) goods intended for re-export; p) imports of material for oil and gas industry. Exemptions for imports are applied only when conditions are met for exemption of customs duties.</p>
<p>VAT registration is mandatory if the value of a taxpayer's transactions in a continuous period of up to 12 months exceeds GEL 24,000. For all others registration is voluntary.</p>		
<p>Taxpayers with at least 25 percent of taxable turnover taxed at zero rate are entitled to a tax refund within 15 days of receipt of a refund application. For other taxpayers the tax credit is carried forward to the following period.</p>		
<p>100 percent of the revenues are kept by the central government, however in Adjara, the regional government is entitled to 40 and 30 percent of the revenues collected by the customs and tax departments respectively.</p>		

Nature of Tax	Rates	Special Rules, Exemptions, Allowances and Deductions
<p>Taxpayers are all physical and legal persons producing excisable goods on the territory of Georgia or importing excisable goods.</p> <p>Excisable goods are: alcoholic beverages; fuels and lubricants; tobacco products; passenger automobiles and tires; salmon and sturgeon caviar and other valuable fish and seafood products.</p> <p>100 percent of the revenue is kept by the central government, however, the regional government of Adjara is entitled to 40 percent of the revenue collected.</p>	<p>Alcoholic beverages and tobacco products are taxed at various specific rates.</p> <p>15 percent on passenger automobiles and tires.</p> <p>20 percent on salmon and sturgeon caviar and other valuable fish and seafood products.</p> <p>60 percent on oil and derivatives.</p> <p>60 percent on condensed natural gas, except pipeline.</p> <p>80 percent on light, medium and heavy distillates of oil.</p> <p>60 percent on oil gas and gas-like hydrocarbons.</p> <p>60 percent on other products produced from crude oil and bituminous minerals.</p> <p>GEL 400 per ton. of liquid products of pyrolysis.</p>	<p>Zero rated:</p> <p>a) exports; b) services related to international air transportation, aviation lubricants and other supplies to international air transportation; c) supply of capital assets; d) gold transferred to the NBG.</p>
<p>D. Excise Taxes</p>		
<p>Levied on imported goods crossing the customs frontier of Georgia.</p> <p>100 percent of the revenue is kept by the central government, however the regional government of Adjara is entitled to 50 percent of duties collected in its jurisdiction.</p>	<p>There are 22 rates ranging from 0 to 30 percent. Approximately one-third of the goods pay a 12 percent tariff and most other goods pay less than that. Six percent of the goods have a zero rate.</p>	<p>The law on customs tariffs presents multiple exemptions and goods taxed at zero rate. The main ones are:</p> <p>Exemptions:</p> <p>a) goods financed by foreign grants or preferential credits; b) goods for use of foreign diplomatic or similar representatives; c) temporary imports; d) raw materials and semi-finished goods to manufacture exports; e) aviation fuel, lubricants, and other goods for air transportation.</p> <p>Goods taxed at zero rate:</p> <p>a) wheat; baby food, and diabetic foodstuffs; b) certain pharmaceutical products; c) malt; d) heavy, medium, and light oil distillates.</p>
<p>E. Customs Duties</p>		

Nature of Tax	Rates	Special Rules, Exemptions, Allowances and Deductions
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F. Tobacco Products Taxation

Levied on imports and local production of tobacco products.

Instead of customs duties, VAT and excise tax, these products are subject to a fixed tax.

There are different specific taxes for smoking tobacco, cigars, cigarillos and cigarettes with filter, and for cigarettes without filter. Imported cigarettes, with and without filter, are subject to higher rates than their domestic equivalents.

G. Payroll Taxes

Levied on wages and salaries.

Consist of contributions to the United Social Insurance Fund. The fund manages the proceeds of the tax to provide pensions, health services, and unemployment insurance.

Employees: 2 percent.

Employers: 31 percent.

Exemptions:

- a) amounts paid to persons confined to correctional institutions;
- b) payments for temporary inability to work paid by the social insurance fund;
- c) amounts paid out of resources financed by grants;
- d) persons working at diplomatic and consular establishments who are not citizens of Georgia;
- e) income of non-residents of Georgia if residing in Georgia for less than 90 days during the tax year paid out by a non-resident of Georgia or hired for oil and gas works.

H. Property Taxes of Physical Persons

Paid by physical persons on immovable property located on the urban territory of Georgia as well as immovable property used for economic activity located on non-urban territory, except for land.

0.1 percent of the inventory value of the building or structure.

Exemptions:

- a) property of persons disabled from childhood, and of certain disabled persons;
- b) property located in mountainous regions.

I. Property Taxes of Enterprises

Paid by domestic and foreign companies and by non-profit organizations whose property or part of whose property is used for economic activities. The tax is levied on fixed assets, uninstalled equipment, incomplete capital investment and intangible assets that are listed on the balance sheet.

1 percent on the balance sheet residual value of the assets calculated according to average value of the assets in the beginning and at the end of the calendar year.

Exemptions:

- a) property used for environmental and fire protection;
- b) land;
- c) motor roads, communications and electronic transmission wires;
- d) standardizing and test bench equipment of the territorial agencies of the State Department of Standardization, Metrology and Certification of Georgia;
- e) property that has been mothballed;
- f) property of non-profit organizations, except the property used for economic activities;
- g) vessels sailing under the flag of Georgia;
- h) property needed for oil and gas industry;
- i) property of enterprises located in mountain regions;
- j) property of hotels under certain conditions.

Nature of Tax	Rates	Special Rules, Exemptions, Allowances and Deductions
J. Land Tax		
Paid by physical and legal persons who own or use agricultural and non-agricultural land.	Base rates for agricultural land tax differ by region, usage of the land, and land quality and are established in GEL per hectare. The rate on non-agricultural land is GEL 0.24 per square meter per year.	Exemptions: a) portion of state-owned land allocated to budget organizations; b) land plots allocated to scientific research and educational institutions; c) plots allocated to organizations for the disabled, veterans of war funded from the budget; d) orphanages, boarding schools, children villages that are free of charge; e) organizations for the protection of historical and native monuments if not for profit; f) natural parks, botanical gardens, public gardens, cemeteries, zoological gardens and parks, etc; g) city reservoirs and their water areas, lands used for transport and underground communications; h) hydrometeorological centers and centers to monitor pollution; i) reservoirs for operations of electrical stations and irrigation/drainage systems; j) state-owned and unused pastures and meadows; k) land with damaged topsoil because of natural phenomena; l) land for recultivation proposed for the first five years following reallocation of ownership; m) airports, airfields and navigation security zones; n) hunting farms; o) land used for renewable energy generation; p) land used to carry out oil and gas transactions; q) land of medical institutions that are not used for non-medical activities; r) other exemptions by regional and personal characteristics.

V. GEORGIA—EXTERNAL DEBT SUSTAINABILITY ANALYSIS¹⁴

A. Introduction and Summary

67. The debt sustainability analysis (DSA) presented in this paper uses work underway by FAD and PDR on a framework for assessing sustainability in low-income countries (LICs). This is an adaptation of the existing Fund framework for assessing sustainability (intended primarily for emerging-market economies) to LICs, which incorporates specific LIC features relevant for medium-term sustainability analysis.¹⁵

68. **The DSA includes two components—a detailed medium-term baseline scenario setting out assumptions on economic policies and key parameters, and a set of stress tests around the baseline,** which are intended to explore the robustness of baseline projections to alternative assumptions on key parameters and macroeconomic performance. The stress tests are based on Georgia’s recent historical performance. This DSA is complemented by a simulation of a hypothetical Naples-terms restructuring of Georgia’s bilateral debt in the context of the Paris Club.

69. Reflecting data availability, **the DSA covers only public and publicly-guaranteed external debt** and excludes private sector debt and contingent liabilities, including those from the energy sector.¹⁶ The stress tests consider the impact on medium-term debt sustainability of a hypothetical government takeover of sizable contingent liabilities; the experiment is a standardized one and not tailored to the potential size of external contingent liabilities in Georgia.

70. **The baseline scenario shows a steady improvement in debt indicators, but a lingering burden of Georgia’s external obligations on its public finances.** Significantly improving debt indicators would require Georgia to abstain from borrowing on commercial terms and to continue shifting toward concessional financing, while substantially strengthening its fiscal position. The stress tests suggest that external debt indicators could deteriorate considerably under adverse external or domestic developments (e.g., lower export

¹⁴ Prepared by Lisandro Abrego.

¹⁵ See *Assessing Sustainability* (SM/02/166) and *Sustainability Assessments—Review of Application and Mythological Refinements* (SM/03/206).

¹⁶ Energy sector debts are likely to account for the majority of excluded contingent liabilities. Debts stemming from energy supplied by Azerbaijan, Russia, Turkey, Anglo Oil and Itera as listed in Table II-2 of this selected issues paper, for a total of US\$185.4 million (5.5 percent of GDP), are not covered by an explicit government guarantee and hence are not included in this debt sustainability analysis. This number should be viewed as a lowerbound estimate for contingent external liabilities.

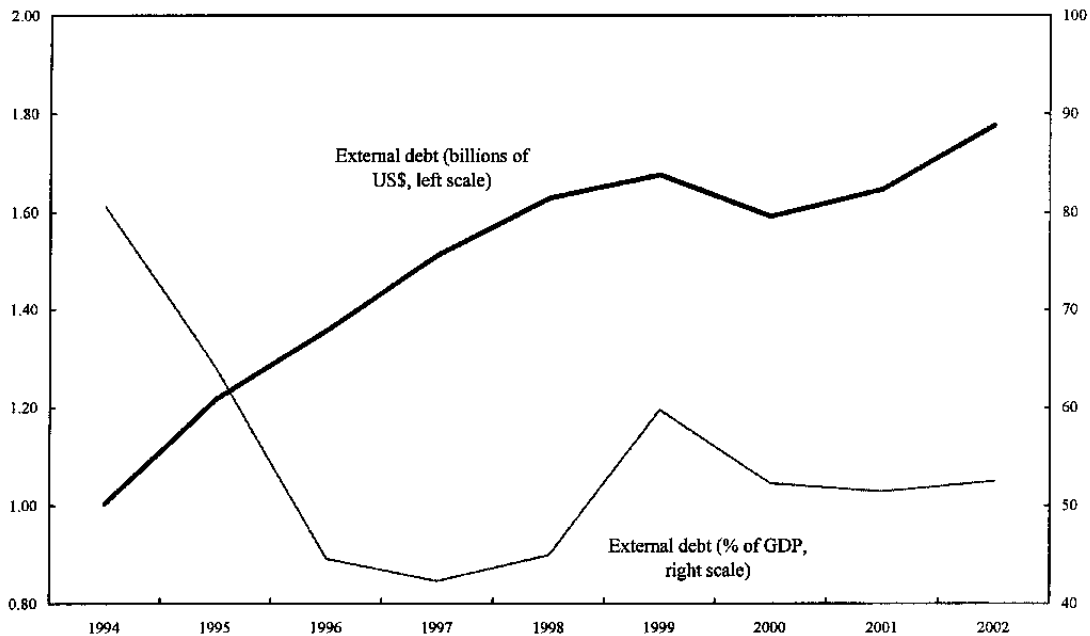
growth or substantial currency depreciation). A concessional restructuring of Georgia's bilateral debt would significantly improve the debt indicators and enhance sustainability prospects.

71. The paper is organized as follows. The next section provides some background on Georgia's external debt and its evolution since independence. Section C discusses the baseline DSA and its underlying assumptions. Sections D and E discuss sensitivity analysis around the baseline and simulations results from a debt restructuring on Naples terms. The last section presents a summary and conclusions.

B. Background on Georgia's External Public Debt

72. **The bulk of Georgia's external debt was accumulated after independence, with very rapid growth during the early 1990s.** By 1994, following a civil war and economic collapse, nominal public debt had climbed to US\$1 billion, or 81 percent of GDP (Figure V-1), much of it stemming from energy sector borrowing because of the massive dislocations in the sector. In the context of macroeconomic adjustment and more limited borrowing, the pace of indebtedness slowed during the second half of the 1990s, although the debt continued to grow in absolute terms. By 1999, the debt stock had risen to US\$1.7 billion, but the ratio to GDP had declined to 60 percent, following strong output growth in the second half of the decade. With little net borrowing, debt accumulation has further slowed in recent years, to a stock of US\$1.8 billion at end-2002 (because of the large 1999 depreciation of the lari following the Russian crisis, the ratio to GDP declined only to 53 percent despite relatively strong economic growth).

Figure V-1. External Public and Publicly Guaranteed Debt
(In U.S. Dollars and in percent of GDP, 1994-2002)



Sources: Georgian authorities; and Fund staff estimates.

73. **The creditor composition of Georgia’s external public debt has also changed significantly since the early years of independence, as financing from IFIs increased substantially in the mid-1990s.** The share of bilateral creditors in the total debt stock declined from 81 percent at end-1994 to 50 percent at end-1998 and 47 percent at end-2002 (Figure V-2). As noted earlier, a significant part of this debt is related to suppliers’ credits from BRO countries (especially Russia and Turkmenistan) contracted mostly during the early 1990s to finance energy-related imports. BRO countries accounted for 65 percent of total claims in 1994, but their share had come down to 38 percent by 1998 and 31 percent by 2002. Claims by Paris Club creditors, excluding Russia, have been relatively low (around 10 percent) and have increased only slightly since 1994. In turn, the share of IMF and World Bank claims has risen steadily since 1994, reaching 37 percent in 1998 and 45 percent in 2002.

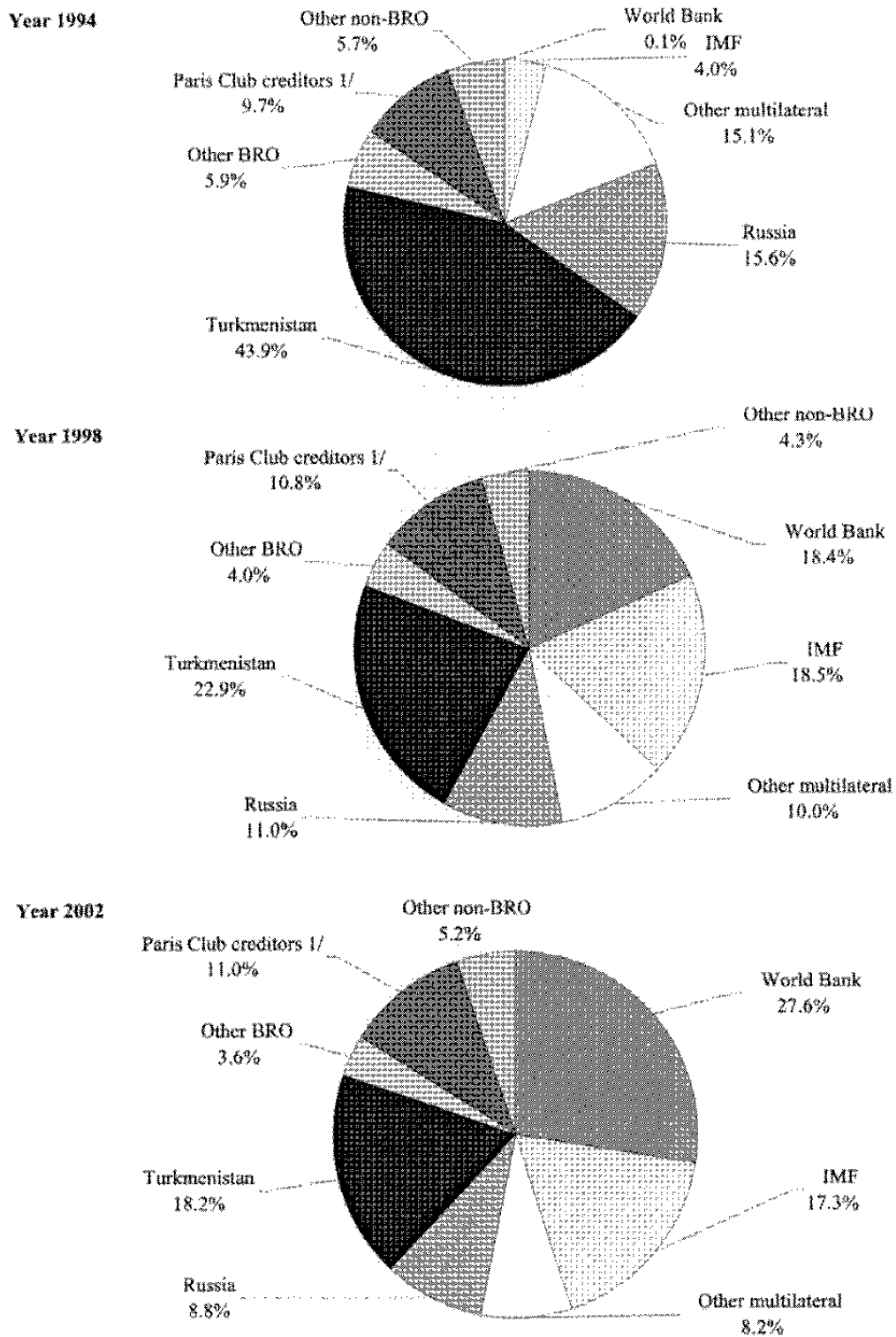
74. **The rapid debt accumulation and the economic collapse of the early 1990s resulted in a heavy debt burden, which Georgia has sought to ease through a series of reschedulings.** During 1995-98, Georgia’s bilateral debt was rescheduled through 11 independent country-specific deals. However, Georgia soon began to accumulate arrears on some of the rescheduled debt. In 2001, the Paris Club granted a flow rescheduling of principal obligations on “enhanced Houston terms.”¹⁷ These reschedulings have provided substantial cash-flow relief, but—to the extent that they have been mainly non-concessional—have implied little relief in NPV terms, a fact reflected in the relatively low level of concessionality of Georgia’s debt (the overall grant element was 17 percent in 2002).

75. **With low concessionality and a relatively short maturity structure, and against the backdrop of low government revenues, Georgia’s external debt has remained burdensome.** The NPV of debt and scheduled debt service relative to exports are above the average for other non-HIPC low-income countries.¹⁸ By contrast, indicators in relation to central government revenue are much less favorable. At end-2002, the ratio of NPV of debt to government revenue was 500 percent, while scheduled debt service payments amounted to 51 percent of revenue. This reflects partly the fact that, at less than 10 percent of GDP, central government revenue collections in Georgia are among the lowest in low-income countries.

¹⁷ Under the Paris Club agreement, ODA debt was rescheduled over 20 years, with 10-year grace; non-ODA loans were rescheduled also over 20 years, but with a 3-year grace period.

¹⁸ Georgia’s ratios of NPV of debt and debt service to exports were, respectively, 148 percent and 23 percent in 2002 (Table V-1). The corresponding ratios for non-HIPC low-income countries were 143 percent and 15 percent (see IDA and IMF (2003), *Heavily Indebted Poor Countries—Status of Implementation*, SM/03/294).

Figure V-2. Georgia: Structure of External Public and Publicly-Guaranteed Debt



Source: Georgian authorities; and Fund staff estimates.

1/ Excludes Russia.

C. Baseline Medium-Term Scenario

76. **The baseline scenario is predicated on continued implementation of economic reforms.** It assumes an annual average real GDP growth rate of 4 percent during 2003-08 and 3.5 percent thereafter. The current account deficit—excluding pipeline construction-related imports—would decline progressively, with exports and imports assumed to grow at an annual average of about 7 percent over 2003-08 and at about 5 percent thereafter. The relatively strong export performance during 2003-08 reflects rapid GDP growth by main trading partners, rising commodity prices and strong growth in transport services (10 percent on average during 2003-08), following the expected completion of the oil and gas pipelines. Import growth reflects the temporary import increase associated with the construction of the pipelines (an income elasticity of 1.5 is used for other imports). The real exchange rate is assumed to remain constant at its end-May 2003 level. The ratio of central government revenue to GDP is assumed to grow, on average, 0.6 percentage points per annum.

77. **On the financing side, new borrowing is assumed to be modest and mostly on concessional terms,** with new lending from multilateral creditors less than in the 1990s. The baseline assumes that borrowing from bilateral sources would be slightly above current levels, and be all on highly concessional terms. Grants are assumed to increase over time, especially from 2005 onward, reflecting the expected faster pace of reform implementation. The baseline scenario also assumes (for illustrative purposes) that Georgia will eventually be able to reschedule principal bilateral maturities falling due in 2003 on terms similar to the 2001 Paris Club agreement. Financing gaps are assumed to be filled through a combination of grants and concessional loans.

78. **The baseline scenario features a steady improvement in debt indicators** (Table V-1). The ratio of NPV of debt to exports is projected to fall to 123 percent by 2005 and then to stabilize at 80 percent by 2015. This declining trend is supported by low net new borrowing and relatively strong export performance. Under the baseline, the debt service ratio would be reduced to 15 percent by 2005, 10 percent by 2008, and under 7 percent in the outer years.

79. **Debt indicators relative to government revenue also show a steady improvement, but would remain high throughout most of the projection period** (Table V-2). The NPV of debt to revenue ratio would fall below 250 percent by 2008, and under 200 percent by 2010. The associated debt service ratio would be 24 percent in 2008, declining to 12 percent by 2015. These projections reflect a relatively slow improvement in central government revenue, from a very low base, to 16 percent by 2015.

Table V-1. Georgia: External Debt Indicators Relative to Exports 1/
(In percent)

	2002	2003	2004	2005	2006	2007	2008	2010	2012	2015
	Actual				Projections					
NPV of debt to exports ratio 2/										
Baseline	148	145	133	123	114	106	100	89	85	82
Stress tests 3/										
1. Export growth and non-interest current account (NICA) at historical averages	118	97	81	87	93	80	72	67
2. Export growth at historical average minus two standard deviations in 2004-05	148	167	195	203	193	171	164	158
3. NICA at historical average minus two standard deviations in 2004-045	137	132	121	111	104	88	85	82
4. Export growth and NICA at historical averages minus one standard deviation in 2004-05	125	115	108	127	142	127	113	106
5. Net official transfers at historical average minus two standard deviations in 2004-05	143	131	120	110	103	89	85	82
6. 10 percent of GDP increase in other debt-creating flows in 2004	173	155	138	123	110	91	86	82
Debt service to exports ratio 4/										
Baseline	23.4	15.6	15.7	15.3	13.2	11.6	9.9	10.1	6.6	6.4
Stress tests 3/										
1. Export growth and non-interest current account (NICA) at historical averages	15.0	11.3	7.0	4.0	5.1	9.4	8.6	5.5
2. Export growth at historical average minus two standard deviations in 2004-05	21.7	29.5	25.4	22.3	19.1	19.3	12.6	12.3
3. NICA at historical average minus two standard deviations in 2004-045	15.7	16.3	15.4	13.6	11.8	10.7	6.4	6.4
4. Export growth and NICA at historical averages minus one standard deviation in 2004-05	17.7	15.9	10.2	6.1	8.1	14.9	13.7	8.7
5. Net official transfers at historical average minus two standard deviations in 2004-05	15.7	17.6	15.4	13.6	11.8	10.4	6.7	6.4
6. 10 percent of GDP increase in other debt-creating flows in 2004	15.7	24.2	21.6	19.5	17.3	11.3	7.1	6.5

Source: Country authorities and staff estimates, projections and simulations.

1/ Includes public and publicly guaranteed debt only.

2/ Based on three-year backward-looking average of exports of goods and services.

3/ Historical averages are for period 1996-2002.

4/ Based on current-year exports of goods and services.

Table V-2. Georgia: External Debt Indicators Relative to Government Revenue 1/
(In percent)

	2002	2003	2004	2005	2006	2007	2008	2010	2012	2015
	Actual				Projections					
NPV of debt to revenue ratio 2/										
Baseline	501	404	354	323	283	253	231	190	168	146
Stress tests 3/										
1. Real GDP growth at historical average	347	316	276	244	221	177	154	129
2. Real GDP growth at historical average minus two standard deviations in 2004-05	374	366	321	287	262	215	191	165
3. 30 percent real depreciation in 2004	467	427	375	336	309	258	230	199
4. Net official transfers at historical average minus two standard deviations in 2004-05	380	344	298	263	237	191	168	146
5. 10 percent of GDP increase in other debt-creating flows in 2004	459	407	343	293	254	194	169	146
Debt service to revenue ratio 2/										
Baseline	77.2	46.2	44.7	42.8	35.3	29.6	24.4	22.6	13.8	12.0
Stress tests 3/										
1. GDP growth at historical average	43.7	41.7	34.5	29.3	24.1	22.0	13.6	12.2
2. Real GDP growth at historical average minus two standard deviations in 2004-05	47.3	48.4	40.0	33.6	27.7	25.7	15.6	13.6
3. 30 percent real depreciation in 2004	60.0	55.5	45.6	38.3	31.4	32.8	21.0	18.8
4. Net official transfers at historical average minus two standard deviations in 2004-05	44.7	49.0	40.9	34.7	29.0	23.4	14.1	12.0
5. 10 percent of GDP increase in other debt-creating flows in 2004	44.7	67.5	57.7	49.8	42.4	25.5	14.9	12.1

Source: Country authorities and staff estimates, projections and simulations.

1/ Includes public and publicly guaranteed debt only.

2/ Historical averages are for period 1996-2002.

3/ Central government revenue excluding grants (includes Road Fund).

Box V-1. Georgia: Has the Debt Problem Deepened?

Debt sustainability analyses were performed for five low-income CIS countries in advance of the February 2002 CIS-7 conference in London.^{1/} Compared to the results of the February 2002 analysis, the present study shows a substantial increase in the ratio of the NPV of Georgia's external debt to exports and to government revenue.

Under the February 2002 scenario with debt rescheduling on Houston terms (based on the 2001 Paris Club agreement and treating 2003 and 2004 maturities on Houston terms), the ratio of the NPV of debt to exports was projected to decline from 97 in 2002 to 76 in 2008, and the ratio of the NPV of debt to central government revenue to decline from 295 to 201 over the same period. This compares favorably to the ratios reported in the baseline scenario in this study (Tables V-I and V-II).

Three main factors account for this deterioration in Georgia's debt ratios. First, the use of lower discount rates in the current study reduces the concessionality of Georgia's external debt and increases the NPVs. Second, the recent depreciation of the US dollar against major currencies raises Georgia's external debt expressed in U.S. dollars significantly, as a substantial fraction of Georgia's external debt is denominated in Euros or SDRs. Third, the present study uses a lower base for export projections than the London paper, as 2002 exports were lower than originally projected.^{2/} The increase in the debt ratios cannot be attributed to additional borrowing, as Georgia has not contracted much additional external debt in the past 18 months. Projected growth rates of exports and government revenue are broadly comparable in the two studies.

1/ See IMF and World Bank, *Poverty Reduction, Growth and Debt Sustainability in Low-Income CIS countries*, February 2002. Available on the CIS-7 initiative's website: www.cis-7.org.

2/ Also, in the 2002 study all extrabudgetary funds were included in central government revenue, whereas the present study only includes the Road Fund.

D. Stress Tests

80. This section tries to gauge the robustness or ambitiousness of baseline projections by applying a set of sensitivity tests. **The tests assume that key macroeconomic variables (e.g., export growth, current account balance, official grants) are at their recent historical averages, or below them by a factor reflecting their historical volatility.** Historical averages are computed for the last seven years (1996-2002) and volatility is measured through standard deviations. The alternative scenarios—listed in Tables V-1 and V-2—assume that financing needs over and above those projected in the baseline are met through borrowing on commercial terms (five years maturity, including one year grace, and market interest rates). This assumption affects the path of the various indicators, with NPV ratios declining relatively quickly over time and debt service ratios rising rapidly following the shocks.

81. **The stress tests show that the medium-term debt dynamics can be highly sensitive to some alternative assumptions.** Under more sluggish export growth or an exogenous increase in debt (e.g., through the assumption of significant non-guaranteed liabilities by the government), the ratio of the NPV of debt to exports would increase by up to

40 percentage points, climbing to almost 173 percent under the latter scenario in 2004 (Table V-1). The ratio of debt service to exports would go up by 10-15 percentage points relative to the baseline, reaching 24-30 percent in 2005. Changes of this magnitude could put the balance of payments under severe stress, especially given Georgia's weak international reserve position.¹⁹

82. **Indicators relative to government revenue would also deteriorate sharply under certain scenarios** (Table V-2). For example, under a hypothetical 30 percent real depreciation in 2004, the NPV ratio would jump to 467 percent and would remain above 300 percent through 2008; the associated debt service ratio would increase to 60 percent and then decline to under 40 percent by 2007. An "exogenous" increase in debt would have a similar impact on debt indicators (stress test 5 in Table V-2).

83. Some of the stress tests involving the external current account and real GDP growth look more favorable than under the baseline (stress tests 1 and 3 in Table V-1, and stress test 1 in Table V-2). This is because performance in terms of these variables during the period over which historical averages are computed (1996-02) was stronger than assumed under the baseline for the years the stress tests are carried out.

E. Restructuring of Bilateral Debt

84. This section simulates a restructuring of Georgia's bilateral debt in the context of the Paris Club. **The simulation assumes a hypothetical stock operation on Naples terms comprising all eligible bilateral debt.** This implies that two-thirds of non-ODA debt is forgiven and the remaining third is rescheduled over 23 years, with 6 years of grace. ODA debt is rescheduled over 40 years, with 16 years of grace, implying a reduction in NPV terms of about two-thirds. The restructuring is assumed to be based on the stock of debt at end-2003.

85. **A restructuring on Naples terms would have a significant impact on the various debt indicators,** reflecting a high share (43 percent at end-2003) of bilateral obligations in total debt, and the eligibility for restructuring of almost all bilateral debt. Under the scenario, the ratios of NPV of debt to exports and revenue would decline to 98 percent and 275 percent (in the base year), respectively (Table V-3).²⁰ The corresponding debt service ratios would

¹⁹ Gross international reserves excluding pipeline-related imports are projected at the equivalent of 1.3 months of imports at end-2003, and to increase to 2 months of imports by 2008. Even under this modest improvement, financing gaps would emerge in the balance of payments throughout the projection period.

²⁰ The NPV of debt to revenue ratio after Naples terms would be above the HIPC Initiative threshold (250 percent), but the ratio of government revenue to GDP (of less than 10 percent) would be below the threshold for eligibility under the fiscal criterion (15 percent).

decrease by an average of 5 and 20 percentage points over the period 2004-06 compared to the baseline. The ratio of debt service to exports would reach single digits by 2004, while the debt service/revenue ratio would fall to under 25 percent by the same year, below 20 percent by 2006, and to 10 percent by 2015. The path and level of the debt service ratios suggest that Georgia's external debt would become manageable with a stock operation on Naples terms.

86. Note that if the hypothetical stock operation took place later (say, in 2006-07) but was preceded by a flow rescheduling on Naples terms starting in 2004, the picture described above would remain largely unaltered. The debt service ratios would change little as the portion of debt service not being cancelled would be rescheduled on the terms described in paragraph 84. The NPV ratios would, of course, be higher during the period of the flow rescheduling (2004-06), but would subsequently converge to those presented in Table V-3, following the stock operation.

F. Summary and Conclusions

87. **Under relatively strong growth performance and low new borrowing, Georgia's debt indicators are projected to improve steadily over the medium term, but the country's external obligations are likely to remain fiscally burdensome.** Debt indicators in general could deteriorate sharply under external or domestic developments that result in sluggish export growth or a substantial currency depreciation.

88. A concessional restructuring of Georgia's bilateral debt would produce a substantial improvement in debt indicators and would enhance medium-term sustainability prospects. However, embarking on a sustainability path would crucially require that Georgia (a) abstains from borrowing on commercial terms and continues to shift its financing mix toward more concessional sources (including grants); (b) considerably increases tax revenue collections; and (c) implements the reforms required to achieve and maintain solid export and GDP growth.

Table V-3. Georgia: External Debt Indicators After Naples Terms Rescheduling 1/
(In percent)

	Projections								
	2003	2004	2005	2006	2007	2008	2010	2012	2015
NPV of debt to exports ratio 2/	98	95	94	91	89	87	83	83	82
Debt service to exports ratio 3/	15.6	8.0	8.1	7.4	6.6	6.1	6.5	5.3	5.4
NPV of debt to revenue ratio 4/	275	253	246	226	212	201	187	176	169
Debt service to revenue ratio 4/	46.5	22.8	22.5	19.8	16.9	15.0	14.7	11.1	10.0

Source: Country authorities and staff estimates, projections and simulations.

1/ Includes public and publicly-guaranteed debt only.

2/ Based on three-year backward-looking average of exports of goods and services.

3/ Based on current-year exports of goods and services.

4/ Central government revenue excluding grants (includes Road Fund).

VI. FISCAL TECHNICAL ASSISTANCE²¹

89. Since independence in 1991, Georgia has received a substantial amount of technical assistance from the international donor community covering a broad range of areas. Progress in implementing recommendations on fiscal issues, however, has been slow. The following presents an overview of the fiscal TA received by Georgia in different areas, the progress accomplished, and further reforms needed to improve fiscal policy and administration.

Area	TA provider	Accomplishments	Needed Reforms
Treasury	IMF, U.S. Treasury	A central treasury and regional branches were created and computerized, treasury accounts and chart of accounts were developed, the coverage of treasury was broadened, and a basic fiscal information system was developed.	Implementation of the Single Treasury Account and of proper commitment controls are ongoing. Further assistance is needed in the areas of financial planning and cash management, introduction of international accounting standards, streamlining of tax refunds, revenue arrears reporting system, internal and external audit, and accounting and reporting.
Budgetary process	IMF, World Bank, U.S. Treasury	A new budget systems law (BSL) was adopted.	Budget classification, medium-term and strategic framework for budget preparation and elevation of BSL to organic law status.
Tax administration	IMF, World Bank, USAID	Inclusion in the tax code of a special section on tax administration, modernization of registration, return filing, and payment processes. Increase of registered taxpayers, issuance of tax identification numbers, establishment of a large taxpayers unit, improved quality of taxpayer services, increased degree of computerization, classification of the stock of tax arrears, introduction of powers to enforce collection through seizure of property. Broadening the mandate of the Ministry of Finance to include strengthened investigative powers.	Addressing corruption problems. Establishment of tax enforcement competencies. Improvement of management and technical skills of staff (ongoing). Introduction of adequate salary structure. Adoption of performance monitoring systems. Introduction of effective self-assessment system. Improvement in tax audits to curb tax evasion. Streamlining of VAT refund process. Automatization of tax arrears registration.

²¹ Prepared by Alejandro Hajdenberg.

Area	TA provider	Accomplishments	Needed Reforms
Tax policy	IMF, World Bank, USAID, U.S. Treasury	Adoption of a modern tax code. Increase in revenue to GDP ratio. Consolidation of corporate income tax rates. Introduction of adequate VAT threshold, small business taxation and fixed taxation of independent workers.	Elimination of tax incentives, exemptions, and the practice of tax advance payments. Symmetric treatment of imported and domestic excisable goods.
Customs	IMF, World Bank, European Customs, U.S. Customs Service, UNCTAD	Development of customs clearance procedures, of an organizational structure and network of customs offices, and computer systems.	Introduction of inspections and clearance at entry points. Improvement of control of in-transit goods. Update of organizational structure, managerial practices (ongoing with EU support), and technology in use. Solution of corruption problems (eliminate scope for discretionary action). Completion of customs legislation and regulations and conform to the revised Kyoto Convention (ongoing with EU support). Strengthening of customs' enforcement capabilities. Improving control of exemptions.
Social protection	IMF, World Bank, DFID	Social protection programs have been found to be effective in alleviating poverty.	Restructuring of public pensions system to better link benefits and contributions. Broadening of coverage and reduction of evasion of contributions. Regular payment of benefits and elimination of arrears. Streamlining of administration. Internally-displaced persons (IDP) and poverty benefit programs need improved design, stricter eligibility requirements, better differentiation and a more efficient administration.
Intergovernmental relations	IMF, World Bank, USAID, DFID, UNDP	Adoption of a modern legislation setting expenditure responsibilities and assignment of revenues.	Improvement in the equity of the system by increasing the amount of transfers and reducing the amount of shared taxes. Shift of the responsibility of property and land tax collections to local governments. Setting an objective formula to allocate transfers to local governments.

Table A-1. Georgia: GDP by Origin, 1997–2003

	1997	1998	1999	2000	2001	2002	2003 Q1
	(In millions of lari)						
Nominal GDP	4,638.1	5,040.2	5,664.9	6,012.7	6,637.8	7,457.1	1,894.1
	(In percent of GDP)						
Share in GDP							
Agriculture, Forestry, Fishing	29.0	26.7	24.7	20.2	20.7	19.3	22.3
Industry	13.3	12.3	13.0	13.7	12.2	12.4	11.3
Processing products by household	4.9	4.7	4.5	3.7	4.5	4.3	3.6
Construction	3.5	4.6	3.7	3.7	3.9	4.7	4.5
Trade	10.9	10.4	11.5	12.7	13.1	12.9	13.8
Hotels and Restaurants	2.0	1.9	2.4	2.3	2.9	2.9	3.3
Transport and Communications	7.6	10.9	11.9	14.3	13.8	14.7	13.5
Financial Intermediation and Real Estate	9.9	9.7	9.1	8.5	8.3	8.2	9.1
General Administration and Defense	3.7	3.9	3.5	3.4	3.7	3.9	2.5
Education	2.7	2.8	3.2	3.6	3.6	3.8	3.7
Health	3.5	4.5	4.3	5.2	4.8	4.4	3.7
Other	9.1	7.6	8.2	8.7	8.7	8.4	8.6
	(In percent)						
Real growth over same period in previous year							
GDP	10.6	2.9	3.0	1.9	4.7	5.6	7.4
Agriculture, Forestry, Fishing	3.9	-6.6	6.9	-12.0	8.2	-1.4	-0.9
Industry	4.3	-1.8	3.7	5.3	-4.5	7.8	5.0
Processing products by household	1.5	-2.8	2.0	-2.0	2.6	0.9	5.0
Construction	51.5	35.2	-21.5	4.0	10.2	31.3	48.6
Trade	2.2	1.6	3.8	10.8	8.5	4.5	2.6
Hotels and Restaurants	29.0	6.4	9.4	7.9	31.8	7.2	13.4
Transport and Communications	29.0	48.8	5.7	12.8	1.5	10.0	13.1
Financial Intermediation and Real Estate	34.4	8.8	5.1	2.8	9.1	11.7	22.1
General Administration and Defense	10.3	9.2	-6.3	0.4	-3.7	1.2	0.8
Education	-1.5	-3.0	-9.5	8.2	3.5	1.5	6.4
Health	0.3	-1.0	3.6	3.0	0.3	1.6	-4.8
Other	-3.8	-9.3	10.5	2.5	10.1	6.2	11.9

Source: Georgian State Department of Statistics.

Table A-2. Georgia: Production of Selected Industrial Commodities, 1990–2002

(In thousands of tons; unless otherwise indicated)

	1990	1997	1998	1999	2000	2001	2002
Fuel and energy							
Electric power (in billions of kWh)	14.2	7.2	8.1	8.1	7.5	6.9	7.3
Coal	956.0	4.6	14.7	12.0	7.3	5.0	6.0
Oil	186.4	133.8	119.2	91.3	109.5	98.8	73.9
Natural gas (in millions of m3)	59.9	...	...	...	79.5	40.2	16.7
Gasoline	398.5	4.4	...	3.6	1.8	...	...
Diesel fuel	658.0	8.1	13.8	22.3	8.8	2.0	0.9
Fuel oil ("Mazut")	898.0	12.4	15.9	23.2	16.0	8.6	13.6
Metallurgy							
Cast-iron	624.8	1.1	0.1	...	0.0	...	...
Steel	1315.3	103.2	56.4	7.0	0.1	...	...
Finished roll steel ferrous metal	1105.0	86.7	42.7	7.2	1.4	...	...
Steel pipes	499.4	23.5	8.5	0.1	0.2	...	...
Manganese ore	1251.6	14.2	16.0	54.9	63.1	98.4	103.4
Electro-ferro manganese	42.4	0.0	3.4	4.9	0.6	0.1	...
Machine-building							
Subversive electric motors (in units)	11265.0	329.0	74.0	63.0	559.0	402.0	44.0
A/C motors (in thousands of kW)	187.7	0.1	...	...	...	...	...
Electric welding equipment (in thousands of units)	16.0	0.0	0.0	...	...	...	...
Metal-cutting machines (in units)	1568.0	28.0	21.0	2.0	3.0	2.0	9.0
Main-line locomotives (in units)	86.0	...	...	...	4.0	3.0	3.0
Trucks (in thousands of units)	5736.0	82.0	39.0	38.0	44.0	4.0	...
Chemical/timber products							
Mineral fertilizers	130.3	80.9	55.4	95.1	100.2	39.2	83.2
Chemical fibers and threads	32.4	0.6	0.3	0.3	0.0	0.0	...
Synthetic ammoniac	219.2	102.1	77.5	126.6	136.2	57.9	111.3
Synthetic detergents (in tons)	7921.0	46.8	10.9	...	...	...	...
Sawn wood (in thousands of m3)	551.0	16.7	33.0	34.3	42.8	43.5	51.7
Construction							
Cement	1290.0	94.1	198.6	341.4	347.7	335.2	346.8
Prefabricated ferro-concrete structures (in thousands of m3)	2450.0	8.8	8.7	9.3	13.4	4.6	3.7
Masonry concrete and silicate blocks (in millions of units)	816.4	16.6	16.5	12.4	11.3	8.3	8.4
Natural stone decorative tiles (in thousands of m3)	...	...	14.6	10.4	12.4	14.7	11.2
General merchandise and household appliances							
Porcelain and faience dishware (in thousands of units)	11650.0	191.6	274.2	320.5	185.9	91.8	53.8
Color TV (in units)	51314.0	2037.0	1039.0	1310.0	1585.0	1117.0	11.0
Notebooks (in thousands of units)	710000.0	953.4	316.0	370.0	194.0	213.0	262.0

Source: Georgian State Department of Statistics.

Table A-3. Georgia: Transportation Indicators, 1997–2002
(In thousands of tons)

	1997	1998	1999	2000	2001	2002
Freight transport	19,703	24,124	25,913	30,060	33,241	37,437
Rail	7,200	8,495	9,492	11,496	13,210	14,900
Road	12,200	15,000	16,000	18,500	20,000	22,500
Sea	300	625	419	63	31	36

Source: Georgian State Department of Statistics.

Table A-4. Georgia: Population and Employment, 1997–2002

(In thousands)

	1997	1998 3/	1999	2000	2001	2002
Total population 1/	4,558.4	4,504.9	4,469.8	4,435.2	4,401.4	4,371.5
Males	2,153.9	2,127.7	2,110.2	2,092.8	2,075.8	2,061.7
Females	2,404.5	2,377.2	2,359.6	2,342.4	2,325.6	2,309.8
Urban	2,441.9	2,401.8	2,371.7	2,342.0	2,312.9	2,284.8
Rural	2,116.5	2,103.1	2,098.1	2,093.2	2,088.5	2,086.7
Under 16 years of age	1,084.5	1,059.5	1,037.7	1,015.7	996.3	987.5
In active years 2/	2,803.2	2,767.4	2,743.9	2,721.2	2,697.3	2,678.9
Over active age	670.7	678.0	688.2	698.3	707.8	705.1
Population employed	2,233.2	1,731.1	1,732.6	1,748.8	1,877.7	1,839.2
State sector	570.7	598.2	541.7	439.0	438.9	432.1
<i>Of which:</i>						
Industry and construction	97.7	88.8	69.4	69.3	62.2	56.9
Agriculture	42.3	25.3	21.2	7.9	6.7	5.8
Transportation and communications	58.4	48.1	42.0	36.7	29.6	34.8
Trade and other materials sectors	31.3	20.8	18.4	17.4	10.5	9.8
Health, education, and science	240.2	212.1	203.2	202.3	197.4	174.3
Administration and finance 4/	45.3	119.2	108.6	82.9	90.0	100.4
Other nonmaterial sector	55.5	83.9	79.0	22.5	42.2	50.1
Private sector	1,615.5	1,132.9	1,190.9	1,309.8	1,438.8	1,407.1
<i>Of which:</i>						
Self-employed	1,529.2	969.3	982.8	999.6	1,152.2	1,153.8
Retired (receiving pension)	1,022.0	979.4	967.8	923.7	896.0	903.6
<i>Of which:</i>						
Retirees employed	64.7	54.5	53.2	39.7	32.1	31.0

Source: Georgian State Department of Statistics.

1/ Excludes population of Abkhazia and South Ossetia.

2/ Since February 20, 1996, working age is 16-60 for women, and 16-65 years for men. Prior to that date, the working age was 16-55 for women, and 16-60 years for men.

3/ In 1998, the State Department of Statistics started to carry out Labor force surveys (using the ILO methodology).

4/ Beginning in 1998—including defense.

Table A-5. Georgia: Unemployment, 1997–2002
(Number of persons, end-of-period)

	1997	1998	1999	2000	2001	2002
Unemployed	158,400	245,300	245,800	212,200	235,700	240,500
Registered unemployed 1/	142,500	98,723	102,597	116,889	109,512	37,030
<i>Of which:</i>						
Receiving benefits	28,884	5,643	3,689	4,783	5,294	3,469
			(In percent)			
Unemployment rate (ILO definition, period average)	7.5	12.3	12.7	10.3	11.1	12.3

Sources: Ministry of Labor and Social Affairs; and Georgian State Department of Statistics.

1/ The system for unemployment registration changed in 2002.

Table A-6. Georgia: Average Monthly Wages, 1997–2003 1/ 2/

(In lari)

	1997	1998	1999	2000	2001	2002	Q1	
							2002	2003 3/
Total economy	43.3	55.4	67.5	72.3	94.6	113.5	105.8	115.3
Industry	57.8	71.9	90.8	108.3	147.7	167.6	182.5	178.0
Workers	53.9	64.9	...	...	...	...	...	...
Agriculture	13.7	16.1	27.5	19.7	33.2	42.3	35.3	46.2
State farms, agricultural enterprises	14.2	15.5	...	...	...	...	...	...
Construction	105.6	113.6	141.1	147.1	145.9	176.1	182.5	197.4
Workers	115.5	128.3	...	...	...	...	...	...
Transportation	82.4	95.7	109.2	138.5	141.1	179.1	176.5	209.5
Railway transportation	69.9	91.6	110.3	104.8	81.5	204.3	229.3	314.6
Waterway transportation	146.7	160.1	130.2	145.4	149.1	226.9	281.5	227.0
Urban transportation	81.9	133.7	138.2	120.3	90.0	92.5	104.5	103.0
Communications	60.3	67.7	100.6	111.4	109.1	102.4	80.7	97.6
Trade and distribution	28.9	30.5	37.6	47.0	57.4	72.8	76.8	79.8
Computer services	46.5	51.6	83.4	80.9	74.0	131.2	87.4	154.3
Housing and communal services	48.1	72.4	99.9	92.5	83.9	89.2	78.2	87.8
Public health and social security	23.8	26.6	34.9	32.0	45.6	55.6	52.7	60.3
Public education	28.2	46.4	44.1	45.5	45.5	56.6	53.0	60.4
Culture	30.1	33.8	50.1	71.2	73.2	82.1	77.3	86.7
Art	43.9	62.5	66.6	65.7	74.5	88.5	79.4	68.9
Science and related services	46.7	61.2	72.3	64.3	66.9	66.1	68.7	70.1
State administration and management	55.6	73.2	90.0	88.5	105.9	119.1	100.0	113.2
Memorandum items:								
Real wages total economy (1997=100)	100.0	123.6	126.3	130.1	162.6	184.7	...	...
Real wages growth rate (in percent) 4/	39.6	23.6	2.3	3.0	25.0	13.6	...	...
Dollar monthly wages:								
Georgia	33.4	39.8	33.4	36.6	45.6	51.7	...	...
Russia	166.8	114.2	64.2	80.1	112.5	140.9	...	...
Turkey	443.5	455.1	522.5	535.9	383.8	474.5	...	...
Average annual salary								
Total economy	520.8	723.6	810.1	867.6	1,135.2	1,362.0	...	...
Industry	693.6	897.6	1,089.6	1,299.6	1,772.4	2,011.2	...	...
Agriculture	164.4	214.8	329.4	236.4	398.1	507.6	...	...

Source: Georgian State Department of Statistics; and Fund staff calculations.

1/ Wages include cash compensation and the value of goods received in kind.

2/ These data are subject to large margins of error.

3/ Preliminary estimate.

4/ Calculated using the average CPI price level of given period over average CPI price level of the same period in the previous year.

Table A-7. Georgia: Prices, 1992–2003

	Consumer Price Index		Producer Price Index	
	(Percent change)			
	Period average	End of period	Period average	End of period
1992	887.4	1,176.9	...	...
1993	3,125.4	7,487.9	...	...
1994	15,601.8	6,472.8	...	...
1995	162.7	57.4	...	...
1996	39.4	13.8	...	...
1997	7.1	7.3	...	...
1998	3.6	10.7	2.3	3.7
1999	19.2	10.9	15.7	15.7
2000	4.0	4.6	5.8	2.4
2001	4.7	3.4	3.6	8.9
2002	5.6	5.4	6.0	1.5
	Over previous month	Over same month previous year	Over previous month	Over same month previous year
2002				
January	2.0	4.7	-0.2	8.0
February	1.2	5.3	0.5	8.4
March	0.4	5.7	0.3	6.9
April	1.8	6.5	1.6	8.3
May	0.0	7.6	0.1	8.0
June	-2.3	5.5	-0.3	7.0
July	-1.1	5.1	-0.9	6.6
August	-0.1	4.7	1.0	8.6
September	0.4	5.7	-0.5	7.7
October	0.4	5.4	0.3	0.7
November	1.1	5.1	0.0	1.1
December	1.7	5.4	-0.2	1.5
2003				
January	2.1	5.5	0.6	2.4
February	-0.5	3.7	1.3	3.2
March	0.0	3.4	-0.9	2.0
April	0.5	2.1	-1.4	-1.1
May	0.2	2.3	2.1	0.9
June	0.1	4.8	0.4	1.6
July	-0.9	5.0	...	...
August	-0.1	5.1	...	...

Source: Georgian State Department of Statistics.

Table A-8. General Government Operations, 1998–2003

	1998	1999	2000	2001	2002	2003 Q1
	Actual	Actual	Actual	Actual	Actual	Prelim.
	(in millions of lari)					
Total revenue and grants (excl. privat.)	786.4	873.3	913.3	1,081.9	1,177.2	306.6
Total revenue	740.8	825.1	897.1	1,036.0	1,156.3	298.8
Tax revenue 1/	643.6	782.3	851.5	951.5	1,076.0	273.4
Taxes on income	87.8	104.8	108.2	135.8	143.0	30.3
Taxes on profits	50.5	55.6	79.7	66.6	82.5	22.7
VAT	219.7	248.1	289.8	357.3	413.7	111.3
Customs duties	67.0	33.7	53.1	55.5	63.9	15.7
Excises	38.7	118.5	90.2	89.9	91.3	17.6
Other taxes	62.3	88.6	85.7	90.6	111.6	24.0
Nontax revenue	97.1	42.8	45.6	84.5	80.3	25.4
NBG profit transfers	...	...	0.0	20.0	35.0	15.0
Fees/budgetary organizations	...	...	13.4	6.7	17.3	3.5
Other	...	...	20.2	48.7	5.0	4.1
Other local budgets	...	...	0.0	0.0	8.8	2.0
Capital revenue (dividends, profit transfers)	...	...	10.3	9.0	14.2	0.9
Extrabudgetary revenue 2/	117.5	133.1	144.8	155.9	169.9	51.8
Pension and medical funds 3/	...	...	115.4	118.6	127.9	42.1
Employment fund	...	...	4.9	5.1	...	...
Road fund	...	...	24.5	32.1	42.0	9.6
Of which: Gasoline excise	...	...	4.3	10.4	13.7	2.1
Grants 8/	45.7	48.2	16.2	45.9	20.9	7.8
Total expenditure and net lending	1096.4	1252.9	1,155.9	1,211.9	1,324.2	364.3
Current expenditure	997.3	1132.5	1,094.2	1,095.7	1,172.8	327.7
Wages and salaries 2/	176.7	190.8	180.1	168.7	176.9	55.9
Goods and services	202.4	190.9	132.2	132.5	158.3	37.4
Transfers and subsidies 4/	119.3	142.2	166.7	136.9	132.5	38.7
Of which: Energy commitments	...	...	...	0.0	...	...
Interest payments	114.8	159.0	178.4	117.5	145.9	48.8
Domestic	62.8	80.5	87.7	66.2	80.2	23.2
External	51.9	78.6	90.7	51.3	65.7	25.6
Extrabudgetary expenditures 5/	212.5	211.7	203.7	235.0	243.6	81.5
Pension and medical funds 3/	...	...	174.0	197.8	201.6	71.9
Road fund	...	...	24.5	32.1	42.0	9.6
Local government expenditures 6/	171.7	237.9	233.1	305.0	315.6	65.4
Capital expenditure	65.5	48.7	30.2	71.9	78.6	17.6
Net lending	33.6	71.7	31.6	44.3	72.8	19.1
Overall balance (commitments)	-309.9	-379.6	-242.6	-130.0	-147.1	-57.7
Adjustment to cash basis	64.0	97.6	89.0	20.9	8.1	46.1
Net change in expenditure arrears (-, reduction) 7/	64.0	95.9	84.0	12.7	-29.8	29.9
External interest	...	...	0.0	0.1	0.0	0.0
Domestic expenditure	...	...	84.0	12.6	-29.8	29.9
TMU definition	...	...	84.0	11.3	-29.8	34.9
Statistical discrepancy	0.0	1.7	5.0	8.2	37.9	16.1
Overall balance (cash)	-246.0	-282.0	-153.6	-109.1	-139.0	-11.6
Total financing	246.0	282.0	153.6	109.1	139.0	11.6
Privatization	73.4	52.7	19.1	5.6	15.3	5.2
Domestic	97.9	131.9	133.0	-25.3	-7.8	-9.2
NBG credit (loans and t-bills) net of deposits 8/	109.8	187.1	136.9	-15.0	16.8	-12.4
Of which: NBG recapitalization	0.0	70.3	-42.2	-28.1	0.0	0.0
Commercial banks (t-bills and deposits)	-2.1	0.0	-1.5	1.5	-27.7	8.5
Commercial banks (other)	...	...	-13.1	0.0	0.0	0.0
Nonbank (t-bills and other)	-9.7	15.1	10.7	-11.8	3.1	-5.3
Offset to NBG recapitalization	0.0	-70.3	42.2	28.1	0.0	0.0
External	74.7	68.7	1.6	128.8	131.5	24.2
Disbursements	100.2	138.4	68.6	162.4	170.3	28.7
Amortization 9/	-115.4	-182.0	-210.9	-256.6	-115.7	-28.1
Changes in arrears (-, reduction)	-73.6	112.4	132.0	-14.3	0.0	23.6
Macroeconomic support	163.5	0.0	11.8	237.3	77.0	0.0
Net U.S. in-kind loans	...	28.6	10.0	...	...	...
Adjustment for net withheld Adjara transfers 9/	...	...	...	...	...	-8.5
Memorandum items:						
Tax revenue, program definition	643.6	782.3	851.5	951.5	1,246.0	273.4
Cigarette and petroleum tax revenue	...	...	61.8	79.7	138.6	23.9
Social spending (cash basis)	...	...	...	539.5	624.9	160.9
Public Debt (end of period)	...	...	...	...	...	...
Nominal GDP (in millions of lari)	5,040.2	5,664.9	6,012.7	6,637.8	7,457.1	1,894.1

Table A-8. General Government Operations, 1998–2003 (concluded)

	1998 Actual	1999 Actual	2000 Actual	2001 Actual	2002 Actual	2003 Q1 Prelim.
	(In percent of GDP)					
Total revenue and grants (excl. privat.)	15.6	15.4	15.2	16.3	15.8	16.2
Total revenue	14.7	14.6	14.9	15.6	15.5	15.8
Tax revenue 1/	12.8	13.8	14.2	14.3	14.4	14.4
Taxes on income	1.7	1.9	1.8	2.0	1.9	1.6
Taxes on profits	1.0	1.0	1.3	1.0	1.1	1.2
VAT	4.4	4.4	4.8	5.4	5.5	5.9
Customs duties	1.3	0.6	0.9	0.8	0.9	0.8
Excises	0.8	2.1	1.5	1.4	1.2	0.9
Other taxes	1.2	1.6	1.4	1.4	1.5	1.3
Nontax revenue	1.9	0.8	0.8	1.3	1.1	1.3
Extrabudgetary revenue 2/	2.3	2.3	2.4	2.3	2.3	2.7
Pension and medical funds 3/	...	...	1.9	1.8	1.7	2.2
Employment fund	...	...	0.1	0.1	...	...
Road fund	...	...	0.4	0.5	0.6	0.5
<i>Of which: Gasoline excise</i>	...	...	0.1	0.2	0.2	0.1
Grants 8/	0.9	0.9	0.3	0.7	0.3	0.4
Total expenditure and net lending	21.8	22.1	19.2	18.3	17.8	19.2
Current expenditure	19.8	20.0	18.2	16.5	15.7	17.3
Wages and salaries 2/	3.5	3.4	3.0	2.5	2.4	3.0
Goods and services	4.0	3.4	2.2	2.0	2.1	2.0
Transfers and subsidies 4/	2.4	2.5	2.8	2.1	1.8	2.0
Interest payments	2.3	2.8	3.0	1.8	2.0	2.6
Domestic	1.2	1.4	1.5	1.0	1.1	1.2
External	1.0	1.4	1.5	0.8	0.9	1.4
Extrabudgetary expenditures 5/	4.2	3.7	3.4	3.5	3.3	4.3
Pension and medical funds 3/	...	...	2.9	3.0	2.7	3.8
Road fund	...	...	0.4	0.5	0.6	0.5
Local government expenditures 6/	3.4	4.2	3.9	4.6	4.2	3.5
Capital expenditure	1.3	0.9	0.5	1.1	1.1	0.9
Net lending	0.7	1.3	0.5	0.7	1.0	1.0
Overall balance (commitments)	-6.1	-6.7	-4.0	-2.0	-2.0	-3.0
Adjustment to cash basis	1.3	1.7	1.5	0.3	0.1	2.4
Net change in expenditure arrears (-, reduction) 7/	1.3	1.7	1.4	0.2	-0.4	1.6
External interest	0.0	0.0	0.0	0.0	0.0	0.0
Domestic expenditure	0.0	0.0	1.4	0.2	-0.4	1.6
TMU definition	0.0	0.0	1.4	0.2	-0.4	1.8
Statistical discrepancy	0.0	0.0	0.1	0.1	0.5	0.9
Overall balance (cash)	-4.9	-5.0	-2.6	-1.6	-1.9	-0.6
Total financing	4.9	5.0	2.6	1.6	1.9	0.6
Privatization	1.5	0.9	0.3	0.1	0.2	0.3
Domestic	1.9	2.3	2.2	-0.4	-0.1	-0.5
NBG credit (loans and t-bills) net of deposits 8/	2.2	3.3	2.3	-0.2	0.2	-0.7
<i>Of which: NBG recapitalization</i>	0.0	1.2	-0.7	-0.4	0.0	0.0
Commercial banks (t-bills and deposits)	0.0	0.0	0.0	0.0	-0.4	0.4
Nonbank (t-bills and other)	-0.2	0.3	0.2	-0.2	0.0	-0.3
External	1.5	1.2	0.0	1.9	1.8	1.3
Disbursements	2.0	2.4	1.1	2.4	2.3	1.5
Amortization 9/	-2.3	-3.2	-3.5	-3.9	-1.6	-1.5
Changes in arrears (-, reduction)	-1.5	2.0	2.2	-0.2	0.0	1.2
Macroeconomic support	3.2	0.0	0.2	3.6	1.0	0.0
Net U.S. in-kind loans	...	0.5	0.2	...	...	...
Adjustment for net withheld Adjara transfers 9/	...	...	...	...	...	-0.4
Memorandum items:						
Tax revenue, program definition	0.0	0.0	14.2	14.3	16.7	14.4
Cigarette and petroleum tax revenue	12.8	13.8	1.0	1.2	1.9	1.3
Social spending (cash basis)	...	...	...	8.1	8.4	8.5
Public debt	...	...	...	...	...	...
Nominal GDP (in millions of lari)	5,040.2	5,664.9	6,012.7	6,637.8	7,457.1	1,894.1

1/ Program definition for tax revenue includes extrabudgetary revenue.

2/ Exclude payroll to SSF and to EF (2000 and 2001) or employment programs (2002).

3/ The previously off-budget state medical fund was consolidated with the state pension fund in January 2003.

4/ Exclude transfers from central budget to local budgets, to SSF, and to EF (2000 and 2001) or employment programs (2002).

5/ Include transfers and payroll from central budgets and payroll from local budgets.

6/ Include transfers from central budget. Exclude payroll to SSF and to EF (2000 and 2001) or employment programs (2002).

7/ TMU arrears includes social spending items, such as wages, pensions, food in-kind, refugee allowances and a part of local spending.

8/ Excluding 2001 recapitalization transfers (28.1 million lari).

9/ Beginning in 2003, financing is adjusted by the amount of withheld tax revenue collected by Adjara on behalf of the central government.

Table A-9. Georgia: Personal Income Tax Structure

Income Threshold	Marginal Tax Rate	Cumulative Tax Liability	Examples				
			Taxable income	Standard deduction	Net tax income	Tax due	Average tax rate
Less than GEL 200	12 percent	12 percent of all earned income below GEL 200	150	108	42	5	3.4%
GEL 201-350	15 percent	GEL 24 plus 15 percent of income greater than GEL 201	350	108	242	30	8.6%
GEL 351-600	17 percent	GEL 46.5 plus 17 percent of income greater than GEL 351	575	108	467	66	11.5%
Greater than GEL 601	20 percent	GEL 89 plus 20 percent of income greater than GEL 601	1,500	108	1,392	247	16.5%

1/ As of 1997, a tax deduction of GEL 9 per month (108 annually) was introduced to be applied against wage earnings.

2/ Tax exempt sources of income include gifts and inheritance, state pensions and other stipends, alimony, self-employed farm income and capital gains on personal assets.

3/ An income exemption of GEL 3,000 is available for invalids since childhood, certain categories of the blind, World War II participants, single mothers, and adoptive parents.

4/ An income exemption of GEL 1,500 is available for certain categories of invalids, inhabitants of mountainous regions with more than 3 children, which is reduced to a reduction of 50 percent of the tax liability for families with less than 3 children.

Table A-10. Georgia: Statutory Revenue Sharing Arrangements, 1998–2003 1/

	1998		1999		2000		2001		2002		2003	
	State	Local	State	Local	State	Local	State	Local	State	Local	State	Local
VAT												
Standard, collected by Tax Dept. (STD) 2/	100	0	100	0	100	0	100	0	100	0	100	0
Standard, collected by Customs (SCD)	100	0	100	0	100	0	100	0	100	0	100	0
Ajara, collected by Customs (SCD)	60	40	60	40	60	40	60	40	60	40	60	40
Ajara, collected by Tax Dept. (STD)	70	30	70	30	70	30	70	30	70	30	70	30
Tbilisi, collected by Tax Dept. (STD)	85	15	85	15	85	15	100	0	100	0	100	0
Excises												
Standard	100	0	100	0	100	0	100	0	100	0	100	0
Ajara, collected by Customs (SCD)	60	40	60	40	60	40	60	40	60	40	60	40
Profit tax												
Standard	40	60	40	60	40	60	15	85	15	85	15	85
Ajara and Abkhazia	1	99	1	99	1	99	1	99	1	99	1	99
Tbilisi	40	60	40	60	85	15	15	85	15	85	15	85
Income tax												
Standard	40	60	40	60	40	60	15	85	15	85	15	85
Ajara and Abkhazia	1	99	1	99	1	99	1	99	1	99	1	99
Tbilisi	40	60	40	60	85	15	15	85	15	85	15	85
Customs duties												
Standard	100	0	100	0	100	0	100	0	100	0	100	0
Ajara, collected by Customs (SCD)	60	40	60	40	50	50	50	50	50	50	50	50
Poti	95	5	95	5	95	5	100	0	100	0	100	0
Other taxes 3/	0	100	0	100	0	100	0	100	0	100	0	100

Sources: Georgian authorities.

1/ Legislative changes introduced in the 2000 budget will shift all VAT and excise tax revenue to the state level (central government and extrabudgetary funds).

2/ This includes the natural resource tax, ecology (environmental) tax, land tax, property tax, as well as miscellaneous other taxes.

3/ The division of the revenue depends on the specifics of the transaction.

Table A-11. Georgia: Tax Arrears, 1998–2003 1/
(Beginning of period)

	1998		1999		2000		2001	2002		2003	
	January	July	January	July	January	July	January	January	July	January	July
(In millions of lari)											
Total tax arrears	172.2	216.2	309.6	351.1	456.3	512.0	789.8	1123.3	1333.7	1579.2	1842.1
VAT	47.1	59.7	102.5	101.1	130.6	160.7	243.2	346.5	447.0	501.7	583.5
Profit tax	20.9	27.0	46.5	56.7	70.7	82.8	107.6	172.4	199.5	246.9	302.4
Personal income tax	...	...	...	...	...	...	...	55.5	67.6	79.5	97.1
Excise tax	8.6	16.6	20.2	22.5	155.5	18.1	22.6	21.0	22.9	24.8	27.0
Property tax	...	...	...	...	...	...	...	98.3	115.2	119.2	135.7
Land tax	16.3	16.7	31.9	38.9	57.8	64.5	93.4	122.1	131.9	173.6	187.3
Other taxes collected by Tax Dept. (STD)	18.5	36.1	58.2	68.2	90.2	108.1	169.8	110.0	111.0	161.2	182.6
Taxes collected by Customs (SCD)	...	...	4.8	...	...	...	...	0.0	0.0	0.0	0.0
Payroll taxes	60.9	60.2	50.3	63.6	80.2	83.2	153.2	197.3	238.7	272.3	326.5
Pension Fund	60.0	59.0	48.8	61.6	76.7	79.8	147.3	190.6	230.5	263.4	326.5
Employment Fund	0.9	1.2	1.5	2.0	3.5	3.4	5.9	6.7	8.2	8.9	0.0
(In percent of GDP) 2/											
Total tax arrears 2/	3.8	4.6	6.1	6.6	8.1	8.7	13.1	16.9	19.0	21.2	23.4
VAT	1.1	1.3	2.0	1.9	2.3	2.7	4.0	5.2	6.4	6.7	7.4
Profit tax	0.5	0.6	0.9	1.1	1.2	1.4	1.8	2.6	2.8	3.3	3.8
Personal income tax	...	...	...	...	...	...	...	0.8	1.0	1.1	1.2
Excise tax	0.2	0.4	0.4	0.4	2.7	0.3	0.4	0.3	0.3	0.3	0.3
Property tax	...	...	...	...	...	...	...	1.5	1.6	1.6	1.7
Land tax	0.4	0.4	0.6	0.7	1.0	1.1	1.6	1.8	1.9	2.3	2.4
Other taxes collected by Tax Dept. (STD)	0.4	0.8	1.2	1.3	1.6	1.8	2.8	1.7	1.6	2.2	2.3
Taxes collected by Customs (SCD)	...	...	0.1	...	...	...	...	0.0	0.0	0.0	0.0
Payroll taxes	1.4	1.3	1.0	1.2	1.4	1.4	2.5	3.0	3.4	3.7	4.2
Pension Fund	1.3	1.3	1.0	1.2	1.4	1.4	2.4	2.9	3.3	3.5	4.2
Employment Fund	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.0

Sources: Georgian authorities; and Fund staff estimates.

1/ The coverage of tax arrears includes contributions to the pension fund, taxes collected by the State Customs Department and payroll taxes associated with the Employment Fund before 2003. Arrears to the Road Fund and some local governments taxes are excluded. The data include unpaid penalties for overdue tax payment obligations.

2/ Presented as a percentage of GDP in the preceding four quarters.

Table A-12. Georgia: Revenue Withheld by Adjara, 1999–2002

	1999		2000		2001		2002	
	State tax share	Amount withheld	State tax share	Amount withheld	State tax share	Amount withheld	State tax share	Amount withheld
(In millions of lari)								
Total tax revenue	33.6	22.0	51.3	14.4	39.5	13.4	60.3	45.5
Profit tax	0.2	0.1	0.3	0.3	0.2	0.1	0.2	0.2
Income tax	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
VAT	8.4	5.4	17.9	10.1	15.7	8.0	27.0	27.0
Excise	9.0	0.9	10.2	0.2	3.6	1.9	7.4	7.4
Customs	0.4	0.0	5.9	0.0	1.9	0.0	5.8	5.8
Other taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Property tax								
License fees on specific businesses								
Nontax revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Administrative fines								
Fees collected by Saktech Inspection								
Extrabudgetary funds	15.5	15.5	16.9	3.7	18.0	3.3	19.8	5.0
United Social Security Fund	12.2	12.2	13.2	0.0	14.7	0.0	14.8	0.0
Road Fund	3.3	3.3	3.7	3.7	3.3	3.3	5.0	5.0

Source: Georgian authorities.

Table A-13. Central Government Expenditure by Functional Classification, 1998-2002

	1998		1999		2000		2001		2002	
	million lari	% of GDP	million lari	% of GDP	million lari	% of GDP	million lari	% of GDP	million lari	% of GDP
Agriculture, forestry, fishing, and hunting	22.2	0.4	15.5	0.3	12.3	0.2	14.8	0.2	8.9	0.1
Defense	56.5	1.1	35.7	0.6	28.9	0.5	36.2	0.5	47.9	0.6
Education	30.4	0.6	29.6	0.5	26.9	0.4	31.5	0.5	37.0	0.5
Fuel and energy	3.8	0.1	11.5	0.2	25.3	0.4	9.0	0.1	16.9	0.2
Health care	26.8	0.5	15.7	0.3	20.5	0.3	33.0	0.5	39.8	0.5
Housing and community services	7.1	0.1	5.1	0.1	4.2	0.1	3.8	0.1	4.3	0.1
Industry and construction	2.0	0.0	0.8	0.0	0.3	0.0	0.6	0.0	0.8	0.0
Public order and security	65.9	1.3	75.7	1.3	63.9	1.1	77.7	1.2	80.4	1.1
Recreation, culture, sports, and religious activities	33.1	0.7	25.6	0.5	21.2	0.4	20.0	0.3	24.7	0.3
Social insurance and social security	109.9	2.2	137.5	2.4	109.3	1.8	109.4	1.6	110.7	1.5
Transport and communication	15.3	0.3	2.2	0.0	9.7	0.2	2.2	0.0	1.3	0.0
Other services related to economic activities	15.0	0.3	2.7	0.0	1.7	0.0	2.2	0.0	2.8	0.0
State operations	65.5	1.3	125.1	2.2	100.8	1.7	172.6	2.6	218.0	2.9
Non-classified expenditures	203.4	4.0	275.8	4.9	256.4	4.3	237.7	3.6	264.0	3.5
Total expenditure	656.9	13.0	758.5	13.4	681.4	11.3	750.7	11.3	857.5	11.5
Nominal GDP	5,040.2		5,664.9		6,012.7		6,637.8		7,457.1	

Source: Georgian authorities.

Table A-14. Georgia: Monetary Survey, 1997–2003 1/

	1997	1998	1999	2000				2001				2002				2003	
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.
	(Stocks, end-of-period; in millions of lari)																
Net foreign assets	-72.2	-376.2	-446.7	-446.1	-446.5	-368.2	-422.2	-433.7	-402.8	-403.0	-335.9	-389.0	-423.0	-351.4	-302.9	-328.9	-326.8
Net domestic assets	445.3	744.7	891.2	894.7	926.8	942.0	1040.5	1028.8	1037.9	1091.4	1068.3	1146.4	1189.8	1149.5	1166.5	1215.0	1252.9
Domestic credit	567.2	790.5	1080.9	1050.1	1119.7	1171.0	1282.8	1239.5	1270.6	1330.1	1296.9	1338.5	1372.7	1372.7	1427.5	1477.4	1537.8
Net claims on general government 2/	357.7	496.5	686.2	654.7	674.6	691.8	766.2	719.2	733.5	741.1	724.6	720.5	723.3	702.1	713.7	709.8	722.8
Credit to the rest of the economy	209.5	293.9	394.8	395.4	445.1	479.3	516.6	520.3	537.2	589.0	572.3	618.0	649.4	670.6	713.8	767.5	815.0
Other items, net 2/	-122.0	-45.8	-189.7	-155.4	-193.0	-229.1	-242.4	-210.7	-232.7	-238.7	-228.6	-192.1	-182.9	-223.2	-261.0	-262.3	-284.9
Broad money (M3)	373.0	368.5	444.6	448.6	480.3	573.7	618.2	595.1	635.1	688.4	732.4	757.4	766.7	798.1	863.6	886.1	926.1
Broad money, excluding foreign exchange deposits (M2)	295.2	261.1	286.1	284.1	280.6	327.0	382.1	345.2	362.5	384.4	403.8	406.1	404.7	420.6	462.3	448.1	450.4
Currency held by the public	239.9	212.2	244.0	233.7	234.3	269.1	315.0	294.9	300.5	321.8	348.9	346.3	345.2	355.7	390.8	372.8	374.9
Currency in circulation (M0)	254.6	222.0	259.8	249.2	249.0	287.5	329.2	310.0	319.9	338.2	365.7	361.6	363.9	380.5	417.2	398.6	407.7
Less: Banks' vault cash	-14.7	-9.8	-15.8	-15.5	-14.7	-18.4	-14.2	-15.1	-19.4	-16.5	-16.8	-15.3	-18.8	-24.8	-26.4	-25.8	-32.8
Deposit liabilities (domestic currency)	55.3	48.9	42.1	50.4	46.3	57.9	67.1	50.2	62.0	62.7	55.0	59.8	59.6	64.8	71.5	75.3	75.5
Foreign currency deposits	77.8	107.4	158.4	164.5	199.6	246.8	236.2	250.0	272.6	304.0	328.6	351.3	362.0	377.6	401.3	438.0	475.7
Total deposit liabilities	133.2	156.3	200.6	214.9	246.0	304.6	303.2	300.2	334.6	366.6	383.6	411.1	421.6	442.4	472.8	513.3	551.2
	(Flows, with respect to end of previous period; in millions of lari)																
Net foreign assets	-93.4	-303.9	-70.5	0.6	-0.4	78.3	-54.0	-11.5	30.9	-0.2	67.1	-53.1	-34.0	71.6	48.5	-26.0	2.1
Net domestic assets	210.2	299.4	146.5	3.5	32.0	15.2	98.5	-11.6	9.0	53.5	-23.1	78.1	43.4	-40.2	16.9	48.5	37.9
Domestic credit	243.4	223.2	290.5	-30.8	69.6	51.3	111.8	-43.3	31.1	59.5	-33.2	41.5	34.3	0.0	54.8	49.8	60.4
Net claims on general government	162.1	138.8	189.7	-31.5	19.9	17.1	74.5	-47.0	14.2	7.7	-16.5	-4.1	2.8	-21.2	11.6	-3.9	13.0
Credit to the rest of the economy	81.3	84.4	100.8	0.7	49.7	34.1	37.4	3.7	16.9	51.8	-16.7	45.7	31.4	21.2	43.2	53.7	47.4
Other items, net	-33.2	76.2	-144.0	34.4	-37.6	-36.1	-13.3	31.7	-22.1	-6.0	10.1	36.5	9.2	-40.2	-37.9	-1.3	-22.5
Broad money (M3)	116.8	-4.5	76.0	4.1	31.6	93.5	44.5	-23.1	40.0	53.3	44.1	24.9	9.4	31.4	65.4	22.5	40.0
Broad money, excluding foreign exchange deposits (M2)	77.3	-34.1	25.0	-2.0	-3.5	46.3	55.1	-36.9	17.3	21.9	19.4	2.2	-1.3	15.8	41.7	-14.2	2.3
Foreign currency deposits	39.5	29.6	51.0	6.1	35.1	47.1	-10.6	13.8	22.6	31.4	24.7	22.7	10.7	15.6	23.7	36.7	37.7
	(Change, as a percent of broad money at the end of the previous year)																
Net foreign assets	-36.4	-81.5	-19.1	0.1	0.0	17.6	5.5	-1.9	3.1	3.1	14.0	-7.3	-11.9	-2.1	4.5	-3.0	0.2
	(Percentage change with respect to the end of the previous year)																
Net domestic assets	89.4	67.2	19.7	0.4	4.0	5.7	16.7	-1.1	-0.2	4.9	2.7	7.3	11.4	7.6	9.2	4.2	7.4
Broad money (M3)	45.6	-1.2	20.6	0.9	8.0	29.1	39.1	-3.7	2.7	11.3	18.5	3.4	4.7	9.0	17.9	2.6	7.2
Broad money, excluding foreign exchange deposits (M2)	35.4	-11.5	9.6	-0.7	-1.9	14.3	33.5	-9.7	-5.1	0.6	5.7	0.6	0.2	4.1	14.5	-3.1	-2.6
Memorandum items:																	
M3 multiplier 3/	1.35	1.42	1.44	1.49	1.63	1.70	1.58	1.66	1.66	1.70	1.70	1.75	1.75	1.73	1.70	1.81	1.73
M3 velocity 4/	14.0	14.9	13.7	12.4	11.7	10.7	10.9	10.1	10.5	9.7	9.8	9.0	9.5	9.5	9.3	8.5	8.8

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

1/ Valued at end-period actual exchange rates.

2/ Data for end-March 1999 reflect the issuance of a lari 70.3 million government bond to recapitalize the NBG for losses from revaluation of its international reserves. Data for end-June through end-1999 reflect an estimate of direct borrowing by the government from the commercial banks.

3/ M3 divided by reserve money.

4/ Annualized quarterly GDP divided by end-quarter M3.

Table A-15. Georgia: Accounts of the National Bank of Georgia, 1997-2003 1/

	1997	1998	1999	2000				2001				2002				2003	
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.
(Stocks, end-of-period; in millions of lari)																	
Net foreign assets	-105.2	-389.9	-440.3	-430.7	-446.3	-388.8	-409.4	-430.4	-409.0	-400.7	-339.6	-372.6	-411.8	-376.9	-327.9	-345.0	-338.7
Encumbered reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net international reserves	-105.2	-389.9	-440.3	-430.7	-446.3	-388.8	-409.4	-430.4	-409.0	-400.7	-339.6	-372.6	-411.8	-376.9	-327.9	-345.0	-338.7
Gold	0.7	1.0	1.0	1.0	1.1	1.0	1.0	1.0	1.0	1.1	1.1	1.2	1.3	1.3	1.3	1.3	1.3
Foreign exchange reserves	262.3	221.5	255.5	237.3	215.5	237.9	216.1	240.8	241.6	267.7	331.8	328.6	320.2	392.9	413.2	400.8	395.4
Use of Fund Resources	-332.0	-546.3	-617.4	-592.2	-584.5	-554.7	-549.8	-595.6	-578.4	-589.7	-591.4	-617.4	-636.6	-676.3	-645.6	-645.7	-627.9
Other foreign assets, net	-36.2	-66.0	-79.5	-76.9	-78.3	-72.9	-76.6	-76.5	-73.3	-79.9	-81.0	-85.1	-96.7	-94.8	-97.0	-101.5	-107.5
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net domestic assets	382.3	649.6	748.8	731.9	741.2	726.3	800.6	789.7	792.4	805.5	769.4	805.4	849.3	837.5	836.9	835.5	843.9
Net claims on general government 2/	360.6	499.6	687.5	660.1	683.8	702.7	782.2	735.5	753.8	759.0	739.1	730.7	746.6	753.4	755.9	743.5	756.9
Claims on banks	3.5	6.6	1.9	-1.0	0.9	0.4	4.0	-0.7	2.3	0.2	0.7	0.5	0.0	0.0	0.0	-4.8	0.0
Claims on rest of the economy	36.6	66.7	80.9	78.3	79.6	74.2	77.9	77.7	74.3	81.1	78.3	82.1	93.0	91.5	93.9	98.3	104.2
Other items, net 2/	-18.4	76.8	-21.4	-5.5	-23.1	-51.0	-63.5	-22.7	-38.1	-34.8	-48.7	-7.8	9.7	-7.5	-13.0	-1.5	-17.2
Reserve money	277.1	259.7	308.5	301.2	294.9	337.5	391.2	359.3	383.4	404.7	429.9	432.8	437.6	460.6	509.0	490.6	505.2
Currency in circulation	254.6	222.0	259.8	249.2	249.0	287.5	329.2	310.0	319.9	338.2	365.7	361.6	363.9	380.5	417.2	398.6	407.7
Required reserves	15.7	18.0	29.7	33.5	32.7	38.7	38.9	40.9	48.6	51.3	53.3	57.6	61.0	68.2	72.2	74.1	84.6
Balances on banks' correspondent a/cs	6.9	19.7	19.0	18.5	13.1	11.3	23.1	8.5	15.0	15.2	10.9	13.5	12.6	11.9	19.6	17.8	12.8
(Flows, with respect to end of previous period; in millions of lari)																	
Net foreign assets	-104.3	-284.7	-50.4	9.6	-15.5	57.4	-20.6	-21.0	21.4	8.2	61.1	-33.1	-39.1	34.9	48.9	-17.0	6.3
Net international reserves	-104.3	-284.7	-50.4	9.6	-15.5	57.4	-20.6	-21.0	21.4	8.2	61.1	-33.1	-39.1	34.9	48.9	-17.0	6.3
Net domestic assets	172.5	267.3	99.2	-16.9	9.2	-14.8	74.3	-10.9	2.7	13.0	-36.0	36.0	43.9	-11.8	-0.6	-1.4	8.4
Net claims on general government	151.8	138.9	187.9	-27.4	23.7	18.9	79.5	-46.7	18.3	5.2	-19.9	-8.5	15.9	6.9	2.5	-12.4	13.4
Claims on banks	-10.3	3.1	-4.7	-2.9	1.9	-0.5	3.6	-4.7	3.0	-2.2	0.5	-0.2	-0.5	0.0	0.0	-4.8	4.8
Other items, net	-5.6	95.2	-98.2	15.9	-17.6	-27.9	-12.5	40.8	-15.3	3.3	-13.9	40.9	17.5	-17.2	-5.4	11.4	-15.7
Reserve money	68.1	-17.3	48.8	-7.3	-6.3	42.6	53.7	-31.9	24.1	21.3	25.1	2.9	4.8	23.1	48.4	-18.4	14.6
Currency in circulation	69.0	-32.6	37.8	-10.6	-0.2	38.5	41.7	-19.2	9.9	18.3	27.4	-4.0	2.3	16.6	36.7	-18.5	9.1
Required reserves	1.9	2.4	11.6	3.8	-0.8	6.0	0.2	2.0	7.7	2.7	2.0	4.3	3.4	7.2	4.0	1.9	10.5
Balances on banks' correspondent accounts	-2.8	12.8	-0.7	-0.5	-5.4	-1.8	11.8	-14.6	6.5	0.2	-4.3	2.7	-1.0	-0.7	7.7	-1.7	-5.0
(Change, as a percent of reserve money at the end of previous year)																	
Net foreign assets	-49.9	-102.7	-19.4	3.1	-5.0	18.6	-6.7	-5.4	5.5	2.1	15.6	-7.7	-9.1	8.1	11.4	-3.3	1.2
Net international reserves	-49.9	-102.7	-19.4	3.1	-5.0	18.6	-6.7	-5.4	5.5	2.1	15.6	-7.7	-9.1	8.1	11.4	-3.3	1.2
(Percentage change, with respect to the end of the previous year)																	
Net domestic assets	82.2	69.9	15.3	-2.3	-1.0	-3.0	6.9	-1.4	-1.0	0.6	-3.9	4.7	10.4	8.8	8.8	-0.2	0.8
Reserve money	32.6	-6.3	18.8	-2.4	-4.4	9.4	26.8	-8.1	-2.0	3.5	9.9	0.7	1.8	7.2	18.4	-3.6	-0.7
Currency in circulation	37.2	-12.8	17.0	-4.1	-4.1	10.7	26.7	-5.8	-2.8	2.7	11.1	-1.1	-0.5	4.1	14.1	-4.4	-2.3

Source: National Bank of Georgia.

1/ Valued at end-of-period actual exchange rates.

2/ Data for end-March 1999 reflect the issuance of a lari 70.3 million government bond to recapitalize the NBG for losses from revaluation of its net international reserves.

Table A-16. Georgia: Summary Accounts of Commercial Banks, 1997–2003 1/
(In millions of lari, end of period)

	1997	1998	1999	2000				2001				2002				2003	
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.
Net foreign assets	33.0	13.7	-6.3	-15.4	-0.2	20.6	-12.8	-3.3	6.2	-2.3	3.7	-16.4	-11.3	25.5	25.0	16.1	11.9
NFA convertible	32.7	13.7	-6.7	-15.4	-0.2	20.6	-12.8	-3.3	6.2	-2.3	3.7	-16.4	-11.3	25.5	25.0	16.1	11.9
Gold	1.1	0.5	0.2	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign exchange	47.2	82.8	93.1	84.8	105.7	130.3	104.8	129.7	140.3	134.7	151.1	157.1	189.9	207.5	207.0	205.0	200.8
Foreign liabilities	-15.6	-69.7	-100.0	-100.4	-106.0	-109.7	-117.6	-133.0	-134.1	-137.0	-147.4	-173.5	-201.2	-182.1	-182.0	-188.9	-188.9
NFA nonconvertible	0.3	0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net domestic assets	100.2	142.6	206.9	230.3	246.2	284.0	316.0	303.5	328.4	368.9	379.9	427.4	432.9	416.9	447.7	497.2	539.3
Domestic credit	170.0	224.2	312.6	311.7	356.3	394.1	422.7	426.4	442.4	490.0	479.5	525.7	533.1	527.7	577.7	635.5	676.7
Net claims on general government	-2.9	-3.0	-1.3	-5.4	-9.2	-10.9	-16.0	-16.3	-20.4	-17.9	-14.5	-10.2	-23.3	-51.3	-42.2	-33.7	-34.1
Net claims on republican government 2/	0.4	5.0	4.4	1.9	-2.4	-4.3	-8.5	-7.9	-8.3	-6.3	-2.3	1.4	-5.1	-39.8	21.7	37.2	37.7
Claims on private sector	172.9	227.3	313.9	317.1	365.5	405.0	438.7	442.7	462.8	507.9	494.0	535.9	556.4	579.0	619.8	669.2	710.7
Of which: foreign exchange loans	77.0	154.4	234.9	248.9	292.6	326.7	348.1	360.0	362.6	405.9	405.8	448.0	474.2	499.5	525.1	570.8	609.2
Other assets (net)	-69.9	-81.6	-105.7	-81.4	-110.1	-110.1	-106.7	-122.8	-114.0	-121.1	-99.6	-98.3	-100.3	-110.8	-129.9	-138.3	-137.4
Deposit liabilities	133.2	156.3	200.6	214.9	246.0	304.6	303.2	300.2	334.6	366.6	383.6	411.1	421.6	442.4	472.8	513.3	551.2
Domestic currency deposits	55.3	48.9	42.1	50.4	46.3	57.9	67.1	50.2	62.0	62.7	55.0	59.8	59.6	64.8	71.5	75.3	75.5
Foreign currency deposits	77.8	107.4	158.4	164.5	199.6	246.8	236.2	250.0	272.6	304.0	328.6	351.3	362.0	377.6	401.3	438.0	475.7
Memorandum items:																	
Share of foreign exchange deposits	58.4	68.7	79.0	76.5	81.2	81.0	77.9	83.3	81.5	82.9	85.7	85.5	85.9	85.3	84.9	85.3	86.3
Exchange rate (in lari, end-of-period)	1.3	1.8	1.9	1.9	2.0	2.0	2.0	2.1	2.1	2.1	2.1	2.2	2.2	2.2	2.1	2.1	2.1

Source: National Bank of Georgia.

1/ Valued at end-period actual exchange rates.

2/ Data for end-June through end-December 2000 reflect an estimate of direct borrowing by the government from commercial banks.

Table A-17. Georgia: Developments in the Commercial Banking System, 1997–2002

	1997	1998	1999	2000	2001	2002
Number of commercial banks	53	43	38	32	29	27
Former state owned	3	3	3	3	3	3
Other domestic	50	39	33	27	24	22
Foreign branches	0	1	2	2	2	2
	(In millions of lari, end-of-period)					
Assets of commercial banking system	328.9	469.7	594.0	765.2	880.4	1,116.5
Loans of commercial banks	177.9	230.2	309.0	430.3	489.8	629.5
Lari	94.8	73.4	70.7	81.0	90.7	97.0
Foreign exchange	83.1	156.8	238.3	349.3	399.1	532.5
Deposits of commercial banks	133.1	156.3	200.5	303.3	383.6	472.8
Lari	55.3	48.9	42.1	67.1	55.0	71.5
Foreign exchange	77.8	107.4	158.4	236.2	328.6	401.3
Household deposits of commercial banks	44.1	42.7	66.4	108.4	162.9	252.7
	(In percent of GDP)					
Assets of commercial banking system	7.1	9.3	10.5	12.7	13.3	15.0
Loans of commercial banks	3.8	4.6	5.5	7.2	7.4	8.5
Deposits of commercial banks	2.9	3.1	3.5	5.0	5.8	6.4
Household deposits of commercial banks	1.0	0.8	1.2	1.8	2.5	3.4
	(Annual percent change)					
Loans of commercial banks	42.3	29.4	34.2	39.3	13.8	28.5
Lari	22.8	-22.6	-3.7	14.6	12.0	6.9
Foreign exchange	73.8	88.7	52.0	46.6	14.3	33.4
Deposits of commercial banks	62.3	17.4	28.3	51.3	26.5	23.3
Lari	26.5	-11.6	-13.9	59.4	-18.0	30.0
Foreign exchange	103.1	38.0	47.5	49.1	39.1	22.1
	(In percent)					
Loan to deposit ratio	133.7	147.3	154.1	141.9	127.7	133.1
Lari	171.4	150.1	167.9	120.7	164.9	135.7
Foreign exchange	106.8	146.0	150.4	147.9	121.5	132.7
Memorandum items:						
Broad money (M3, in millions of lari)	373.0	368.5	444.6	618.2	732.4	863.6
In percent of GDP	8.0	7.3	7.8	10.3	11.0	11.6
Currency outside of NBG (in millions of lari)	277.1	259.7	308.5	391.2	429.9	509.0
In percent of broad money (M1/M3)	74.3	70.5	69.4	63.3	58.7	58.9
In percent of GDP	6.0	5.2	5.4	6.5	6.5	6.9
Nominal GDP (in millions of lari)	4,639	5,041	5,666	6,016	6,638	7,427

Source: National Bank of Georgia.

Table A-18. Georgia: Structure of Commercial Bank Deposits, 1997–2003

	1997	1998	1999	2000	2001	2002	2003
	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	Jun.
	(In millions of lari, end-of-period)						
Domestic currency deposits	55.3	48.9	42.0	67.1	55.0	71.5	75.5
Deposits of enterprises 1/	45.0	41.5	34.7	58.6	47.6	61.0	61.2
Deposits of households/individuals	10.3	7.4	7.3	8.5	7.4	10.5	14.3
Foreign currency deposits	77.8	107.4	157.0	236.2	328.6	401.3	475.7
Deposits of enterprises 1/	44.0	72.1	97.9	141.8	173.1	159.1	130.0
Deposits of households/individuals	33.8	35.3	59.1	94.4	155.5	242.2	345.7
Total deposits	133.2	156.3	199.0	303.2	383.6	472.8	551.2
Deposits of enterprises 1/	89.0	113.6	132.6	200.3	220.7	220.1	191.2
Deposits of households/individuals	44.1	42.7	66.4	102.9	162.9	252.7	360.0
	(In percent of total)						
Domestic currency deposits	41.5	31.3	21.1	22.1	14.3	15.1	13.7
Deposits of enterprises 1/	33.8	26.6	17.5	19.3	12.4	12.9	11.1
Deposits of households/individuals	7.7	4.7	3.6	2.8	1.9	2.2	2.6
Foreign currency deposits	58.5	68.7	78.9	77.9	85.7	84.9	86.3
Deposits of enterprises 1/	33.1	46.1	49.2	46.7	45.1	33.6	23.6
Deposits of households/individuals	25.4	22.6	29.7	31.1	40.5	51.2	62.7
Total deposits	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Deposits of enterprises 1/	66.9	72.7	66.7	66.1	57.5	46.5	34.7
Deposits of households/individuals	33.1	27.3	33.3	33.9	42.5	53.5	65.3
Memorandum items:							
Foreign currency deposits (in millions of U.S. dollar) 2/	59.7	59.7	81.3	119.6	159.5	192.0	225.4
Exchange rate (lari/U.S. dollar; end-of-period)	1.3	1.8	1.9	2.0	2.06	2.09	2.11

Source: National Bank of Georgia.

1/ Including deposits of cooperatives, state companies, and so-called public organizations.

2/ Reported data in domestic currency, converted at end-period exchange rate.

Table A-19. Georgia: Currency Composition of Commercial Bank Credit, 1997–2003 1/

	1997	1998	1999	2000	2001	2002				2003	
	Dec.	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.
	(In millions of lari)										
Credit to the economy 2/	172.9	227.3	313.9	438.7	494.0	535.9	556.4	579.0	619.8	669.2	710.7
Domestic currency claims	95.9	83.8	92.3	90.6	88.2	87.9	82.2	79.5	94.7	98.4	78.2
Foreign currency claims	77.0	143.5	221.6	348.1	405.8	448.0	474.2	499.5	525.1	570.8	632.6
	(In percent of total)										
Credit to the economy 2/	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Domestic currency claims	55.5	36.9	29.4	20.6	17.9	16.4	14.8	13.7	15.3	14.7	11.0
Foreign currency claims	44.5	63.1	70.6	79.4	82.1	83.6	85.2	86.3	84.7	85.3	89.0
Memorandum items:											
Exchange rate (lari/US\$; end-of-period)	1.3	1.8	1.9	2.0	2.1	2.2	2.2	2.2	2.1	2.1	2.1

Source: National Bank of Georgia.

1/ Excluding claims of the Savings Bank before July 1995.

2/ Credit to the nongovernment sectors.

Table A-20. Georgia: Interest Rates, 1997–2003
(In percent per year, non-compounded)

	1997	1998	1999	2000	2001	2002				2003	
	Dec.	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.
Commercial banks (3-month) 1/											
Deposits	15.5	12.5	12.5	11.0	9.0	9.5	9.5	10.1	9.8	8.9	8.7
Domestic currency	14.0	10.0	12.0	10.0	8.0	9.0	9.0	10.3	9.3	8.5	8.6
Former state banks	4.9	11.9	11.8	13.0	12.5	12.0	10.2	11.8	11.7	9.2	9.6
Other	14.5	8.5	12.4	9.8	7.8	8.8	8.9	10.2	9.1	8.4	8.5
Foreign currency	17.0	15.0	13.0	12.0	10.0	10.0	10.0	9.8	10.2	9.3	8.7
Former state banks	12.0	11.5	10.0	10.0	10.2	11.7	10.6	9.1	10.6	9.2	7.8
Other	20.0	16.7	14.6	12.7	10.0	8.8	9.7	10.7	9.8	9.4	9.7
Loans	45.0	45.0	32.0	30.0	31.0	29.5	32.0	32.3	26.5	31.8	29.6
Domestic currency	45.0	38.0	24.0	25.0	30.0	30.0	32.0	34.7	28.3	36.2	30.8
Former state banks	51.8	59.3	46.5	36.1	41.0	35.5	36.2	49.9	29.1	50.2	28.0
Other	41.5	32.1	21.6	20.7	27.4	28.4	29.8	30.1	28.1	31.4	32.7
Foreign currency	45.0	52.0	40.0	35.0	32.0	29.0	32.0	29.8	24.6	27.3	28.4
Former state banks	35.5	72.3	44.9	41.5	38.7	34.3	34.5	32.3	26.2	30.2	30.4
Other	47.1	46.2	38.4	33.1	27.7	25.2	28.0	27.0	23.7	24.3	25.3
Interbank credit auction											
7-day	33.1	...	27.0	...	...	...	...	31.0	19.8	16.7	14.9
1-month	48.1	...	29.0	6.3	...	30.0	...	30.3	22.4	21.0	17.0
2-month	...	...	...	...	...	...	...	...	...	...	...
3-month	...	...	...	20.0	...	...	25.0	...	...	...	...
Interest rate spread 2/											
In domestic currency	29.5	32.5	19.5	19.0	22.0	20.0	22.5	22.2	16.7	22.9	21.0
In foreign currency	31.0	28.0	12.0	15.0	22.0	21.0	23.0	24.4	19.0	27.7	22.2
In foreign currency	28.0	37.0	27.0	23.0	22.0	19.0	22.0	20.0	14.4	18.0	19.7
Memorandum item:											
12-month inflation	7.3	10.7	10.9	4.6	2.5	5.8	5.7	5.9	5.4	3.5	4.8

Source: National Bank of Georgia.

1/ Average weighted interest rates on deposits and loans.

2/ Defined as lending rate minus deposit rates.

Table A-21. Georgia: Prudential Indicators of Commercial Banks, 1997–2003
(End-of-period)

	1997	1998	1999	2000	2001	2002	2003	
							Q1	Q2
Capital adequacy ratio (in percent)	30.6	34.9	38.5	36.7	33.1	21.9	20.5	20.1
Leverage ratio 1/	45.0	43.5	45.6	44.2	39.9	36.1	34.2	35.4
Nonperforming loans 2/	5.9	5.4	6.6	7.1	11.6	7.9	7.8	7.4
Specific provisions 2/	5.4	3.1	2.6	4.7	7.5	4.4	4.1	4.3
Loans collateralized by real estate 2/	...	...	...	...	30.2	33.3	31.2	30.1
Loans in foreign exchange 2/	44.5	64.8	71.8	81.4	81.4	83.8	84.2	85.3
Net foreign assets (in millions of lari)	33.0	13.7	-6.3	-12.7	3.7	25.0	16.1	11.9
Net foreign assets (in percent of total assets)	9.7	2.9	-1.1	-1.7	0.4	2.2	1.4	1.0
Net open foreign exchange position 3/	...	18.1	15.2	15.7	6.9	9.3	8.0	7.9
Liquidity ratio (in percent)	37.8	44.5	40.3	36.8	38.5	45.4	47.0	44.4

Source: National Bank of Georgia.

1/ Defined as the ratio of total capital to total liabilities; an increase in the ratio indicates an improvement.

2/ Percent of total loans.

3/ Percent of total regulatory capital.

Table A-22. Georgia: Regulatory Framework for Commercial Banks as of June 1, 2003 1/

Type	Prudential Regulation
1 Compulsory Standards	
Capital adequacy ratios	
Tier one capital 2/	8 percent (risk-weighted) of total assets 3/
Regulatory capital 4/	12 percent (risk-weighted) 3/
Liquidity indicator	Maintain liquid assets at least 30 percent of short-term liabilities (with maturity of six months)
Limits on lending	
Lending to a single insider	5 percent of total capital
Total lending to all insiders	25 percent of total capital
Lending to a single outsider	15 percent of total capital
Total lending to the 10 largest borrowers	50 percent of total loans
Loan loss provisioning requirements	2 percent for performing loans 10 percent for watch loans 30 percent for sub-standard loans 50 percent for doubtful loans 100 percent for loss loans
Minimum capital licensing requirements	
For new banks	Lari 5 million
For existing licensed banks	Lari 5 million
Required reserves	14 percent of total deposits
Foreign exchange	Overall foreign exchange open position limit is 20 percent of regulatory capital (shortcut method)
Off-site supervision	Quarterly off-site monitoring
On-site supervision	Once in 6-18 months, depending on bank's rating
2 Other Requirements	
Limit on fixed assets	Net fixed assets must not exceed 30 percent of equity capital
Limit on current assets	Current assets must not be less than 90 percent of current liabilities
Limit on equity investment	Total amount of equity investment must not exceed 50 percent of equity capital
Limit on ownership by any one shareholder	For individuals and non-bank companies 25 percent of share capital
Financial statements and ratio calculations	Monthly reporting
Annual audits	Law requirement, to be performed by certified and recognized independent audit company
Deposit protection	None
Money laundering regulations	None
Sanctions	According to the law and special regulations

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

1/ BIS (Bank for International Settlements) recommended standards, which were adopted in September 1997, are the minimum requirements.

2/ "Tier One Capital" includes: (I) common share capital; (II) retained earnings; (III) capital surplus; (IV) less revaluation of fixed assets recorded in share capital; (V) less any treasury stocks; (VI) less intangible assets, goodwill.

3/ Regulations on classification of assets by the underlying risk is effective from January 1, 1999.

4/ "Regulatory Capital" includes: (I) tier one capital plus (II) tier two capital, which must not exceed 100 percent of tier one capital; (III) less investments in Georgian resident banks' capital; (IV) less non-consolidated investments in subsidiaries capital.

Table A-23. Georgia: Balance of Payments, 1997–2002

(In millions of U.S. dollars; unless otherwise indicated)

	1997	1998	1999	2000	2001	2002
Current account (including transfers) 1/	-364.1	-370.3	-217.5	-175.6	-179.2	-202.5
Trade balance	-558.9	-685.4	-536.0	-409.2	-461.8	-475.6
Exports	493.5	478.3	477.0	527.7	473.0	468.6
Imports	-1,052.4	-1,163.7	-1,013.0	-937.0	-934.8	-944.1
Non-factor services	-148.0	-31.1	-5.2	-144.5	113.6	114.8
Credits	167.9	242.1	242.1	261.6	516.2	499.6
Debits	-315.9	-273.2	-247.3	-406.1	-402.6	-384.8
Factor services	138.6	117.4	121.0	4.5	26.8	24.0
Credits	186.6	193.3	206.1	88.7	93.0	92.9
Debits	-48.0	-75.9	-85.1	-84.2	-66.2	-68.9
Transfers	204.3	228.9	183.2	119.1	158.8	130.1
Capital account	266.7	253.7	102.2	88.3	94.4	119.0
Medium- and long-term borrowing	52.0	35.8	24.5	-94.9	-10.8	-25.5
Disbursements	105.5	117.7	107.0	14.8	117.5	138.5
Amortization due	-53.5	-81.9	-82.4	-109.6	-128.3	-164.0
Other capital	214.7	217.9	77.7	183.2	105.2	144.5
Errors and omissions	3.8	-7.5	39.0	22.7	-12.2	-7.4
Overall balance	-93.6	-124.1	-76.3	-64.6	-97.0	-90.8
Overall financing	93.6	124.1	76.3	64.6	97.0	91.0
Increase in net international reserves (-) 2/	-15.3	54.9	-14.0	23.0	-51.7	-36.6
Exceptional financing 3/	108.9	69.2	90.3	41.7	148.7	127.6
Memorandum items:						
Current account including transfers (in percent of GDP)	-10.2	-10.2	-7.8	-5.8	-5.6	-6.0
Gross international reserves	173.3	118.4	132.4	109.4	161.1	197.7
In months of imports of goods and non-factor services	1.5	1.0	1.3	1.0	1.4	1.8

Sources: Georgian State Department and Statistics; National Bank of Georgia; and Fund staff estimates.

1/ From 2000 onwards, the current account is based on a new series estimated by the NBG that is not consistent with data prior to 2000.

2/ Includes a valuation adjustment.

3/ Includes arrears, debt relief, and macroeconomic support.

Table A-24. Georgia: Geographic Distribution of Trade, by Country, 1998–2002
(In percent of total)

	1998	1999	2000	2001	2002
Exports					
Total	100.0	100.0	100.0	100.0	100.0
Russia	28.7	18.7	21.1	23.0	17.4
Turkey	10.5	15.8	22.7	21.5	15.3
Azerbaijan	9.6	8.1	6.4	3.3	8.8
Armenia	9.3	6.3	4.1	3.9	5.8
Germany	6.9	10.3	10.4	2.5	1.6
United States	5.8	4.2	2.2	3.0	3.9
Italy	4.7	4.5	3.8	2.7	2.2
Ukraine	4.4	4.6	3.3	3.7	3.7
France	3.2	0.3	0.4	0.1	1.0
Switzerland	2.8	2.4	4.1	4.9	7.0
Netherlands	1.7	0.9	0.6	1.1	1.3
Bulgaria	1.6	0.2	0.7	0.2	0.0
Others	10.8	23.7	20.1	30.4	32.0
Imports					
Total	100.0	100.0	100.0	100.0	100.0
Russia	14.8	19.2	14.1	13.7	16.3
Turkey	11.1	12.2	16.0	15.4	11.8
Azerbaijan	8.3	6.9	8.5	10.8	10.8
Germany	9.3	7.3	7.7	9.4	7.6
United Kingdom	7.7	3.5	3.5	3.7	3.6
United States	8.6	11.9	5.5	4.1	4.4
Switzerland	3.7	0.2	3.5	2.1	2.4
Ukraine	3.5	4.5	5.4	7.3	7.9
Bulgaria	3.1	1.9	2.4	1.6	1.9
Italy	3.3	2.0	2.7	3.7	5.2
Netherlands	2.9	2.0	1.2	1.3	2.0
France	2.5	5.0	1.7	2.7	2.0
Romania	2.1	2.1	2.0	2.5	0.6
Others	19.1	21.3	25.7	21.8	23.4

Source: Georgian State Department of Statistics.

Table A-25. Georgia: Composition of Major Exports, 1997–2002 1/
(In millions of U.S. dollars)

	1997	1998	1999	2000	2001	2002
Scrap metals	...	1.0	23.5	39.0	32.9	36.3
Ferro alloys	15.5	22.3	20.1	13.6	17.5	15.5
Aluminium waste and scrap	...	0.1	1.5	12.9	15.4	5.4
Non-ferrous metal pipes	17.5	4.6	0.8	1.9	1.3	0.6
Crude oil and related oil products	14.4	5.7	4.8	12.8	9.3	6.5
Oil and oil products	13.4	9.2	7.1	6.4	5.6	4.0
Tea	13.9	8.9	11.4	6.1	5.8	4.7
Fertilizers	13.8	10.6	11.4	16.2	4.9	12.0
Citrus fruits (including dry fruits)	5.2	5.6	1.9	2.5	1.6	1.6
Copper ore	7.2	2.0	1.0	9.8	9.6	13.2
Alcoholic beverage (excluding wine)	4.5	7.4	5.5	4.0	5.9	6.5
Wine and related products	12.5	15.4	14.6	29.0	32.2	33.1
Non-alloyed steel and cast iron	9.3	3.1	0.8	0.5	0.1	0.2
Mineral water	17.6	7.2	2.6	9.5	11.7	17.4
Electricity	11.9	5.5	9.7	7.2	11.1	6.5
Others	82.9	83.8	121.4	158.6	155.2	187.1
Total exports	239.8	192.3	238.2	329.9	320.0	350.4

Source: Georgian State Department of Statistics.

1/ The analysis is based on the raw data provided by the State Department of Statistics that cover only recorded trade. Total exports differ significantly from staff estimates in the balance of payments table that include estimates of unrecorded trade.

Table A-26. Georgia: Composition of Major Imports, 1997–2002 1/
(In millions of U.S. dollars)

	1997	1998	1999	2000	2001	2002
Oil and oil products (excluding crude oil)	152.2	130.3	57.7	71.9	87.7	88.9
Oil, gas, and related products	74.0	54.5	62.4	48.6	49.1	52.3
Sugar	39.1	16.2	16.2	24.6	24.1	34.5
Cigars and cigarettes	107.8	7.4	35.2	29.4	18.7	18.9
Electricity	26.8	25.7	14.6	15.1	15.6	15.7
Wheat and flour	37.1	26.5	14.8	20.3	14.8	5.5
Beer	3.1	0.8	0.1	0.1	0.1	0.4
Wheat and rye byproducts	57.2	31.8	15.5	21.9	11.2	15.5
Sunflower and cotton oil	2.2	4.7	1.1	1.0	2.0	3.0
Poultry products	10.1	12.3	14.5	11.0	11.2	12.5
Medicine	35.9	36.3	41.5	33.9	38.3	46.0
Coffee and coffee substitute	9.0	5.4	5.0	4.3	2.0	1.1
Radio receiver	0.7	1.1	0.1	1.2	0.4	0.2
Automobiles	45.3	65.2	37.7	15.2	12.4	21.8
Electronic devices	5.4	8.3	7.8	4.9	5.7	5.4
Pipes and other related products	13.0	27.6	0.6	2.2	5.9	2.5
Others	322.8	426.3	277.1	345.1	381.4	419.9
Total imports	941.7	880.4	601.9	650.7	680.7	744.1

Source: Georgian State Department of Statistics.

1/ The analysis is based on the raw data provided by the State Department of Statistics that cover only recorded trade. Total imports differ significantly from staff estimates in the balance of payments table that include estimates of unrecorded trade.

Table A-27. Georgia: External Debt Outstanding, 1994–2002
(In millions of U.S. dollars)

	1994	1995	1996	1997	1998	1999	2000	2001	2002
Total debt outstanding	1,003.9	1,216.7	1,357.2	1,512.4	1,634.4	1,706.3	1,612.5	1,712.4	1,858.1
Public and publicly guaranteed	1,003.9	1,216.7	1,357.2	1,512.4	1,629.4	1,676.1	1,590.2	1,654.7	1,776.1
Multilateral	193.2	364.5	520.3	655.5	764.7	829.2	788.7	859.4	942.7
World Bank	1.0	86.0	162.7	227.0	300.5	358.8	377.3	441.7	490.6
IMF	40.5	116.1	189.5	257.8	302.1	319.0	281.8	291.1	308.2
European Union	151.7	160.8	155.1	145.5	129.8	116.8	92.4	91.3	95.8
Other	0.0	1.6	12.8	25.2	32.3	34.7	37.3	35.3	48.1
Bilateral	810.7	852.2	836.9	856.9	864.7	846.9	801.4	795.3	833.4
BRO	655.9	684.3	634.5	638.3	618.7	593.6	559.4	547.0	545.6
Russia	156.3	167.1	175.4	179.3	179.3	179.3	156.9	156.9	156.9
Turkmenistan 1/	440.3	453.2	393.6	393.6	373.9	348.9	336.9	324.9	324.1
Armenia	18.1	19.7	19.6	19.6	19.6	19.6	20.0	19.6	19.6
Azerbaijan	15.0	15.7	16.2	16.2	16.2	16.2	16.2	16.2	16.2
Kazakhstan	24.1	26.7	27.8	27.8	27.8	27.8	27.8	27.8	27.8
Other	2.0	2.0	2.0	1.9	1.9	1.9	1.7	1.7	1.0
Non-BRO	154.8	167.9	202.4	218.6	246.1	253.2	242.0	248.2	287.8
Turkey	42.0	45.4	47.9	54.3	54.3	54.3	54.3	54.3	54.3
Austria	97.4	104.2	110.3	90.0	90.0	83.8	72.5	70.3	81.5
Germany	0.0	2.8	27.6	33.3	46.4	51.7	50.4	53.9	66.5
Japan	0.0	0.0	0.0	0.0	0.0	0.0	3.2	10.0	19.8
Netherlands	0.0	0.0	0.0	4.4	4.5	4.6	4.1	4.0	3.9
USA	0.0	0.0	0.0	19.9	34.7	42.5	42.2	39.6	38.9
Others	15.4	15.6	16.6	16.7	16.1	16.3	15.3	16.0	22.8
Private non-guaranteed 2/	0.0	0.0	0.0	0.0	5.0	30.2	22.3	57.7	82.0

Sources: Georgian authorities; and Fund staff estimates.

1/ Includes arrears.

2/ Excludes short-term debt.

Table A-28. Georgia: External Debt Service Obligations, 1998–2002
(In millions of U.S. dollars)

	1998			1999			2000			2001			2002		
	Interest	Principal	Total	Interest	Principal	Total	Interest	Principal	Total	Interest	Principal	Total	Interest	Principal	Total
Total debt service due	42.1	82.9	125.0	48.2	103.3	151.5	57.5	135.5	193.0	49.3	141.2	190.5	42.1	194.0	236.1
Medium/long term	42.2	82.9	125.0	48.2	103.3	151.5	57.5	135.5	193.0	49.3	141.2	190.5	42.1	194.0	236.1
Public and publicly guaranteed	42.2	82.9	125.0	48.2	103.3	151.5	56.7	133.4	190.1	48.7	138.7	189.9	37.4	190.3	227.7
Official creditors	42.2	82.9	125.0	48.2	103.3	151.5	56.7	133.0	189.7	48.6	138.7	187.2	37.3	190.3	227.6
Multilateral	9.4	3.8	13.2	13.2	24.4	37.6	17.1	30.5	47.6	11.0	17.2	28.2	11.3	36.5	47.8
Bilateral	32.8	79.0	111.8	35.0	78.9	113.9	39.6	102.6	142.2	37.6	121.5	159.1	26.0	153.8	179.8
Private creditors	--	--	--	--	--	--	--	0.4	0.4	0.1	--	0.1	0.1	--	0.1
Private non-guaranteed	--	--	--	--	--	--	0.8	2.1	2.9	0.6	2.6	3.2	4.7	3.7	8.4
Short term	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Memorandum items:															
Debt service (percent of exports of GNFS)	5.9	11.5	17.4	6.5	14.1	20.6	5.5	13.0	18.5	5.1	14.5	19.6	4.3	20.0	24.3

Sources: Georgian authorities; and Fund staff estimates.

Table A-29. Georgia: Exchange Rates, 1997–2003 1/

	Lari per U.S. dollar		Lari per thousands of ruble		NEER 2/	REER 2/
	Period average	End-of-period	Period average	End-of-period	End-of-period	End-of-period
1997 Q1	1.298	1.294	0.220	0.220	133.5	137.6
Q2	1.299	1.300	0.220	0.230	137.3	135.1
Q3	1.295	1.298	0.220	0.220	143.8	136.1
Q4	1.308	1.304	0.220	0.220	146.4	137.8
Year	1.300	1.304	0.220	0.220	140.3	136.6
1998 Q1	1.327	1.335	0.220	0.219	151.1	138.6
Q2	1.342	1.348	0.218	0.217	152.5	132.5
Q3	1.350	1.364	0.169	0.085	185.2	140.6
Q4	1.544	1.790	0.086	0.086	152.5	123.3
Year	1.391	1.790	0.173	0.086	160.3	133.7
1999 Q1	2.199	2.215	0.094	0.090	135.1	113.0
Q2	2.059	1.940	0.083	0.080	161.5	127.0
Q3	1.875	1.850	0.075	0.073	176.7	131.4
Q4	1.951	1.960	0.074	0.071	178.0	132.2
Year	2.021	1.960	0.082	0.071	162.8	125.9
2000 Q1	1.991	1.950	0.071	0.069	185.7	133.1
Q2	1.976	1.968	0.069	0.070	189.0	130.8
Q3	1.965	1.964	0.070	0.071	196.2	135.5
Q4	1.974	1.971	0.070	0.069	194.6	133.2
Year	1.977	1.975	0.070	0.070	191.4	133.1
2001 Q1	2.049	2.060	0.072	0.072	199.7	133.1
Q2	2.062	2.045	0.071	0.071	213.8	134.6
Q3	2.069	2.061	0.070	0.070	217.7	132.2
Q4	2.115	2.060	0.071	0.070	213.4	129.7
Year	2.074	2.060	0.071	0.071	211.2	132.4
2002 Q1	2.212	2.215	0.072	0.071	204.6	124.7
Q2	2.220	2.190	0.071	0.071	205.8	122.3
Q3	2.188	2.170	0.069	0.069	211.1	122.0
Q4	2.164	2.180	0.068	0.067	213.0	123.6
Year	2.196	2.180	0.070	0.070	208.6	123.2
2003 Q1	2.173	2.120	0.069	0.068	208.0	118.9
Q2	2.154	2.110	0.070	0.070	197.1	111.8

Sources: National Bank of Georgia; IMF, Information Notice System; and Fund staff estimates.

1/ Lari exchange rates are those prevailing on the Tbilisi Interbank Foreign Exchange (TIBFEX).

2/ Nominal effective exchange rate and real effective exchange rate. Index, 1995=100. Increase indicates appreciation.