



MINISTRY FOR FOREIGN
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Aid for Trade Needs Assessment – Georgia Trade and Human Development

April 2011



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The **Aid for Trade agenda** is one of the most important development-related outcomes of the 2005 WTO Ministerial Conference in Hong Kong. It targets developing countries through strengthening their productive capacities, trade-related infrastructures and ability to compete in regional and global markets. Trade plays an important role in development, although the relationship between trade and human development is not automatic. In order to be inclusive, trade has to be set in a human development framework. It needs to be conceived as a tool to expand the abilities and choices of people.

The Aid for Trade initiative covers the following categories:

- Trade policies and regulations;
- trade development;
- developing productive capacities;
- trade related adjustment;
- other trade-related needs.

UNDP's regional **Aid for Trade project 'Wider Europe: Aid for Trade for Central Asia, South Caucasus and Western CIS'**, financed in the context of Finland's Wider Europe Initiative, focuses on the identification of capacity gaps and technical assistance needs both at the national and sub-regional level in Central Asia, the South Caucasus and Western CIS and support of economic development in the areas located along the selected transport corridors, helping small entrepreneurs to gain from new trade opportunities.

The **Wider Europe Initiative** is Finland's harmonised regional development framework. The initiative targets the following themes: security, trade and development, information society development, energy and the environment and social sustainability. The framework includes three regional cooperation programmes – in Eastern Europe (Belarus, Moldova and Ukraine), the South Caucasus (Armenia, Azerbaijan and Georgia) and Central Asia (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan).

The **Needs Assessments** produced under the Aid for Trade project form part of a long-term vision of developing trade capacities, which will benefit human development in the region. The recommendations presented are expected to constitute the basis for a second phase (2011–2013), focusing on the implementation of the recommendations developed in the national and regional Needs Assessments.

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UNDP Regional Bureau for Europe and the Commonwealth of Independent States



I am pleased to present this publication on the assessment of the needs of trade development in Georgia and recommendations for policy makers on the wide range of the policy options for further facilitating access of entrepreneurs to local and foreign markets for goods and services.

I would like to mention that this initiative is an integral part of the regional Aid for Trade project under 'Wider Europe: Aid for Trade for Central Asia, South Caucasus and Western CIS' which covers Central Asia, the South Caucasus and Western CIS.

I strongly believe, that UNDP supported coordinated action of the national stakeholders from these countries which, on the one hand face similar development challenges and, on the one other hand, have rather different opportunities and development needs, will result in formulation and implementing of effective trade development policy.

I would like to express our gratitude and appreciation for the support provided by the Government of Finland through the Wider Europe instrument, the team of Aid for Trade project from UNDP Bratislava Regional Office for Europe and CIS who successfully manage this project and the team of the authors who applied their knowledge and took into consideration the opinions of the national stakeholders and experts.

I hope that this publication will facilitate the dialogue and cooperation among the public and private sector, as well as, independent researchers and experts for developing the policy which makes the trade to work better for development.

Jamie McGoldrick
UNDP Resident Representative in Georgia

Team for the preparation of the Publication

Authors

Mikheil Tokmazishvili
George Berulava

Advisory group

Jacek Cukrowski
Kim Boermans
George Nanobashvili

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Acronyms and abbreviations

BSEC	Black Sea Economic Cooperation
CAB	Conformity Assessment Body
EA	European co-operation for Accreditation
EaP	Eastern Partnership Initiative
ENP	European Neighbourhood Policy
EU	European Union
FAOSTAT	Food and Agriculture Organization of the United Nations Statistics
FTA	Free Trade Agreement
FDI	Foreign Direct Investment
FIZ	Free Industrial Zones
GAC	Georgian Accreditation Centre
GSP	Generalized System of Preferences
GNIA	Georgian National Investment Agency
ILAC	International Laboratory Accreditation Cooperation
ILO	International labour Organization
IMF	International Monetary Fund
IT	Informational Technologies
MoA	Ministry of Agriculture
MoFA	Ministry of Foreign Affairs
MoED	Ministry of Economic Development
MFN	Most Favourable Nation
PCA	Partnership and Cooperation Agreement
SDS	State Department for Statistics
SME	Small and Medium Enterprises
TBT	Technical Barriers to Trade
TIFA	Trade and Investment Framework Agreement
WB	World Bank
WTO	World Trade Organization

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Executive Summary

The Georgian Government undertook a very ambitious institutional and business reform programme after the ‘rose revolution’ in 2003. The elimination and simplification of business regulations boosted the country’s competitiveness and facilitated international trade. Business reforms were accompanied by significant capital inflows and GDP growth. Georgia became the top reformer country in the world, which allowed it to maintain economic growth during the global financial crisis and demonstrated resilience after the Russia-Georgian army conflict in 2008.

Though improving the business climate had a positive influence on the increase in gross output, the growth in Georgia has mainly been macroeconomic, and was associated with excess absorption and credit expansion, and foreign investment mainly in non-tradable sectors.

Study revealed that at the quality of economic growth has remained low with respect to social sustainability and innovations. In particular, economic growth was not related to innovations and investment in high-technology industries which would increase employment and equity in income distribution.

Economic reforms reduced bureaucratic obstacles, making it possible for businesses to expand their operations, create new jobs and increase employment and output. At the same time business climate reforms have had little effect on small and medium-sized business and the sectors sensitive to trade, like agriculture, which remains to be the largest employer. The share of small and medium businesses has not undergone significant changes in the recent period and the agriculture sector demonstrates low levels of investment and poor trade performance, due to political, institutional and human capital obstacles.

During the course of 2006, Russia, Georgia’s main trading partner, imposed a series of trade and transit barriers on products from Georgia. This contributed to a sharp slowdown in export growth, especially in the agro-food sector. Georgia lost his main agro food market and reorientation to EU markets was not easy because of the low competitiveness of Georgian enterprises.

Moreover, the result of analysis of the foreign trade relations of Georgia show that trade liberalization efforts stimulated export, but in fact, exporters largely haven’t been able to make use of the international trade preferences. Business reforms have to be supported with adequate measurements in the field of human resources in order to promote and intensify foreign trade and stimulate exporters’ profit growth from the ease of doing business.

The study finds that the reduction of inequality, poverty and unemployment rates and promotion of job creation in the private sector is still an urgent necessity for Georgia, without which attaining social cohesion and, consequently, ensuring economic development will not be feasible. An important way to deal with this issue is attaining high productivity levels in sectors employing large shares of workers through the elaboration and implementation of development strategies oriented towards efficient restructuring and upgrading of human capital.

The circumstances under which Georgian enterprises were compelled to diversify export routes have revealed a need to improve the skills and knowledge of the labour force, technology, infrastructure and logistics of organizations.

It is emphasized that in parallel with preparing Georgia’s government strategy and programme of TBT (Technical Barriers for Trade) in the framework of preliminary negotiations with FTA (Free Trade Agreement), there is a need to improve trade service institutions on the legislative level.

The study’s emphasis on one of main sector of economy of Georgia, shows that the increase of employment in Georgia is related mainly to activities in the agricultural sector and business climate reforms. Agriculture production needs support and readjustment in order to increase the export capacities of Georgian agriculture entrepreneurs and find ways to improve its competitiveness.

Examination of the Georgian wine industry reveals a need for specialists and adequate scientific knowledge, training of high-qualified wine and vine specialists; improving educational capacities; supporting scientific and research activities; establishment of market information and intelligence system, a differentiation strategy focused on creation of strong brand awareness. The introduction of a special support programme in such areas as mechanization, use of fertilizers and irrigation, agriculture management practices, organization, providing quality and safety controls will enhance

the efficiency of farms and improve the trade capacity that was badly hit by the introduction of the Russian embargo, as it was Georgia’s main trade partner.

The results show that trade liberalization will be beneficial for the agricultural markets due to positive welfare effects and that further support of SME and entrepreneurship in key sectors should be considered by policy makers. The enhancement of trade competition proficiency should be promoted, on the one hand, through building up institutional mechanisms by the government, and, on the other hand, through partnership relationships and joint efforts of private companies. To ensure long term economic development, and stable growth rates, the social impact of growth must be improved, alongside the elimination of barriers for producers who want to produce for export.

The recommendations cover several groups of proposals: institutional changes, organizational measurements, directions of partnership relations including with government and self-government bodies, possible schemes of reducing risks and financial instruments development.

Key priority areas are presented in the Action Matrix, which covers such components as support to the Government of Georgia in national trade policy-making development and increasing coordination between state institutions; strengthening information, research and training in support of trade policy making; strengthening the capacity of public and private trade development institutions, improving the Georgian Accreditation centre (GAC) and sanitary and phytosanitary (SPS) capacity; improving trade promotion services; improving access to credits and insurance; improving transportation and logistics; promoting Georgian wine export and sector development (establishing and promoting ‘Brand Georgian Wine’ (BGW) at global markets); increasing resources for agricultural and agro-food research; establishing agricultural and agro-food extension services and vocational education in agriculture and manufacturing. All these issues are crucial for Georgia and are subjects of discussion within the government of Georgia and with international donors.

Introduction

Georgia, a small, strategically located middle-income country of 4.5 million people in the South Caucasus, had an estimated per capita income of USD 2,414 in 2009, over 2.6 times its level at the beginning of the review period in 2003, when sustained growth resumed following many years of economic decline.

After independence in 1991, Georgia started a transition period with low level of income, slender fiscal resources, and weak institutional and administrative capacity as a legacy of the communist period. With the breakdown of communism, social protection system, social infrastructure and labour markets collapsed. Intensification of economic and social problems was conditioned by internal wars, civil conflicts and closure or blockage of trade routes. The wars in 1991–1993 in the South Ossetian and Abkhazian autonomous republics were followed by migration, economic disruption and decline.

In the mid-1990s the Georgian authorities achieved macroeconomic stability through implementing a stabilization programme.

The Georgian economy received new stimulus following the rose revolution in November 2003. The Government undertook a very ambitious reform programme which enhanced macroeconomic stability and ensured stable rates of real GDP growth.

At present on-going reforms are conducive to human development needs. Georgia has just started reforming its trade policy, arrangements, regulations and infrastructure aiming at improving the macroeconomic and business environment. At the same time Georgia is working on a free trade agreement with EU that could be a driving force for the advancement of deep and better integration in the region.

It has access to EU markets included in GSP+, but related institutional, infrastructural, informational, human capital and technological difficulties still weigh down exports of Georgian products and implantation in EU markets.

The overall goal of this report is to help the government to design coherent plans for improving trade policy, regulations, infrastructure and human development measurements through determining trade-related needs and priorities within the context of economic development and poverty reduction strategies, to actively involve all stakeholders, including business associations and civil society, in the transformation of the macroeconomic and business environment and adjustment of human development processes, to emphasise the spheres where donors technical assistance and sponsorship are necessary.

This report seeks to help Georgia build supply-side capacity and trade-related infrastructure so that it can benefit from trade agreements and enhance the contribution of trade to development.

The paper provides an economic and institutional analysis of the country and offers policy advice from the point of view of improving of spheres related to trade and the wellbeing of the population. Recent developments in the Georgian economy are discussed in more detail. In particular, **the first chapter** analyses macroeconomic and business environment features of Georgia before and after the ‘rose revolution’. Much attention is given to discussion of the impact of the global financial crisis and the war with Russia on the economy of Georgia. The chapter contains a review of social environment and human development challenges.

The second chapter contains a review of foreign trade relations, development of regional trade issues and current investment policies. It includes a brief description of tariff and non-tariff policies, custom and trade procedures, the impact of international conventions and arrangements on trade performance and human development of the country, investment performance and investments' impact on promotion of trade and human development.

Chapter three presents opportunities to further promotion of trade. It sets out technical regulations affecting trade, characterizes standards, certification, testing, sanitary and phytosanitary measures; considers infrastructure services, institutions and barriers to trade. At the end of the chapter a SWOT analysis of trade and the investment environment is given.

Chapter four Analysis of human development in sensitive sectors – explores the prospects of the agriculture and food sectors in Georgia in terms of trade expansion and human development, highlights trade capacity constraints and overcoming trade barriers in the sector of wine and spirits.

At the end, the paper outlines **conclusions and recommendations** and sets out **matrix of action** for further development of trade and human development.

1. Macroeconomic development and social environment

1.1. Overview of the developments of the economy before the ‘rose revolution’

In Georgia the process of transition from the Soviet system to the market economy was accompanied, as was the case in many other post-communist countries, by substantial difficulties. Georgia experienced significant problems stemming from political instability caused by armed conflicts in separatist regions and civil war, and problems related to the transition to a free market economy. The economic situation in Georgia became rather unstable. This was reflected in a reduction in personal incomes, hyperinflation of the national currency, and a serious drop in industrial and agricultural production.

According to official data, the output in 1994 declined 30 per cent compared to 1990. Monthly consumer price inflation in coupon (national currency at the time) terms averaged 60–70 per cent per month in 1993–1994. From 1990 to 1994, official data indicated that employment declined by one third. The administrative capacity of the Government and its ability to conduct relevant economic policy also deteriorated.

In 1994, the Georgian authorities began to cooperate closely with the IMF and the World Bank to address Georgia's massive economic problems by implementing a programme of stabilization and structural reform. These anti-crisis, large-scale economic reforms encompassed the entire range of the Georgian economy: restructuring the monetary policy and the banking system, acceleration of privatization, price liberalization, transformation of the fiscal system, liberalization of foreign trade, development of revenue system and an appropriate legal framework, etc. The implementation of these reforms allowed for dramatic improvement of the situation within a relatively short period of time. Georgia's GDP grew rapidly, and in 1997, GDP growth reached 11 per cent. Moreover, by that time relative political stability was achieved and a new constitution was adopted.

The progress in curbing inflation has been particularly impressive. Average monthly inflation fell from the hyperinflationary level of 57 per cent in 1995 (end-of-period basis) to 7 per cent in 1997. Unfortunately, the period of economic revival was very short. Double-digit real output growth and decline in inflation continued until 1998. Due to the crisis in Russia and droughts in 1998 and 2000, as well as severe energy supply problems and underlying structural problems, the GDP growth decreased to 3 per cent in 1998, and the inflation rate grew and remained at over 20 per cent during much of 1999.

Until 2003 the economy of Georgia was expanding at a moderate 3 to 3.5 per cent growth rate. In 1998–2003, inflation rate was about 4 to 5 per cent, reflecting a restrictive monetary policy, a more stable exchange rate, and the absence of demand-side pressures. Both the government and market institutions remained underdeveloped. It's worth noting that in 2003 the Georgian economy was one third the size it was in 1990.¹

The low rate of economic growth was accompanied by an enormous **trade deficit**, which widened especially in 1996 and 1997, reflecting higher rates of import growth than that of export. Despite the reversed tendency in the next few years until 2003, the Georgian economy became an import-oriented country. Capital account was weak, reflecting lower loan disbursements offsetting foreign direct investment. The inflow of foreign direct investment (FDI) in 1996–1998 was related to the construction of the Baku–Supsa oil pipeline. Moreover, Georgia had incurred a huge external debt of almost of 80 per cent of GDP in 1994. Georgia's ability to pay its obligations was very low. At the end of 2000 the total stock of external debt reached 53 per cent of GDP. Debt sustainability remained a serious concern.

The weak export capacity of Georgia was aggravated by the repeated fluctuation of the national currency (GEL) exchange rate. The Russian crisis in 1998 and Georgia's weak fiscal position caused large scale depreciation of the currency. The GEL depreciated moderately in early 2001, following the crisis in Turkey. The Russian crisis and the loss of confidence in financial markets put a significant strain on the banking system, but a full-scale crisis in the banking system and debt was averted.

¹ Source: National Statistics Office of Georgia. Available from www.geostat.ge.

By adopting a strict **monetary policy** and allowing the GEL to depreciate, the Georgian authorities handled the crisis. This crisis, however, revealed the fact that despite all the achievements in macroeconomic stabilization process, the Georgian economic system remained fragile and vulnerable in the face of external shocks and new stimulus for its enhancement were badly needed.

In 1998–2003 the revenues of the State budget accounted only for 11–12 per cent of GDP. Such situation in the **fiscal sphere** did not allow the country to launch the relevant social programmes and develop basic infrastructure. The high level of corruption only worsened the situation.

Social life and human development tendencies adequately reflected the weakness of the macroeconomic development area. After the short-lived revival of the economy in 1995 to 1997, the social indicators worsened and after recovering from the recession in 1999 until 2003 the low level of living standards remained almost unchangeable.

The majority of the employed population was engaged in low-paying and insecure segments of the labour market and subject to poor working conditions. Most jobs were created in the informal sector, a major provider of urban jobs, and in the low-productive agricultural sector; many of these were part-time or temporary jobs, offering extremely low remuneration and insufficient to improve the household budget situation. Informal activities, which were mostly a way of surviving, were largely unrecognized, unrecorded and unregulated small-scale activities, many of which were irregular self-employment. Moreover, there was a substantial shift of employment from the industry sector to the agriculture sector. As a result, the low-productive agriculture sector had become one of the main sources of employment.

The official unemployment rate reached as high as 14 per cent and self-employers accounted for 70 per cent in total labour force.² Almost 85 per cent of the total number of those unemployed was concentrated in cities. This strengthened the intensification of regional distribution of added value and transfers, increased the economic contrast between city and village, and negatively affected both ‘donors’ employed in cities and ‘recipients’ living in villages. Inequality deepened not only between cities and villages but between small and big towns. This development was rooted in different employment structures.

In this period **average salaries** were still very low and the worst situation was in budgetary organizations. Generally, average wages amounted to 60–70 per cent of the minimum cost of living. The wages even decreased in real terms during this period. Many public sector employees were paid only token salaries, cases of non-payment of salaries were widespread, arrears in the payment of budgetary employees' salaries persisted and the growth in salaries was eroded by inflation.

In 1998–2003 the national pension decreased from 10 to 7 USD. Expenditures on pensions dropped to 3.15 per cent of GDP and internal debt (on pensions and salaries) grew to 60 million USD.

There was an extremely high poverty rate in rural areas. Poverty in rural areas was conditioned by low labour productivity and low level of education.³

To summarize, during the period of 1996–2003 along with moderate economic growth the total number of employed persons was decreasing. The number of employed people fell by 15 per cent while the GDP increased 2.2 fold. Poverty became the most serious issue in Georgia. For this reason **Economic Development and Poverty Reduction Strategic Plan** (Programme) was prepared by a Georgian governmental commission. This was a strategic statement aiming to overcome the crisis and ensure future development. Though the programme was approved its implementation was destined to fail. During that period the political authority and government, were incapable of combating poverty, because the government had limited capacity to implement its own decisions and decrees.

Extreme poverty and economic stagnation were some of the causes of the ‘rose revolution’ in November 2003. The new government initiated radical changes in the social, political, and institutional fields. A corresponding change followed then in the country's economic and social life.

² This does not include the rural population, which represents half of the total population. Under Georgian law, farmers who own up to 0.8 hectares of land are not counted as unemployed. The average annual income of these farmers was EUR 150–500 and at least two out of three farmers were unemployed; farmers constituted the poorest section of the Georgian society.

³ After the first agricultural census in Georgia (2005), it was revealed that only 15–18 per cent of persons on the Managerial position in agrarian sector have high and middle professional education. (Source: http://www.geostat.ge/cms/site_images/_files/georgian/agriculture/census/1percent2ozogadi.pdf)

1.2. Analysis of institutional reforms after the ‘rose revolution’

Starting in 2004, the new Government implemented radical social, political and institutional changes. The main goals of the new administration included establishing fiscal discipline, restoring the legal basis of the economy, reducing the scale of the shadow economy, and simplifying regulations through the introduction of new laws on business. These changes have affected the economic and social life in the country.

The first step taken by the Government was civil service reform, focused on eliminating redundant agencies and a significant reallocation of personnel. Governmental agencies were restructured with the aim of reducing bureaucracy and increasing both the efficiency of government officials and their remuneration. At the same time, the number of institutions regulating, controlling and inspecting the private sector was decreased.

The Government started an effective fight against corruption, exemplified in the reform of the traffic police and the expedited creation of a Western-style patrol police force. As a consequence, the practice of bribery across the country's roads and highways was effectively eliminated.

International surveys (BEEPS, Doing Business) confirm that concerns over bribery decreased considerably. These surveys indicate a substantial decrease in unofficial payments as well as time spent in dealing with public officials over interpretation of laws and regulations. The number of controlling and inspecting state institutions was reduced drastically. Substantial deregulation was achieved in Georgia, according to these surveys.

Georgia's ranking in Transparency International's Corruption Perceptions Index (CPI) – which analyses the degree to which corruption is perceived to exist among public officials and politicians – has steadily improved in recent years, albeit from a very low level. In 2005, the country ranked 130 out of 159 countries in its level of corruption. In 2009, Georgia ranked 66th out of 180 countries.⁴ The hard-edged fight against corruption affected the lives of people in Georgia and their attitudes toward the Government. According to the 2010 Global Corruption Barometer (GCB) Georgia received the highest rates in the world in terms of the decrease of the level of corruption, with 78% of the surveyed claiming the corruption level has ‘decreased a lot’ or ‘decreased’ in the past three years.⁵ In terms of public perception of effectiveness of Government actions in the fight against corruption, Georgia ranks the 2nd in the world with 77 per cent of Tbilisi's residents stating that the Georgian Government has been effective or extremely effective in fighting corruption. These are the highest rates among 86 surveyed countries around the world.

Georgia is also placed in the least corrupt group of countries. Only 3% of surveyed said that they have paid a bribe within the last 12 months. This score is even lower than the same average score for the EU and North America which is 5%.

The fight against corruption and the implementation of institutional reforms helped to establish financial order in the country, and to yield significant increases in tax revenues and, as a consequence, to overcome the budgetary crisis.

Privatization. After the ‘rose revolution’ a new strategy of privatization was declared with the aim to push forward the reform process in Georgia. As a result, approximately 1,800 enterprises, including small, medium, large as well as ‘strategic’ entities were designated for privatization by the government. The list of enterprises subjected to privatization included key metallurgy, aviation, communication, transport facilities and utilities. The new reformers took into account the difficulties that the Georgian Government faced at the first phase during medium and large scale enterprises (MLE) privatization, and assumed implementation of preliminary restructuring and liquidation/bankruptcy procedures for privatized enterprises. This strategy allows for increasing the attractiveness of privatized enterprises for foreign investors. As it shows in figure 1, which illustrates the dynamics of privatization and incomes from property sales, after the ‘rose revolution’ privatization was pursued mainly for pragmatic goals:

⁴ Source: Transparency International. Available from http://www.transparency.org/policy_research/surveys_indices/cpi/2009/cpi_2009_table.

⁵ http://transparency.org/policy_research/surveys_indices/gcb/2010

higher budget revenues, better investment plans and more efficient use of assets. For instance, income from privatization for the period 2004–2005 alone exceeds the income generated during all previous years (Appendix, Figure 1).

Business environment reforms in Georgia. Since November 2003 considerable efforts have been made to improve the business environment in the country. These reforms received high assessments from international organizations. One meaningful indicator of the progress in the reform of the business environment can be considered the high rankings that Georgia received recently from the World Bank/IFC. In particular, according to World Bank's Doing Business report 2007, Georgia moved from 112 to 37th position in 178-country ranking, receiving the status of the most improved country of the world.⁶ The next year, according to World Bank's Doing Business report 2008, Georgia has advanced to 18th position. During the last year Georgia advanced by one rank and has moved to 12th position according to Doing Business 2011 report (Table 1).

TABLE 1. EASE OF DOING BUSINESS IN GEORGIA, 2010–2011

EASE OF...	DOING BUSINESS 2011 RANK	DOING BUSINESS 2010 RANK	CHANGE IN RANK
Doing Business	12	13	+1
Starting a Business	5	5	-2
Dealing with Construction Permits	7	9	0
Registering Property	2	2	0
Getting Credit	15	30	+15
Protecting Investors	20	41	+21
Paying Taxes	61	61	0
Trading Across Borders	35	31	-4
Enforcing Contracts	41	41	0
Closing a Business	105	96	-9

Source: Doing of Business 2011: Making a Difference for Entrepreneurs.

Available from <http://www.doingbusiness.org/reports/doing-business/doing-business-2011>.

Analysis of the data in Table 1, which reflects the main changes that took place in the Georgian business environment during the last two years, shows that the country improved its position in the following areas: getting credit, protecting investors. With regard to registering property, paying taxes, dealing with construction permits, and enforcing contracts, the position of the country remained unchanged. Georgia's position worsened in the following areas: starting a business, trading across borders, closing a business. It should be mentioned that closing business and paying taxes are Georgia's weakest positions in this ranking.

A radical improvement of the legislation was the initial step for improving the business environment in Georgia. These changes were created after the introduction of the new tax code in January 2005. The old system of taxation, which came into force in 1997, imposed an excessively high tax burden on entrepreneurs and was difficult to administer due to many loopholes and possibilities of dual interpretation. All these factors, together with the poor administration of tax collection agencies, encouraged entrepreneurs to bribe tax officials and/or move to the shadow economy rather than pay taxes. Large numbers of exemptions, allowances and deductions in the old tax code created an unfavourable environment for competition.

The new Tax Code (in 2005) has considerably simplified taxes. The code eliminated 12 out of 21 taxes, the time to register property decreased by 75 per cent and the cost by 70 per cent.⁷ The fiscal burden on entrepreneurs was reduced.

At the same time, the tax collection practice was improved. These changes enabled the Government to increase tax collection and, consequently, state budget revenues; the tax-to-GDP ratio grew from 14.7 per cent in 2000 to 25.8 per cent in 2007. In 2007 the 20 per cent social tax payable by employers

⁶ Doing Business. Measuring Business Regulations. Available from <http://www.doingbusiness.org/ExploreEconomies/?economyid=74#StartingBusiness>.

⁷ Doing Business in 2006.WB&IFC, p. 1–2.

was abolished while income tax was increased from 12 per cent to 25 per cent with the adoption of a schedule of its gradual decrease down to 15 per cent for 2013

The main dimensions of tax reforms can be summarized as follows:

- Introduction of an upper limit of taxable turnover required for mandatory registration of a VAT payer of 100,000 GEL;
- Abolishment of the minimum level of taxable turnover required for voluntary registration;
- In order to encourage fair competition, the list of commodities and services exempt from VAT was reduced significantly. A VAT refunds scheme was introduced. The Code envisaged zero VAT rating for the export of commodities. The zero rating also extends to transportation and other services immediately relating to the international transportation of cargo and passengers, tourist services provided by tour operators for foreign tourists on the territory of Georgia and the rehabilitation of fixed assets in Georgian territory, conducted by foreign enterprises.

The Government introduced the New Tax Code on 1 January 2011. The main priorities of the new tax system are to create a better business environment, provide more protection for entrepreneurs and eliminate existing gaps in interactions between the authorities and business. To attain these objectives a new classification of businesses and a new position – ‘taxpayers’ ombudsman’ were introduced in the New Tax Code.

In particular, the new classification of businesses in Georgia defines: micro, small, medium and large businesses. Micro-businesses comprise individual enterprises with no employees and with an annual turnover below GEL 30,000. These businesses are exempted from tax payments. ‘Small businesses’, which are represented by entities with annual turnover of GEL 200,000 or less, pay only 3–5% of turnover taxes.

The New Tax Code also includes several new regulations and principles with the aim to facilitate doing business in Georgia. Specifically:⁸

- According to the Good Faith principle, a taxpayer might be freed from paying a sanction if the action of the taxpayer is caused by mistake or ignorance rather than by deliberate tax avoidance.
- To motivate honest payers and to provide additional services and privileges, the Revenue Service introduces the Honest payer principle.
- Taxpayers are given the right to make in advance agreements with the Revenue Service on terms of taxation.
- A Private Tax Agent institution is introduced with aim to defend the taxpayers’ rights in the Revenue Service, and to provide them consultation and support in fulfilling tax liabilities.

To improve services for clients a number of electronic services (electronic declarations, cashboxes with a GPRS system, web portal of The Revenue Service and etc.) were introduced.

The important novelty of the New Tax Code is the establishment of the institution of tax ombudsman. According to the law, the tax ombudsman provides annual reports on the situation regarding the protection of taxpayers’ rights to the financial and budgetary committee. The main mission of this institution is to present and defend the taxpayers’ rights, to restore abolished rights as well as to work together with public and private sectors.

The **customs reforms** introduced in Georgia, which simplified procedures for importers and trade partners, have proved successful. The new Customs Code, introduced in 2007, replaced the previous 16 different types of duties with only three. The new duties are set at rates of zero, 5 per cent and 12 per cent, whereas those they replaced ranged from 1 per cent to 25 per cent. Reducing the import-tax base for agricultural goods and construction materials, as well as annulling import taxes for other goods, has made Georgia much more competitive.

Other reforms have reduced the quantity of official **licences and permits** required for various business activities, which had previously created barriers to market entry. In 2005 a new Law on Licensing was adopted, as a result of which, of the previous total of 950 licences and permits, only 150 remain.

⁸ http://www.finchannel.com/Main_News/Business/79143_%E2%80%99C6%25_Economic_Growth_is_Expected_in_2011_in_Georgia%E2%80%9D_-_Saakashvili/

Licensing procedures were rationalized and the time taken to issue licences reduced. Moreover, the legal grounds for governmental intervention in businesses have been restricted.

Georgia sped up approvals for construction permits. The procedure for occupancy certificates was simplified (abandoning the need for a special commission), and time limits shortened (from 45 to 30 days. Water utility and electricity providers can now be approached as one administrative body, and project documentation was made easier. As a result, the time needed to obtain construction licences fell from 227 to 98 days.

A new Labour Code was introduced in 2006. It significantly diminished rigidities in labour markets and streamlined firing and hiring procedures, giving more freedom and flexibility to employers and employees. The Labour Code also introduced regulations for new types of labour agreements that allow the labour market players to benefit more.

The amendments made to the Procedural Code for the courts, introduction of specialized commercial sections of the courts and reforms of the appeals process lead to a decrease in the average duration of simple commercial disputes resolution from 375 to 285 days.

Investor protections were strengthened, including through amendments to the securities law that eliminated loopholes which had allowed corporate insiders to expropriate minority investors. The amended securities law now provides a definition of ‘interested parties in a transaction’, and makes such transactions contingent on supervisory board or shareholder approval. Companies must disclose transaction information to the securities commission, as well as include it in the company’s annual report. The law also requires all conflicts of interest to be disclosed to the supervisory board and improves ways for judicial redress.

The new insolvency law, that was adopted last year, shortens timelines for reorganization of a distressed company or disposition of a debtor’s assets, thus ensuring a more productive use of debtors’ assets and an overall decrease in time.

Reforms implemented in the period from 2004 to 2008 made considerable strides in reversing policies that had previously stifled private initiatives. Georgia’s strategy was to establish a minimal state, and was oriented around a policy of terminating any state regulatory activity that enabled corruption and increased bureaucracy. These reforms mainly concerned the simplification of procedures required for business registration, with an emphasis on reducing the costs of excessive economic and administrative regulations.

All these institutional reforms have created a favourable environment for trade growth. FDI stimulated a boom of entrepreneurial activity, which in turn supported real GDP growth. The number of registered enterprises almost doubled during 2004–2008 period (Appendix, Figure 2).

Despite the lowering of tax rates, the state budget indicators have radically improved. This allowed the Government to initiate serious reforms in the social sphere, develop infrastructure and advance human development dimensions, and to move towards sustainable and transparent reorientation of budgetary expenditures in the areas of health, education and social protection. These factors created a climate necessary for long term sustainable development.

At the same time, it is worth noting that despite the profound achievements in doing business, the competitiveness of the national economy was still very low. According to the World Economic Forum rating, Georgia is in 90th place. These data suggest that in 2009–2010, among the 133 countries Georgia’s ratings along main dimensions are as follows: in terms of institutions and efficiency of infrastructure development rates 72nd position; the macroeconomic stability – 117; health and primary education – 78; in terms of higher education and vocational training – 84; goods markets efficiency – 74; labour market efficiency – 17; financial markets difficulties – 95; technological readiness – 100; the market size – 101; business development – 113; innovations – 119th position.⁹

These figures reflect the competence of optimal utilization of existing and potential resources, including material and especially intellectual capacity, increase productivity, and the country’s other relative advantages. It seems that institutional reforms were not enough to enhance the actual competitiveness of businesses in Georgia.

⁹ The Global Competitiveness Report 2009–2010. 2009 World Economic Forum. Available from <http://www.weforum.org/documents/GCR09/index.html>.

1.3. Analysis of recent trends in the Georgian economy

The ambitious reform programme launched by the government after the ‘rose revolution’ resulted in stable rates of real GDP growth, indicating that significant advances were achieved in the process of business environment reform. This progress was tangible especially until the global financial crisis and armed conflict with Russia in 2008. Below we briefly discuss the recent developments according to main sectors of the economy.

Real sector

In parallel with macroeconomic and institutional reforms, corruption and state involvement in the economy were reduced drastically, the investment climate was improved, and the average annual rate of GDP growth reached 9.3 per cent in 2004–08 (Appendix, Table 1). In the second half of 2008 the rate of annual GDP growth declined sharply, to 2.3 per cent. This slowdown resulted from the conflict with Russia in August 2008, the continuing external threat, and the global financial crisis.

However, before the global financial crisis Georgia experienced continuous growth in real GDP. This economic expansion was supported mainly by continuous real growth of the industrial and construction sectors, financial services, transport and communication, hotels and restaurants, while agriculture negatively contributed to GDP growth. (Table 2 and Appendix, Table 2). After the 2008 crisis the slowdown was noted in practically all sectors.

TABLE 2. INDEXES OF REAL GROWTH BY MAIN ECONOMIC SECTORS, 2003–2009 (PERCENTAGE)

INDICATOR	2003	2004	2005	2006	2007	2008	2009*
Agriculture	100	92.1	103.2	91.1	94.1	89.9	83.8
Industry	100	103.42	114.5	132.2	152.0	151.7	148.0
Construction	100	135.9	155.0	169.3	192.9	171.5	166.0
Trade	100	108.2	118.3	141.7	155.3	173.6	145.3
Transport and communications	100	107.1	118.2	137.7	152.2	149.4	167.9
Hotels and restaurants	100	103.5	120.7	133.3	148.5	155.7	148.9

Source: National Statistics Office of Georgia, www.geostat.ge.

The economic growth resulted also from a significant increase in consumption (both private and public) as well as investment. The composition of GDP shows that both consumption and investment were increasing practically in the same proportion. However, the share of consumption in total GDP exceeded the share of investments by almost three times in 2007. In 2009, the discrepancy between consumption and investments shares aggravated further as the investment levels fell below the 2003 level. According to data presented in Table 3 the reduction in investments was the main cause of the fall in GDP in 2009. However, this fall was to a small extent compensated by an increase in net exports.

TABLE 3. GDP COMPOSITION, 2003–2009 (MILLION GEL)

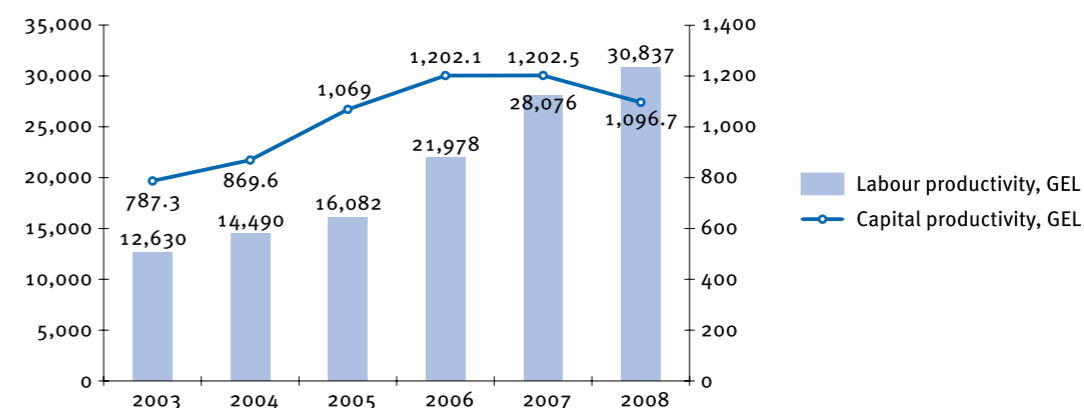
	2003	2004	2005	2006	2007	2008	2009
Private cons.*	6,192.6	7,194.7	7,780.2	10,855.9	12,014.0	14,659.5	14,675.8
Government consumption	836.2	1,379.1	2,014.0	2,116.0	3,717.9	4,936.3	4,399.5
Investment	2,682.3	3,134.8	3,891.5	4,255.3	5,447.5	4,951.6	2,342.9
Net export	-1,249.0	-1,633.5	-2,070.8	-3,330.5	-4,545.0	-5,681.2	-3,492.3
Statistical discrepancy	102.0	-250.8	6.0	-106.8	359.4	208.7	20.2
Total GDP	8,564.1	9,824.3	11,620.9	13,789.9	16,993.8	19,074.9	17,948.6

Source: National Statistics Office of Georgia, www.geostat.ge

*Includes consumption of non-profit institutions serving households.

An important source of real GDP growth was continuous improvement of the efficiency of the economy. In 2008, labour productivity increased by almost 2.5 times and capital productivity by 1.5 times, as compared to 2003 (Figure 1).

FIGURE 1. LABOUR AND CAPITAL PRODUCTIVITY IN GEORGIA, 2003–2008



Source: Entrepreneurship in Georgia, 2009. National Statistics Office of Georgia, www.geostat.ge

Sectors of economy

Agriculture has always been one of the key sectors of the Georgian economy. However, since 1996 the share of agriculture in GDP has been declining with each year. In 2009, its share in GDP reached 9.4 per cent as compared with 20.6 per cent in 2003 (Appendix, Table 2). In total, agricultural output, which consisted mainly of wheat, tobacco, vegetables, fruits and grapes, and tea, decreased substantially (see more details in part 3).

Since the mid-2000s **industry** has grown substantially, with growth peaking, in real terms, at 14 per cent, in 2007.¹⁰ However, afterwards the expansion of industry has slowed down. The share of GDP attributed to the sector decreased from 14.2 per cent in 2003 to 12.1 per cent in 2009. Mining, chemicals, and food-processing are the principal industrial sectors. The coal industry is well established as well. Manganese and non-metallic minerals, mineral fertilizers, synthetic materials and fibres, and pharmaceutical products are the main export products.

Despite the strategic importance of the **energy sector**, its share in industrial output has decreased, due to the rapid growth of other sectors. The Government works on facilitation of investment to improve technical conditions of power stations and gas distribution networks.

¹⁰ National Statistics Office of Georgia, www.geostat.ge

In 2003–07 positive growth rates were recorded in every sector of the economy. The share of **services** (especially financial) in GDP increased rapidly, representing almost one-half of total GDP growth.

Trade is still one of the largest sectors, with more than 15.1 per cent share in GDP. The significant growth that the trade sector experienced in 2008 resulted mainly from the increased retail trade in fuel, motorcars and spare parts.¹¹ There was also an increase in the demand for manufactured food products, furniture and household appliances as well as in the wholesale motorcar trade. However, in 2009, the trade sector showed some decrease in the rate of growth as compared to the previous year.

The **construction sector** (of which pipeline construction only constitutes a small part) has also been growing rapidly. However, in 2008 and 2009 the construction industry, one of the principal sectors in which strong growth had been recorded, decreased its share in GDP to 6.4 and 6.5 per cent, respectively.

The decline in the **transport sector** in 2009 was caused by a decrease in the volume of road and rail cargo resulting from the downturn in trade related to the impact of the economic crisis and 2008 August war.

Banking sector and monetary policy

The growth in economic sectors has been largely supported by the rapid development of the banking sector. Since 2004, due to economic liberalization and an increase in FDI, commercial banks' assets, deposits, and loans grew significantly. Sound monetary policy and the revival of the banking sector provided a strong platform for high economic growth.

Restoration of macroeconomic stability and stable economic growth laid the foundation for significant credit expansion (Appendix, Table 3). Since 2003 the credit-to-GDP ratio increased almost fourfold, and reached 30.6 per cent by the end of 2008. The rates of credit growth averaged 42.2 per cent per year and peaked at 83.2 per cent in 2005. In 2007 and 2008 credit rate grew respectively by 70 and 31 per cent. However, in 2009 due to the global financial crisis, credit to GDP ratio shrunk by 14 per cent. Deposits remained the major source of credit boom during all this period. The deposits-to-GDP ratio almost tripled during 2003–2009. Other channels of this credit boom have been borrowing from abroad (increasing foreign liabilities) and additional capital.

The credit expansion started with high lending rates and large differences between loan and deposit rates. By 2009, the lending rate and the spread between loans and deposit interest rates slightly decreased, but still remain at a relatively high level.

Between 2003 and 2009 bank assets tripled, as had been the case in the 1997–2003 period. In 2009 commercial bank assets amounted to 46.2 per cent of GDP.

According to data (Appendix, Table 4), construction and industry maintained their leading position in the distribution of credit among the sectors of economy. However, during the 2003–2008 these sectors experienced different trends. The share of construction in total credits increased by 10 percentage points, while the share of industry decreased by approximately 10 per cent. In the period after the crisis, the main tendencies in credit distribution were the increase in shares of industry, and transport and communications sectors and the reduction of the share of construction sector of the total credit. Agriculture still attracts a very small portion of investments, despite the fact that this sector accounts for more than 50 per cent of total employment.

Recent credit expansion and increased monetization levels can be considered a result of a catching-up process from low levels of financial performance. The increased supply of credit was matched by increased demand, especially from the private sector.

Inflation represents a serious threat to economic growth. Inflation began to increase in 2004, as the economic environment became more active and dynamic. In 2000–03 the annual rate of GDP growth averaged 4 per cent, and the average annual rate of inflation was only 3.5 per cent. Public expenditures also remained low. However, in 2003–2007 the average annual GDP growth comprised 9.6 per cent, which was more than twice as much as in 2000–2003, while the average annual rate of inflation increased to 11.1 per cent, which was more than three times the level recorded in the 2000–2003 period. However, in 2009, as a result of the slump in energy prices and recession, the official annual inflation rate was 3.0 per cent, the lowest level since the 'rose revolution'.

Fiscal sector

One of the most impressive improvements in the 2004–2009 period was the growth of budgetary revenues. Budgetary revenues increased sixfold as compared to the 2000–2003 period. Total revenues increased from 15.7 per cent in 2003 to 30.7 per cent in 2008. This increase was driven mainly by improved tax collection. Improvements of the administration in budget performance also enabled the country to cover the previously accumulated domestic debts and also to increase salaries and pensions. Government debt during this period has been decreasing continuously from 53.8 per cent to 27 per cent of GDP. The overall fiscal balance was positive during the period of 2004 to 2007 (Appendix, Table 5). In the post crisis period, however, there was some worsening of the main fiscal indicators. Both total revenues and tax revenues slightly decreased, while expenditures increased. As a result, there was a fiscal deficit, which in 2008 and 2009 comprised respectively 2 and 6.5 per cent of GDP. The state debt increased as compared to previous years.

External sector

In 2003–2008 the main developments in the external sector were: a continuing increase of the trade balance deficit and a deterioration of the current account balance; significant inflows of foreign direct investments (including privatization receipts); growth of remittances and an increase in gross international reserves (Appendix, Table 6). The export of goods and services grew from 32.3 per cent of GDP in 2003 to 44 per cent in 2008, while imports almost doubled and comprised 89.5 per cent of GDP in 2008. Such developments led to a serious deterioration of trade and current account balance. In 2008 the deficit of the trade balance and the current account comprised respectively 45.5 per cent and 34.7 per cent of GDP, as compared to 14.5 per cent and 9.6 per cent in 2003.

Despite the increase in the current account deficit, the exchange rate of the GEL had a strong tendency to appreciate. The real effective exchange rate (REER) steadily increased during this entire period, after reaching its lowest point in 2003. This increase was driven mainly by the strong appreciation of bilateral real exchange rate (BRER) with the USD; at the same time it was weakened by depreciation of BRER with the Russian rouble. The fact is that substantial current account and trade deficits have been financed through remittances from abroad and FDI. The transfers from abroad increased almost ten times in the 2003–2008 period. Starting from 2002 Georgia has been experiencing a significant inflow of foreign direct investments (FDI) due to: Baku–Tbilisi–Ceyhan project implementation; privatization process that revived after 2003 and involved the sale of large and medium-sized firms. During the 2003–2007 period the amount of FDI in the economy increased almost five times. The fact that the current account deficit is financed primarily through FDI rather than by debt accumulation, impacts on the sustainability of the external account, since FDI generally implies long-term commitments and can be considered a sign of confidence in the economy.

During the 2008 military conflict with Russia, Georgia's economy proved resilient. However, both this conflict and the global financial crisis have presented Georgia with new economic challenges. These include in particular: overcoming economic damages caused by the war; avoiding a crisis in the banking sector; preventing high inflation; and preserving the stability of the exchange rate of the national currency. In 2009 inflows of FDI were practically halved as compared to the peak level achieved in 2007 (22.9 per cent of GDP). Other capital inflows from the global financial markets as well as remittances also diminished. Fall of capital inflows from abroad led to a downturn in domestic demand.

Economic recession and, in particular, falling domestic demand resulted in negative import growth. Taking in to account the fact that a decline in export revenues was less substantial than the reduction in imports, the trade deficits narrowed from 45.5 per cent in 2008 to 28.8 per cent in 2009, while the current account deficit reduced almost twice in the same period. The central bank continues a small depreciation of the national currency as private capital inflows fall. Because of the economic downturn, social development problems became crucial and essential.

Impact of global financial crisis and armed conflict with Russia on the Georgian economy

Until 2004, Russia was Georgia's largest trading partner. However, the relations between the two countries deteriorated in the mid-2000s, and as a trading partner Russia moved to third place, after Turkey and Azerbaijan. Intensification of political tensions, stemming from the pace of Georgian

¹¹ Georgian Economic Trends. Quarterly Review, October 2008, Georgian-European Policy and Legal Advice Centre.

integration with NATO and the EU, was accompanied by the closure of the Russian market to certain Georgian products, including wine and mineral waters. The ban presented a great challenge for the Georgian economy, and resulted in substantial changes in the foreign trade structure of the country.

The August 2008 conflict represented another potentially severe setback to the economy. It threatened economic stability. The total cost of damages from the five-day war have been estimated at around 1 billion USD, while the heightened awareness of the level of political risk served to inhibit investment and led to a decline in business activities. After the military conflict with Russia in August 2008 internal the displaced population have increased. The growth of the number of Internally Displaced Persons (IDPs) weighed heavily on the government, forcing it to increase expenditures on social needs. Moreover, the negative impact of this conflict was further aggravated by the global financial crisis.

The macroeconomic consequences of the conflict and global financial crisis have already been discussed above in this chapter. In general, a comparison of pre-conflict and post-conflict general macroeconomic indicators shows that the consequences of the conflict are quite noticeable (Table 4). All these factors have significant impact on the social life of population.

TABLE 4. PRE- AND POST-CONFLICT MACROECONOMIC INDICATORS COMPARISON

INDICATOR	PRE-CONFLICT	POST-CONFLICT	
	2007	2008	2009
Growth (per cent)	12.30	2.30	-3.90
Inflation (per cent)	11.00	5.50	3.00
Fiscal balance (per cent of GDP)	0.31	-2.01	-6.50
FDI (US\$ billion)	1.60	1.40	0.70
Current account balance (per cent of GDP)	-27.50	-34.70	-17.50
Debt (per cent of GDP)	23.06	27.02	34.69

Source: Calculations based on data from National Statistics Office of Georgia, www.geostat.ge

However, for 2010 and beyond, economic forecasts are more positive. The IMF expects Georgia to return to a positive GDP growth of 4 per cent, and 4 per cent in 2011, and it expects inflation to return to normal levels of around 5 per cent.¹²

To summarize, despite severe external shocks, the Georgian economy has been resilient. Liberalization and international support provided the basis for economic stability and further development in Georgia. The significant progress in introducing and implementing key economic reforms, preserving sound macroeconomic and financial sector policies, as well as support from international donor organizations and the international community, allowed the Georgian economy to maintain its balance after this shock.

The crucial factor that ensured post-conflict economic recovery was support from international organizations and states. At a joint conference hosted by the EU and World Bank in Brussels in October 2008, 38 countries and 15 international organizations pledged 4.5 billion USD (of which 2 billion USD constituted grants, and 2.5 billion USD were loans) to assist in the post-conflict economic recovery, over a three year period. The donor funds will start exhausting in 2011 and the Government will have to make great efforts in finding new funds to cover the loan payments and ensure the social security of the population.

¹² Georgia: Sixth Review Under the Standby Arrangement and Requests for Modification of Performance Criteria, Waiver of Non-observance of Performance Criterion, Waiver of Applicability of Performance Criterion, and Rephrasing of Purchase – Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Georgia. Country Report No. 10/219. July 16, 2010. <http://www.imf.org/external/pubs/ft/scr/2010/cr10219.pdf>

1.4. Social environment and human development challenges

Social sphere development and poverty

Poverty and Inequality. In 2003, according to the data of the National Statistics Office, 54.5 per cent of population was below the official **poverty level**. Later, based on the new methodology of measurement of the subsistence minimum, the proportion of the population below official poverty line decreased twofold.

During the period after the ‘rose revolution’, despite high rates of economic growth, there was only a slight decrease with respect to three poverty indicators: poverty level, depth of poverty and severity of poverty (Table 5).

At the same time, rural–urban disparity in terms of poverty further deepened, as well as disparities between small and large cities, which are the result of varying employment structures. Along with the spread of unemployment, among the poor there appeared groups of poor and extremely poor. Extremely poor constituted nearly a third of the total poor strata of the population. Poverty affected educated people as well. A new group of so-called ‘new poor’ emerged.

TABLE 5. INDICATORS OF POVERTY, 2004–2009, PER CENT

INDICATOR	2004	2005	2006	2007	2008	2009
POVERTY LEVEL BY MEDIAN CONSUMPTION						
60 per cent of median consumption	24.6	24.1	23.3	21.3	22.1	21.0
40 per cent of median consumption	10.9	10.1	9.4	9.2	9.5	8.8
DEPTH OF POVERTY						
60 per cent of median consumption	8.1	7.6	7.2	6.9	7.0	6.6
40 per cent of median consumption	3.4	3.1	2.8	2.7	2.7	2.6
SEVERITY OF POVERTY						
60 per cent of median consumption	4.0	3.6	3.3	3.2	3.2	3.1
40 per cent of median consumption	1.7	1.5	1.3	1.3	1.2	1.2

Source: National Statistics Office of Georgia, www.geostat.ge

The problem of poverty was aggravated by a relatively high inequality level. Gini coefficient inequality increased during the 2004–2008 period. (Appendix, Table 7). As cross-nation comparison shows, Georgia has the poorest performance among CEE and FSU countries in terms of income inequality.¹³ One important reason is that development reforms, including privatization, failed to stimulate employment and to reduce unemployment. Among external factors there were: closure of the Russian market which was the most accessible for Georgian small entrepreneurs, as well as natural calamities which caused serious damage.¹⁴

Social policy. The old inefficient system of social protection, coupled with limited government financing and growing unemployment resulted in the growth of poverty. The government was unable to carry out radical measures for improving social protection and security until 2004, which resulted in the impoverishment of more than 50 per cent of the population. Despite moderate growth in economy, state institutions for social protection were not sufficiently developed to help various social groups to move out of the poverty by creating guaranteed and stable living conditions for them.

Until 2007 the government provided funding for several social schemes: unemployment benefits, vocational training and re-training, temporary employment of the unemployed and social assistance to the socially vulnerable population, as well as its monitoring and analysis.

Social assistance (at some point provided in the form of family allowance) was mostly focused on persons unable to work and single pensioners. Their assistance package (pension, family allowance, medical insurance, reimbursement of consumed electricity, cash donations of various international

¹³ International human development indicators. Income Gini coefficient. <http://hdrstats.undp.org/en/indicators/67106.html>.

¹⁴ Georgia: Human Development Report, The Reforms and Beyond, (2008). Tbilisi, p.36–37.

organizations, primarily of International Committee of the Red Cross, etc.) was coming close to the minimum consumption basket. The average minimum consumption basket in 2007 was GEL 105, while subsistence minimum of a man with the ability to work – GEL 118; other categories of family assistance were only symbolic and did not have any significant influence on family budgets. The existing social protection system did not cover all categories of beneficiaries and allowances issued were insufficient.

There were inequalities in allocations for IDP assistance which were unified and not differentiated according to financial conditions of the families. IDP allowances were not targeted to the more vulnerable families.

As a result of achievements in the real sector of economy, the social expenditures as per cent of GDP were steadily increasing during the 2003–2006 period in Georgia (Table 6). In 2007 and 2008, however, there was a serious decrease in these indicators, especially in social safety sphere. In 2009 social expenditures as a per cent of GDP improved in all three areas.

TABLE 6. SOCIAL EXPENDITURES AS PER CENT OF GDP, 2004–2009

	2003	2004	2005	2006	2007	2008	2009
Education	2.1	2.9	2.5	3.0	2.7	2.9	3.2
Healthcare	0.4	1.0	1.8	1.6	1.5	1.6	2.0
Social safety	4.0	4.7	5.4	5.0	3.0	1.7	2.6
Total social expenditures	6.5	8.6	9.7	9.6	7.2	6.2	7.8

Source: Georgian Economic Review 2009, GEPLAC, p. 12.

The increased state budget facilitated positive changes in the system of social protection and security. However, as a result of fragmented social reforms, social disparities are still high (Appendix, Table 7). Increasing wealth among some social groups was not accompanied by overall reduction of poverty levels. Social segregation in the population was widespread, which required that the state carry out relevant policies and protect the poor through the revitalization of state aid distribution mechanisms.

During the last two years with the aim of social protection of the population living below poverty line, a state programme focused on the identification and evaluation of socio-economic conditions of families below the extreme poverty line was launched, and a database was subsequently set up. Instead of allowances, monthly monetary benefits were introduced which families could manage themselves.

The new system of social protection is operating alongside the system of issuing benefits to people living below poverty line and to people according to various categories – people living under the extreme poverty line determined by the means testing methods, IDPs, the displaced population, veterans of wars, and mothers of large families and so on.

Demographic trends. There have been negative trends emerging in the course of Georgia's demographic development. Namely, a sharp decline in birth rates and increasing mortality rate (especially among newborns), the logical result of which is the reduced natural growth of population. In 1990–2008 the population of Georgia fell by 19.5 per cent, compared to 11 per cent growth in 1975–1990.¹⁵ These developments coupled with the ageing of the Georgian population are posing serious threats to the renewal of generations and increasing the burden on the employed population.

The demographic aging of the population causes increase of demographic and economic burden of employed). In Georgia, the proportion of those unable to work living on the subsistence of 1,000 able to work has been increasing. If we take into consideration that the unemployment rate is permanently high, the problem of the demographic burden is even worse.

In terms of demographic burden indicators, the proportion of those not having reached the age of entering into the labour market is decreasing, and accordingly, the number of those beyond retirement age is increasing. The share of children under the age of 16 is decreasing, while the number of people beyond the retirement age is increasing.

¹⁵ World Bank Database: <http://devdata.worldbank.org/hnpstats/query/default.html>

The effects of aging are especially painful for the labour market and social protection systems. Social costs are increasing, which are increasing the burden of the employed population. Currently, there are 75 employed for every 100 pensioners, while the optimal proportion is 350–400 employed per 100 pensioners.

Migration. The general trend of population aging, among other factors, results mainly from the fact that, in recent years intensive migration, which started in the 1990s, has been continuing, mainly due to economic conditions. According to the Department of Statistics, 85 per cent of the population which has left the country is of an able-to-work age, while the proportion of the population of this age does not exceed two fifths of the total population.

In recent years gender disparities have also been growing. Among young people leaving Georgia, there are more women than men, which, in the long run, might result in serious socio-demographic problems.

Demographic conditions in Georgia, along with the other factors, are significantly worsened by the migration of the population (especially the young population). Due to poor registration, the precise number of people who migrated from Georgia is not known. However, in the estimation of various experts, this number reaches approximately one million people, which for a small nation like Georgia, is very high. From an economic point of view, the huge loss of labour resources is justified by the fact that remittances sent by the labour migrants to their families is the only source of their daily subsistence, and plays a vital role in fighting poverty. The volume of remittances is increasing each year. In 2008 this indicator was 15.8 times higher than it was in 2000 and comprised 917.9 million USD.

Especially noteworthy is the involvement of youth in emigration. The findings of the study, conducted in 2005, clearly showed a high prevalence of emigration among students.¹⁶ The reasons for emigration according to the study were: receiving education (31.8 per cent), learning foreign languages (15.4 per cent), as well as lack of employment opportunities in the home country (8.8 per cent), while 41 per cent named the opportunity of improving financial conditions.

IDP. A document prepared by the UN Resident Representatives' Humanitarian Affairs Team in 2006 stresses that in the lives of 45 per cent of the total of 220,000 displaced in the 1990s as a result of ethnic conflicts, no significant changes have taken place leading to the improvement of their socio-economic status. 32,000 people still remain in collective centres. These centres did not meet living standards from the very beginning, and presently their infrastructure is completely dilapidated.

By the end of 2008, the Government provided 16,000 families with the newly constructed houses. At the same time, the need of developing social infrastructure and employment generation schemes for the displaced population was identified. It is noteworthy that along with the assistance programmes for the recently displaced population (as a result of the 2008 war with Russia), it also became necessary to carry out new assistance programmes for the IDPs displaced from Abkhazia in the 1990s.

Pensions. Demographic aging of the population and migration both intensively affect the 'pay as you go' state pension system development, requiring the permanent increase of state expenditures on social insurance. Economic growth allowed the government to double pensions. In 2005, average pension increased from 18 to 37.3 GEL, and in 2009 it reached 77.6 GEL. So during the period 2003–2009, pensions increased 4.7 times in absolute terms (Appendix, Table 8).

The increase in pensions did not take place at the expense of an increase of the number of employed persons. There is 0.7 employed person per pensioner and this a heavy burden for the employed, one that will present a serious threat to the state pension system in the future. However, the situation is being neutralized by a rapid growth of average wages both in the private and public sectors.

Recent trends in the labour market

Between 1990 and 2003, the situation with regard to employment deteriorated significantly. It was largely influenced by the shift of the labour force to the agricultural sector resulting from the changes in sectoral structure of the economy; as well as the demographic situation, migration processes and underdevelopment of small and medium businesses.

The economic upsurge that took place during the period of 2003–2008 has not resulted in a serious enhancement of employment variables. The main trends in the employment sphere keep showing a

¹⁶ Chelidze N. (2008). Attitude of Students in the Higher Education Institutions towards Education and Labour Migration; *In the Migration*. Tukhashvili M., ed. Iv. Javakhishvili Tbilisi State University Publications, Tbilisi.

decrease in employment and labour participation levels and an increase in the unemployment rate (Appendix, Table 9).

From 2000 to 2009 the share of economically active population reduced as compared to the total population of the country (by almost at 4 per cent), due to the decrease of the natural growth of the population and the negative migration balance. The decrease was especially visible among the population of working age. Along with this, the number of economically active people has reduced significantly, as well as the number of hired employees. According to official data the number of hired employees reduced to 596,000 in 2009 from 654,300 in 2001. All this happens against the backdrop of just 0.8 per cent reduction in the total population. This indicates a non-optimal structure and negative tendencies of the economically active population.

With intensification of the privatization process, the share of self-employed persons in the employment structure has been increasing substantially at the expense of the share of hired workers, reflecting in part the downsizing process in privatized enterprises

Unlike in advanced transition economies, the increase in the share of self-employment in Georgia is related mainly to activities in the agriculture sector. Taking into account the fact that these activities are oriented largely on self-sustenance and that a significant portion of persons self-employed in agriculture are unpaid family workers, one can conclude that increased self-employment in Georgia reflects, in part, disguised unemployment.

Significant changes took place in the employment structure in the period 2003–2009 (Appendix, Tables 10). The share of the employed decreased relatively in public administration and trade, and increased in industry. Economic revival, especially in the field of construction, has supported employment growth in this sector. In general, construction and financial mediation are the branches where the increase in the economically active population is most tangible.

In 2009 the share of persons employed in the public sector was halved as compared to 2001 (Table 7). However, the share of public sector according to the number of hired staff is still high. In informal sector, self-employed and unpaid workers are the majority.

TABLE 7. STRUCTURE OF EMPLOYMENT IN BUSINESS SECTOR BY FORM OF OWNERSHIP (PER CENT OF TOTAL)

	2001	2004	2005	2006	2007	2008	2009
Public sector	50.1	44.7	37.3	29.6	26.5	23.8	24.5
Private sector	49.9	55.3	62.7	70.4	73.5	76.2	75.5

Source: National Statistics Office of Georgia, www.geostat.ge

Official **unemployment** has increased and reached to 16.5 per cent in 2008, before the financial crisis. Its level despite the reduction of the economically active population is still very high and in 2009 its level has increased 1.5-fold against 2001. This is an indication that unemployment is, first and foremost, a social-economic problem, and not a demographic one.

One of the reasons for this situation in the labour market is the continuous and intensive migration (mainly due to the negative economic environment) along with general aging of the population. Among migrants, 85 per cent are capable of working.

The second reason was the insufficient development of small and medium sized businesses. Economic reforms through eliminating obstacles make it possible for small and medium-sized business to expand their operations, create new jobs, and increase employment and output. However, this was not the case in Georgia. The share of small and medium-sized businesses did not change significantly in the recent period. The number of entrepreneurs registered in Georgia has increased 2.2 fold during the last five years and the rate of their growth considerably exceeded GDP growth.

During the recent period the SME sector found itself in recession. In 2003 about 50.6 per cent of the total workforce was employed in these enterprises (the share of small enterprises amounted to 27.3 per cent, and the share of medium-sized enterprises – 23.3 per cent), and in the overall turnover aggregate share of SMEs amounted to 24 per cent. During the 2003–2009 period, the share of SME in turnover, output and employment has continuously shrunk. In 2009 the number of jobs in the SME sector made up only 38 per cent and their aggregate share in the total turnover decreased to 14.4 per

cent (the share of small enterprises made up 6.6 per cent, and the share of medium-sized enterprises – 7.8 per cent) (Table 8).¹⁷

The economic growth in 2003–2008 period was basically caused by the expansion of large enterprises, while SME show a low level of competitiveness and efficacy and tend to move further down. The level of SME development remains frail.

TABLE 8. EMPLOYED PERSONS BY ENTERPRISE SIZE AND SMES' SHARE IN TOTAL TURNOVER AND TOTAL PRODUCTION VALUE

	2003	2004	2005	2006	2007	2008	2009
SMEs' turnover (per cent of total turnover)	24.0	22.5	23.0	18.7	14.5	12.3	14.4
SMEs' production value (per cent of total production value)	20.3	21.5	18.9	16.1	14.3	16.0	20.3
(IN PER CENT OF TOTAL EMPLOYMENT)							
Employed in small enterprises	27.3	25.5	25.8	23.4	18.7	18.7	18.3
Employed in medium-sized enterprises	23.3	21.8	22.5	23.3	25.4	21.3	19.7
Employed in large enterprises	49.4	52.6	51.7	53.3	55.9	60.0	61.9

Source: National Statistics Office of Georgia, www.geostat.ge

Wages. Along with change in employment structure, the social consequences of the recent development trends were reflected in the change in wages and incomes of employees.

Significant changes took place in the size of wages after the 'rose revolution'. The average nominal wage grew from 94.6 GEL in 2001 and 125.9 GEL in 2003 to 556.8 GEL in 2009 (Appendix, Table 11). Thus the nominal average wage grew almost sixfold during this period. The financial sector, public administration, the mining and quarrying sector pay the highest wages, on average, among the sectors of economy. The worst situation is in agriculture and healthcare. The fact that agriculture, which accounts for more than 50 per cent of total employment, has the lowest salaries among industries indicates a worsening of the social dimension in general.

In the public sector the nominal wages were on average lower during the entire period as compared to the private sector (Appendix, Table 12). However the relative difference in nominal wages between these sectors reduced during the 2000–2009 period. The considerable growth of labour payments of those employed in the public sector has played a significant role in the reduction of this difference.

The average wages increased quickly. The rate of its growth significantly exceeded not only the real, but also the nominal growth rate of GDP (Figure 2). During the 2003–2008 period, on average, salary growth exceeded by almost three times the rate of growth of the real GDP and by approximately 1.5 times that of nominal GDP. The reason for the rapid increase of salaries was that the economic upsurge hasn't been accompanied by a corresponding increase in employment. On the contrary, employment growth during this period mainly had a negative trend. Such a situation led to the increase of wages of the employed.

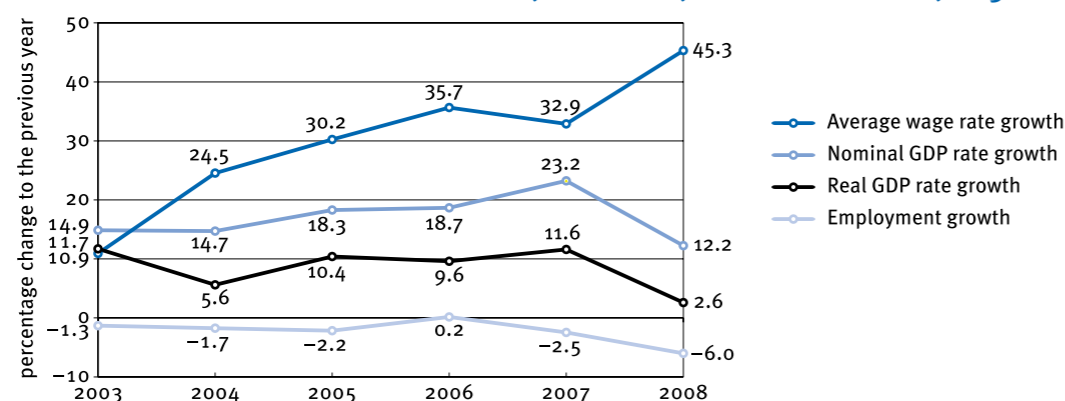
During the 2004–2009 period, real monthly wages and salaries were growing in all sectors of the economy. On average the real wage grew by 2.5 times as compared to 2004. Agriculture, trade and public administration showed the highest rate of growth, while financial intermediation had the lowest. As a result, the share of wages in the total income structure of households increased from 67.8 per cent in 2004 to 83.5 in 2009 (Appendix, Table 13).

Wages differed according to the size of enterprises. Wages in larger enterprises were threefold higher than wages in smaller enterprises. In larger enterprises added value accumulated per employed person was fivefold more than in smaller enterprises. This enables us to conclude that despite the significantly lower wages in smaller enterprises in comparison with larger ones, wages are of higher

¹⁷ Ministry of Economic Development of Georgia, official returns of the State Department of Statistics. For reference, this figure in the EU member-states is more than 60 per cent. It is acknowledged in the economic literature that a country is developing when SME's share in GDP is no less than 40 per cent.

strategic importance in smaller enterprises and their share is higher as a share of the total expenses, as compared to the share in larger enterprises.

FIGURE 2. DYNAMICS OF AVERAGE NOMINAL WAGES, EMPLOYMENT, NOMINAL AND REAL GDP, 2003–2008



Source: National Statistics Office of Georgia, www.geostat.ge

Gender disparities. Women are mainly employed in public sector, while in the private sector, per 100 men there are only 57 women employed. The public sector is more attractive for women despite the fact that wages in the public sector on average are lower than in the private sector. One reason for such preference is that the public sector is characterized by higher stability and protection of employee's rights as compared to the private sector. On the other hand, the private sector prefers to employ men rather than women to avoid possible problems such as those related to child care, and maternity leave costs.

At the same time, out of the total number of the employed, there are 161 highly qualified¹⁸ women specialists per 100 highly qualified men specialists, among qualified specialists – 159 women per 100 men, while among unqualified labourers, there are only 5 women per 100 men.¹⁹

Despite the fact that there are no horizontal disparities in wages, women, hold a low working position in the vertical hierarchy. That is why women in total receive less remuneration as compared to men: women's remuneration in 2007 in manufacturing was only 57.3 per cent as compared to men, in trade, healthcare and social services – 37–40 per cent, in the construction industry – 67.0 per cent, in the hotels and restaurant industry – 55.0 per cent, in transport and communication – 78 per cent, and in financial brokerage – 73 per cent.²⁰

While in the early 1990s the average salary of women employed in the national economy of Georgia constituted 75 per cent of men's salary, by the end of the 1990s, it went down to 52 per cent, and currently it does not exceed 48.6 per cent. All of these factors, coupled with unpaid labour of women in the households—the importance of which is increasing—reflect gender disparities existing in the labour market in Georgia.

There is a positive trend in the increase of the number of employed women. There are 23 women entrepreneurs per 100 men, while the number of employed women is 91. According to a study carried out within the framework of UNDP Project 'Gender and Politics in the South Caucasus', while in 2006 there were 38 per cent of women employed in the private sector, the next year their number increased up to 42 per cent. The same trend can be seen among people holding leading positions in private institutions. The research findings showed that women's involvement increased from 22.3 to 38.2 per cent.²¹ Women are increasingly taking up positions higher in the hierarchy of business management. This trend is due to a liberalization of the economy that makes it easier for women to get involved in doing business.

¹⁸ Having higher education

¹⁹ Labour market in Georgia. (2006), pp. 11, 31, 33, 35, 41.

²⁰ Men and Women in Georgia. (2008), p. 53–54.

²¹ Report on the sociological research for revealing organization with the best gender balance 'Gender and Politics in the South Caucasus', p. 2–4.

Macroeconomic impact on employment effectiveness

The dynamics of productivity by economic sector, calculated as added-value per employee by sector is described in Appendix, Table 14. In 2009, on average, each employee created an added value amounting to almost seven thousand GEL. There was a slight decrease in productivity in 2009 as compared to the previous year. Still, the value added per employee is now almost two and four times higher than it was in 2003 and 1996 respectively. The Government administration, healthcare and social services have experienced the most remarkable growth in productivity (Appendix, Table 15). The value added per employee of the administration was almost four times higher than for the whole economy (Appendix, Table 16). The progress in these sectors can be explained by increased financing and structural optimization implemented during the recent period.

In other sectors of the economy, financial mediation lead productivity, followed by fast growing productivity in the real estate sector, the energy sector, the transport and communication sectors, hotels and restaurants, the construction sector, the mining and quarrying sectors, and the processing industry. In 2009 almost all sectors experienced a small reduction in productivity as compared to the previous year. For instance, in the mining industry productivity peaked at twenty thousand GEL in 2006, while in 2009 this indicator was almost halved.

The lowest productivity and wages are maintained in agriculture (1.630 GEL), followed by education (4.860 GEL). The value added per employee in these sectors is 23 per cent and 70 per cent, respectively, as compared to the rest of the economy. However, while the education sector experienced growth above average, agriculture showed the lowest (126.3 per cent) growth rate as compared to 1996. Self-employment based mostly on manual, low qualified work is widespread in this sector. This growth rate is far behind the average index of the country. Taking into account the fact that agriculture accounts for the largest share of total employment (more than 50 per cent of the total number of employed), poor labour productivity in this sector could have a negative human development impact on the whole. On the other hand, the public administration, an industry characterized by an increase in labour effectiveness, has experienced reduction in the number of employed.

An important feature of macroeconomic development in Georgia is that the sectors of the economy are experiencing rapid growth in either wages or in employment. Sectors characterized by high productivity levels and average monthly earnings—namely mining and quarrying, public administration sectors, real estate, transport and communications sectors, financial intermediation, electricity gas and water supply, and manufacturing—absorb a relatively small share of employment. Meanwhile the sectors that are the largest employers—agriculture, education—have low productivity levels and offer the lowest wages. Only in a few sectors (construction) do we see a combination of both high growth in employment and high average wages. Consequently, the macroeconomic and productivity growth was not accompanied by an increase in employment and reduction in the unemployment level and thus has not resulted in radical change and improvement of the labour market. An important way to improve the macroeconomic impact on labour and social indicators, thus, is attaining high productivity levels in sectors employing large shares of workers through elaboration and implementation of development strategies oriented towards efficient restructuring and upgrading of skills, technologies and acquiring of knowledge.

1.5. Recent developments in the education sector

Education and knowledge have been highly valued in Georgia throughout its history. One vivid illustration of this is the country's high overall education index (0.91) and 100 per cent adult literacy rate.²² However, the socioeconomic transformation process launched in Georgia in the early 1990s plunged the country's education system in a deep crisis. Economic hardship led to a substantial decrease in funding for education, which had a very negative impact on the whole education system. The main deficiencies of the system were the deterioration of educational infrastructure, low motivation of teachers and other personnel, corruption, lack of teaching materials and equipment and outdated curricula. Moreover, the transition to a new socioeconomic system has not been accompanied by a relevant change in education strategy and methods.

²² UNDP. Human Development Report 2008. http://hdrstats.undp.org/countries/data_sheets/cty_ds_GEO.html

Realizing the social inefficiency of the educational system, the Georgian government, with the support of the World Bank, launched an ambitious reform programme at the beginning of the current decade. The goal of the reform was to establish advanced educational standards by using new methods of management, financing and quality control. These reforms laid the legislative groundwork for the 'Law on Higher Education', adopted in 2004, the 'Law on General Education', adopted in 2005, and the 'Law on Vocational Education', adopted in 2007, the new legislative framework was aimed at bringing the Georgian education system closer to the European system.

As a result of the reforms, the education system was transformed through abolishing elements inherited from the Soviet times. These reforms have altered the trends which appeared due to widespread poverty and supported equal access to quality education by all social strata.

Financing of education. Starting in 2005, budget allocations for primary education were carried out according to a new system. Instead of covering the costs of general education schools, the foundation was laid for a student-based funding system, to which teachers' salaries were tied as well. To this end, schools were turned into legal entities of public law and a public monitoring and management system was established for the control of the allocated state funds. Practically, schools and professional education institutions moved to programme funding, while the higher education system moved to grant funding, resulting in the abolishment of the system of cost-based funding.

Generally, the system does little to promote university access for disadvantaged groups, the less well off, and the rural poor, who have less access to education as compared to urban residents. There are some programmes aimed at supporting these groups, but apart from social grants, in the form of needs-based vouchers (a quota is set at ten per cent of all kinds of vouchers), however, only a few of the groups in need can benefit from these programmes. The situation is slightly different with respect to ethnic minority students graduating from Azeri or Armenian schools. Scholarships are available to them but often cannot be taken up, because very few minority students apply to Higher Education Institutions (HEI) in Georgia and even fewer pass the minimum entry requirements.

Overall, between 2004 and 2009, average government spending on the education system was approximately 2.8 per cent of GDP. The distribution of MES (Ministry of Education and Science) financing between key segments of education is presented in Table 9. The primary education has the largest share of MES financing. It should be mentioned that before 2006 this segment was funded through budgets of territorial units (regions). So, from 2006 the MES budget shows a huge increase linked, amongst other factors, to this change. The second important direction of financing is higher education, while vocational education and training (VET) absorbs a minor share of the MES budget.

TABLE 9. SHARES OF VARIOUS SEGMENTS OF EDUCATION FROM TOTAL MINISTRY OF EDUCATION AND SCIENCE (MES) FINANCING, 2003–2009

INDICATORS	2003	2004	2005	2006	2007	2008	2009
(IN THOUSANDS OF GEL)							
MES Budget	14,966.7	67,676.7	80,941.1	358,165.1	410,828.8	458,177.5	537,967.7
Expenditure on primary education	958.4	14,157.4	21,827.6	281,319.4	314,533.0	340,580.1	397,635.1
Expenditure on VET	2,778.1	7,152.5	3,699.7	7,779.1	12,960.0	10,058.0	9,800.0
Expenditure on higher education	5,036.5	26,151.1	22,061.0	33,840.8	43,746.6	51,891.6	66,030.9
(IN PER CENT OF TOTAL)							
Expenditure on primary education	6.4	20.9	27.0	78.5	76.6	74.3	73.9
Expenditure on VET	18.6	10.6	4.6	2.2	3.2	2.2	1.8
Expenditure on higher education	33.7	38.6	27.3	9.4	10.6	11.3	12.3
TOTAL PER CENT *	58.6	70.1	58.8	90.2	90.4	87.9	88.0

* General school were financed via regional budgets before 2006

Source: based on MES estimation 'Black Sea Labour Market Reviews – Georgia country report', ETF report by Eduarda Castel Branco – 2010, (p.40) available at [www.ef.europa.eu/pub/mgmt.nsf/\(getAttachment\)/B8B57962E91F8695C12576E002E304F/\\$File/NOTE868FGP.pdf](http://www.ef.europa.eu/pub/mgmt.nsf/(getAttachment)/B8B57962E91F8695C12576E002E304F/$File/NOTE868FGP.pdf)

While compared to previous years, the funding was considerably increased, it is well below analogous indicators in developed countries. For instance, in the countries of the Organization for European Cooperation and Development (OECD), this indicator constitutes more than 4.5 per cent of the GDP (Table 10).

TABLE 10. INTERNATIONAL COMPARISON: PUBLIC EXPENDITURES ON EDUCATIONAL INSTITUTIONS AS A PERCENTAGE OF GDP, BY SOURCE OF FUNDS AND LEVEL OF EDUCATION (2006) – PER CENT

	PRIMARY, SECONDARY AND POST-SECONDARY AND NON-TERTIARY EDUCATION	TERTIARY EDUCATION	TOTAL, ALL LEVELS OF EDUCATION
OECD average	3.4	1.0	4.9
OECD total	3.4	0.9	4.7
EU 19 average	3.4	1.1	5.0

Source: OECD, Education at a glance, 2009. Available from http://www.oecd.org/document/24/0,3343,en_2649_39263238_43586328_1_1_1_1,00.html#4

Existing gaps in the education sector. Ambitious reform programmes in all spheres of education, however, have faced serious obstacles. As a result, the outcomes of the reform sometimes fall short of the desired aim. Analysis of developments in the labour market reveals a substantial mismatch between the competences of graduates as they come from universities and other educational facilities and the qualifications and skills demanded by the market. This is caused by a lack of cooperation between educational institutions and private businesses. Overall, the education system, despite ambitious reform efforts, still fails to nurture well-educated and skilled human resources capable of adapting rapidly to the changing environment.

1.6. The healthcare sector in Georgia

The enhancement of the nation's healthcare system is one of the key directions for ensuring high-quality economic growth that can be sustained over the long-run. In the pre-transition period the Georgian population had the highest living standard among USSR republics as well as guaranteed free health services. The transition process substantially reduced living standards and made it impossible to maintain the free health care system. As a result of this process, the basic characteristics of the current situation in the health care system are as follows: poor quality of services provided and inefficient administration, low technical efficiency and outdated equipment, lack of financing and unaffordable services. Thus, the improvement of the system is an untapped potential for economic and human development in Georgia.

In the same period, two negative tendencies: the poor level of healthcare services and the poor condition of the population's health were revealed. The poor health status was especially evident in demographic trends, most significantly, in the high levels of infant and maternal mortality.

However, average life expectancy at birth—one of the characterizing indicators of the health care system—has not undergone a drastic decrease over recent period (Table 11). This index reduced significantly, only during the civil war in 1993. In the recent period, average life expectancy at birth has been increasing.

TABLE 11. AVERAGE LIFE EXPECTANCY AT BIRTH

	1990	1991	1992	1993	1994	2001	2002	2003	2004	2005	2006	2007	2008
Male	67.5	67.1	66.0	66.4	66.0	68.1	68.0	68.7	67.9	70.0	69.8	70.5	69.3
Female	75.0	75.0	74.6	73.3	74.1	74.9	74.9	75.3	75.1	77.6	78.5	79.4	79.0
Total	71.4	71.2	70.3	68.9	70.2	71.6	71.5	72.1	71.6	74.0	74.3	75.1	74.2

Source: World Health Organization.

According to the World Health Organization (WHO), the Georgian health care system ranks 44th out of 191 countries with respect to the disability-adjusted life expectancy (DALE) indicator. This indicator, which takes into account the importance of living one's life in good health, substantially differs from unadjusted life expectancy indicator. In 2002 the DALE index was only 64.4 years as compared to 71.5 years of average life expectancy at birth.²³ Nevertheless, both indexes are quite satisfactory as compared to other post-Soviet countries.

The public expenditures on healthcare as a percentage of GDP were reduced drastically (more than ten times) as compared to the pre-transition period. After the 'rose revolution' public healthcare expenditures increased from 0.4 per cent in 2003 to 1.8 per cent of GDP in 2009. Still, this indicator remains low by international standards (Table 12). Not only high income European and American countries spend more of their incomes on health care (almost four times more) but also all other regions, with the exception of Southeast Asian countries, on average devote a higher share of their public resources to healthcare.

TABLE 12. PUBLIC EXPENDITURE ON HEALTH AS PERCENTAGE OF GDP BY REGIONS, 2007

	PUBLIC EXPENDITURE ON HEALTH AS PERCENTAGE OF GDP
Georgia	1.5
Africa	2.8
Americas	6.4
Eastern Mediterranean	2.3
Europe	6.7
South-East Asia	1.3
Western Pacific	4.4
Global	5.8

Source: World Health Organization.

The above analysis suggests that public health financing is one of the key problems in the Georgian healthcare system.

Still, financing was not the only problem in the health care system. The poor administration and low technical and management efficiency of the whole healthcare system represented a serious obstacle for the efficient functioning of this system.

²³ Source: World Health Organization (<http://data.euro.who.int/hfad/b/>)

2. Trade and investment policy

Georgia has undertaken a large number of reform initiatives targeted at reorganization, liberalization and simplification of trade regulations and their implementation. This effort was particularly intensified after the 'rose revolution' of November 2003.

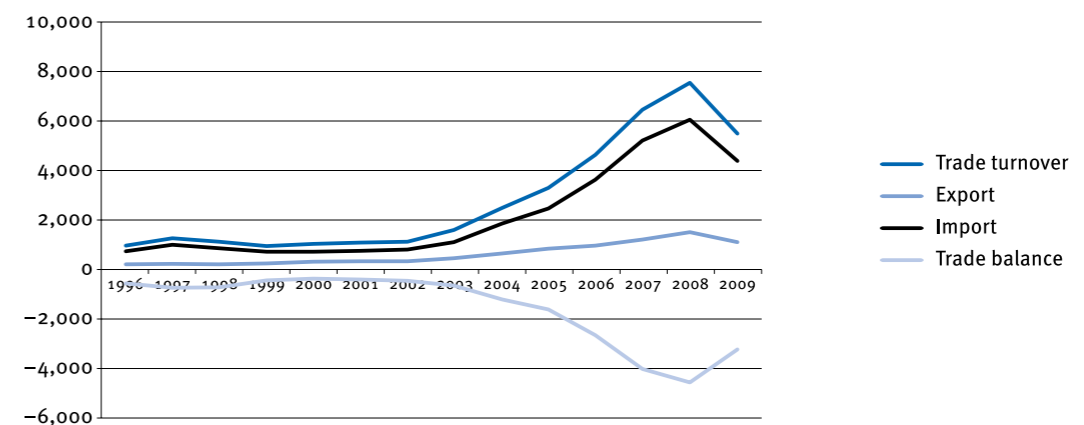
In the period before that, business procedures were burdensome, and operating a business had unnecessarily high costs as a result of inefficient administration and poor institutional development and as a result of lack of business practice and relevant regulations. In particular, the challenges were that the environment for entrepreneurs was uncertain, the supporting infrastructure was weak and the legal and regulatory environment, restricting. Investments and efficiency were lower because of the larger regulatory burden and costs of trade were higher because of tariff and non-tariff barriers. This made business procedures longer and more costly.

From 2004, the country started to eliminate tariff barriers, and condensed non-tariff barriers to trade. These reforms contributed to the creation of more competitive market conditions and improvement of the business environment, diversified international trade and thus generated growth and development.

2.1. Review of foreign trade relations

Since the institutional reforms for improving the business environment, the economy has seen large inflows of foreign investment. However, GDP growth slowed in 2008–09 following the August 2008 conflict with Russia and as a result of a decline in foreign direct investment and workers' remittances in the wake of the global recession. But in total, in the period from 2003 to 2009, trade turnover was 4 times higher compared to with the period from 1996 to 2003. Foreign trade has been growing rapidly since 2003 because of aggressive policy reforms to make it easier and less expensive to trade across borders.

FIGURE 3. TRADE TURNOVER (MILLION USD)



Source: National Statistics Office of Georgia, www.geostat.ge

Despite the trade reforms, which sought to eliminate barriers to foreign trade and implementation of regional and free trade agreements, in the 2003 to 2009 period, the export growth rate was unchanged in comparison with the pre-reform period of 1996 to 2003, while the volumes of imports and the average growth of the trade turnover increased more than twofold. As a result, the trade balance deficit increased from 1.24 times in 1996–2003 years to 4.77 times in the period 2003 to 2009. In the period 2004 to 2008 the share of foreign trade in GDP increased from 53 to 90 per cent and in 2009 it decreased to 77 per cent.

Traditionally, the main export products of Georgia were agricultural products (such as mineral waters, wine, nuts, fruits, citruses) and industrial products (ferroalloys, copper ores, scrap metal, fertilizers, gold, ores, and vehicles). Georgia's imports are natural gas, oil products, machinery and parts, and transport equipment, fuel, grain and other foods and pharmaceuticals.

Historically the Russian Federation was Georgia's primary trading partner. Because of the Russian embargo on Georgian exports, which was gradually implemented starting in December 2005, the total trade between the two countries decreased substantially. Since then, after a series of bans on imports of Georgian products and a break of financial links and a transportation blockade, trade routes were changed. Turkey is now Georgia's main trading partner, followed by Azerbaijan and Ukraine.

In 2009, the main export partners were Turkey (20 per cent), Azerbaijan (14.5), Ukraine (7.4 per cent), Canada (10 per cent), Bulgaria (7.2 per cent), USA (7.2 per cent), and import partners: Turkey (17.9 per cent), Ukraine (9.5 per cent), Azerbaijan (8.6 per cent), Germany (6.8 per cent), Russia (6.6 per cent), USA (5.1 per cent), China (3.9 per cent).²⁴

The main imported products from Turkey in 2009 were: medication, cement, paper and paperboard, polymeric materials, plastic pipes, etc. Imports from other countries concerned only a few products, whereas imports from Turkey were more varied.

From Azerbaijan, the second largest trading partner, mainly oil and oil products were imported, such as petroleum and natural gas. Georgia mainly exported cars, cements, and live cattle.

Ukraine is the third largest trading partner. Georgia exports include spirits and alcoholic beverages, wine, citruses, mineral waters, ferroalloys. It should be noted that after the Russian embargo on Georgian products, the export of wines and alcoholic drinks, mineral waters, as well as citrus, to Ukraine was increased. The main imported goods from Ukraine are tobacco products, sunflower seeds and oil, chocolate products and other goods.

In recent years, trade with EU member states gradually enlarged and the share of EU countries in Georgia's total trade turnover increased year by year. Its foreign trade relations with the EU are strengthened.

In 2009, trade turnover with the EU amounted to 27.8 per cent, whereas imports amounted to 30.5 per cent and exports to 16.9 per cent. Among the top ten trading partners there are four EU member states: Germany, Bulgaria, Italy, and Romania.

In the last few years, there has also been an upward trend in the number of Georgia's trading partners, now standing at 132 countries.

The main products Georgia exports to the EU are: hazelnuts, walnuts, vinegar, ammonium nitrate, non-alcoholic beverages, isotopes, and ferroalloys. For the first time since 2007, Georgia has exported greens, honey and eucalyptus brooms to the EU.

In 2009, only the 10 largest commodities accounted for more than 60 per cent of the total export volume, which indicates that the export from Georgia is still concentrated on a few types of products. In this regard, a positive fact was that in 2009, a new major export commodities emerged, which in previous years generally were not represented or less represented, for example, tea, electricity, medical facilities, isotopes, live cattle, sheep and more.

Trade balance. Trade Balance is negative and this poses a serious challenge that has been aggravated since the imposition of the Russian economic embargo. Both exports and imports increased during the period 2000–09. While the rate of growth of imports has been more rapid, the export-to-import cover ratio reduced gradually, and in 2009 reached 44.1 per cent, compared with 56.6 per cent in 2003, when this rate reached its highest level. Consequently, while the trade deficit grew 3.7 times during the period 2003–09, the current account deficit grew by 3.3 times, reaching 17.7 per cent of GDP in 2009 and around 34.7 per cent in 2008. FDI and transfers from abroad were the main sources of income to cover the deficit. During the period 2000–09 FDI increased 5.8 times and transfers from abroad four times.

²⁴ Source: National Statistics Office of Georgia.

TABLE 13. BALANCE OF PAYMENT OF GEORGIA (MILLION USD)

	2003	2004	2005	2006	2007	2008	2009
Current Balance	-383.3	-353.5	-709.5	-1,174.6	-2,009.1	-2,915.3	-1,274.6
a. Trade Balance	-638.0	-915.5	-1,214.2	-2,019.4	-2,895.8	-3,833.2	-2,399.5
Export of goods	830.6	1,092.1	1,472.4	1,666.5	2,088.3	2,428.0	1,893.2
Import of goods	-1,468.6	-2,007.7	-2,686.6	-3,685.9	-4,984.1	-6,261.1	-4,292.7
b. Balance of services	61.2	69.7	83.5	158.0	161.3	22.7	331.9
Export of services	458	554.8	715.0	885.0	1,094.1	1,260.5	1,306.0
Import of Services	-396.7	-485.1	-631.5	-727.0	-932.8	-1,237.8	-974.1
c. Net Factor Income	13.5	78.5	62.1	162.8	37.0	-165.2	-158.5
d. Net Current transfers	180.0	413.9	359.0	523.9	688.5	1,060.4	951.6
Capital and financial account	389.3	342.4	682.8	1,240.6	2,043.5	2,971.6	1,261.5
Capital account	19.9	40.7	58.6	171.2	127.6	112.3	178.5
Financial account, of which:	369.5	301.7	624.2	1,069.4	1,915.9	2,859.3	1,083.0
Direct investment	330.9	482.8	542.2	1,185.9	1,674.9	1,523.0	764.6

Source: National Statistics Office of Georgia, www.geostat.ge.

Thus, Georgia is mainly oriented on imports. Import growth has served as the main generator of trade turnover expansion in recent years, the large gap between exports and imports illustrates high benefits to importers. Despite the promotion of new export products at international markets, alongside with traditional goods produced in Georgia, the competitiveness and export capacity of Georgian entrepreneurs remained below its potential, and improvements are required. The upward trend in short-term financial inflows, with the trade deficit, was increasingly driving the capital account. In turn, it triggered an international payments crisis, and a collapse in the value of the national currency, GEL. While upward financial inflows followed GEL appreciation, after its decline, the GEL depreciated.

TABLE 14. LARI (GEL): USD EXCHANGE RATES

	2003	2004	2005	2006	2007	2008	2009
Average	2.14	1.91	1.81	1.77	1.67	1.48	1.67
End of period (December)	2.07	1.82	1.79	1.71	1.59	1.66	1.68

Source: National Bank of Georgia

2.2. Trade policy and human development relations

Trade policy. In recently years Georgia has removed significant barriers to free competition, like simplifying the custom duties, licensing and permission practice, property registration, labour regulations and access to financial resources.

In 2006, the government undertook measures to introduce new amendments to the customs code, eliminating many burdensome and bureaucratic regulations. The new customs code reduced the existing 16 types of custom duties to three. The new customs duties ranged between 0.5 and 12 per cent, whereas previous customs duties ranged from 1 to 30 per cent. Bound tariffs of 30 per cent, reduced to 12 per cent, tariffs of 12 per cent reduced to five and many custom duties eliminated. Georgia abolished import duties on almost 90 per cent of goods (except some agricultural products and construction materials). In 2006, because of tariff reduction, trade in Georgia was fully liberalized for non-agricultural products (with some insignificant exceptions), and important agricultural products.

At present, Georgia has one of the lowest tariff rates worldwide. Its average most favoured nations (MFN) tariff rate is 1.4 per cent, on agriculture 8.3 per cent and non-agriculture 0.3 per cent.²⁵ In 2006, the simple average MFN tariff equalled 7.0 per cent, including for agricultural products 11.5 per cent, for non-agricultural products 6.4 per cent.²⁶

Georgia has a trade regime with simplified trade procedures, no quantitative restrictions on export or import and no tariff quotas. There are no non-tariff restrictions (prohibitions, licensing) in international trade included in the Georgian legislation except those cases where health, security, safety and environmental issues are concerned. The share of goods subject to non-tariff restrictions constitutes about 1 per cent of the whole nomenclature.²⁷ Licences are required for imports and exports of only eight items.

In accordance with Georgian legislation, no tariff duty is applied to export or re-export from Georgia. Exports are exempted from VAT as well. Georgia does not use minimum export prices or discriminatory export subsidies.

The new customs code simplified procedures for clearing customs and provides greater protection against evasion. Corruption in customs and tax inspections, as well as abuse by different controlling authorities (including police), has been substantially reduced. Customs administration has improved significantly because of efforts to curtail smuggling and through modernizing border checkpoints and procedures, and reorganizing the central and regional structure of the customs department.

Another characteristic of the new customs code is the simplification and optimization of custom regulations, leaving only seven customs regimes in place of 15. The customs fee for customs procedures, while crossing the state border, amounts to 0.2 per cent of the customs value of goods. All these measures were an important step towards reducing corruption at customs, streamlining customs procedures and bringing them into compliance with international standards. A Risk Management System was introduced in all customs units in 2008. All customs checkpoints have been modernized. In parallel, Georgia is introducing a new harmonized system, including trade procedures.

Requirements such as certificates of origin, invoices or other administrative requirements are no longer a problem, because the documents required impose only small costs and compliance costs (e.g., paperwork, red tape, and documenting origin) are not significant. Obtaining a proof of origin is a simple and quick process; every company can obtain it from the Ministry of Economy and Sustainable Development, within three days without any charge.

All these modifications resulted from the accession of Georgia to the World Trade Organization (WTO) in 2001. As is required by the WTO, upon its entry, Georgia was granted the Most Favourable Nation (MFN) treatment regime by all WTO member states and has granted MFN in return. Bound tariffs have been set on almost all commodities of Georgia.

Since 1994, Georgia has enjoyed a free trade regime with the CIS countries. Goods and services in mutual trade between Georgia and these nations are exempted from customs duties. Economic relations between CIS countries have been regulated based on the CIS multilateral agreement 'On Creation of Free Trade Zone'. All CIS member countries, apart from the Russian Federation, ratified this agreement and it later served as a background document when bilateral agreements on free trade between these countries were being negotiated. Georgia entered into bilateral agreements on free trade with the following eight CIS countries: Russia, Azerbaijan, Turkmenistan, Armenia, Ukraine, Kazakhstan, Moldova and Uzbekistan. (The agreement with Uzbekistan has not been ratified). Bilateral agreements have not been agreed between Georgia and Kyrgyzstan, Tajikistan and Belarus. From 2009, Georgia is no longer a member of CIS, but the bilateral Free Trade Agreements with seven CIS countries (Azerbaijan, Turkmenistan, Armenia, Ukraine, Kazakhstan, Moldova, and Uzbekistan) remained in effect.

The EU has become one of Georgia's priority directions in trade. To foster cooperation, not only in trade issues, but also in political, environmental and cultural areas, the Partnership and Cooperation Agreement (PCA) was agreed. Moreover the EU-Georgia European Neighbourhood Policy Action Plan was agreed in November 2006, which envisages further enhancement of bilateral trade relations, including the possible establishment of a Free Trade Agreement between the EU and Georgia. Intensive

²⁵ http://www.wto.org/english/thewto_e/countries_e/georgia_e.htm

²⁶ Ibid

²⁷ Trade Policy Review. Report by Georgia. WTO. WT/TPR/G/224, 3 November 2009. (09–5397). p.10.

Available from: http://www.wto.org/english/tratop_e/tpr_e/tp324_e.htm.

bilateral consultations with the EU and preparatory works for the future Deep and Comprehensive Free Trade Agreement (DCFTA) negotiations have already started.²⁸

Since 2008, in the framework of Eastern Partnership initiative (EaP), the EU seeks the enhancement of cooperation and support of reforms in its Eastern neighbourhood (Armenia, Azerbaijan, Moldova, Ukraine and Georgia), to support these countries, through assistance programmes, with the improvement of its institutional, economic and social environment and to build a stable and valuable relationship with the EU.²⁹

Since 1999, Georgia has been a beneficiary of the EU Generalized System of Preferences (GSP) that removed customs duties for some Georgian exports to the EU market. Under the current EU Generalized System of Preferences (GSP+) scheme, which is in force from January 2006, Georgia has qualified for the enhanced preferences for sustainable development and good governance, offering it a very advantageous access to the EU market. It has provided a preferential tariff mode for products imported from Georgia, which consists of granting a trade regime without duties on the import of approximately 7,200 products. Under the Generalized System of Preferences Georgia receives preferential access to the markets of the EU, the United States, Canada, Japan, Switzerland and Norway.

Georgia has several free trade agreements with neighbouring countries. On 1 January 2006, Georgia also became the beneficiary of Turkey's 'GSP+' scheme. In November 2007, a free trade agreement between Georgia and Turkey was signed. According to this agreement, customs tariffs on industrial products were fully eliminated. Meanwhile, some agricultural products are subject to tariff-rate quotas.

Georgia has bilateral trade agreements and economic cooperation with 46 countries. The EU-Georgia bilateral negotiations on the Agreement on Protection of Geographical Indications for Agricultural Products and other Foodstuffs is an important step forward in promoting and protecting the quality of the agricultural production. It is almost finalized and is expected to be signed in the near future.

Georgia has joined many multilateral trade agreements and international conventions. Among them, the following important ones should be mentioned: The Paris Convention on Protection of the Industrial Property; The Madrid Agreement on Registration of Trading Trade-Marks; The Agreement on Protection of Patents; The Viennese Convention on Contracts of Sale and Purchase of Goods.

Since 2003 Georgia is a contracting part of an Agreement on Establishment of Free Trade Area between the GUAM (Georgia, Ukraine, Azerbaijan and Moldova) Participating States aiming at forming the conditions for extremely liberal free trade environment. Georgia has had an agreement with the United States since 2007 in the framework of Trade and Investment Framework Agreement (TIFA) that addresses a wide range of trade and investment issues aimed at increasing commercial and investment opportunities by identifying and working to remove impediments to trade and investment flows between the United States and Georgia. In January 2009 the US-Georgia Charter of Strategic Partnership was signed and the possibility of a Free Trade Agreement has been explored.

Georgia is the member of Organization of Black Sea Economic Cooperation (BSEC) which supports collaboration in various spheres of trade and economic development.

²⁸ Trade Policy Review. Report by Georgia. WTO. WT/TPR/G/224, 3 November 2009. (09–5397). p.11.

Available from: http://www.wto.org/english/tratop_e/tpr_e/tp324_e.htm.

²⁹ Eastern partnership: Communication from the European Commission to the European Parliament and the Council, COM(2008) 823, December 3, 2008, Available from: http://ec.europa.eu/external_relations/eastern/docs/como8_823_en.pdf

Impact of international conventions and arrangements on trade performance and human development of the country

Trade arrangements and commitments force the government to improve governance and promote sustainable development. It is stipulated by EU requirement to implement of GSP+ related conventions. The plan is to make progress towards the fulfilment of international obligations as a prerequisite for receiving benefits from a (future) FTA and GSP+. In the period 2005 to 2009 Georgia introduced several laws for better governance and human rights and environmental systems.³⁰

A recent World Bank report states that, while the government has established an environment conducive for private sector investment and has identified growth as a centrepiece of its development strategy, there is a need to further improve business practices and regulations to promote maximum competition and transparency. While the judiciary is being reformed and the courts system reorganized, re-staffed and judges retrained, continued efforts are needed to reduce the perception that it is not independent and that it can be heavy-handed in its approach. Most importantly, there is a need to continue to deepen the dialogue between the government and civil society to build transparency in decision making and programme implementation.³¹

Some conventions regarding women's rights have been more successful. The Law on gender equality was created and the first institutional mechanism—the Gender Advisory Council under the Chairperson of the Parliament of Georgia—was established to ensure that women's rights are equal to those of men in formulating public policy and decision making at the national and local levels. The Law 'On the Struggle Against Human Trade (Trafficking)' was enacted in 2007, and was one progressive step towards embedding human rights in society. Special women's shelters have been created since the adoption of the law 'On Protection and Aid for the Victims of Domestic Violence' in 2006.

Equal rights are enjoyed by both sexes and relevant guarantees are enshrined in Georgian legislation in compliance with recognized international principles, but discrimination against women is still a problem. Women's access to the labour market has improved, but women are still under-represented in key professions and remain primarily confined to low-paying, low-skilled positions. Sexual harassment and domestic violence against women remain social problems.³² There are several spheres where involvement of women requires tangible gender-related changes, including: women's participation in parliament,³³ local government elections and involvement in the executive branch, provision of women property rights, domestic violence and gender-oriented budgets.

The biggest challenge is the group of approximately 220,000 internally displaced persons who have been living in protracted displacement. The government adopted the State Strategy for Internally Displaced Persons, which foresees measures aimed at integrating IDPs into society.³⁴

In general, the reforms served as a necessary background for the application of most of the conventions. Implementation of the conventions is reflected through the whole legislative, institutional and regulatory improvements in the sphere of governance, and recent positive reforms indicate compliance with the mandates in the conventions.

The Government of Georgia have undertaken measures to improve the legislative base and elaborate the environmental code, and form a long-term strategy for environment protection and management of natural resources and institutional optimization. Many environmental projects and substantial assistance from the donors that has been given to country after the war with Russia in August 2008, allows the Georgian government to practically carry out environmental measurements.

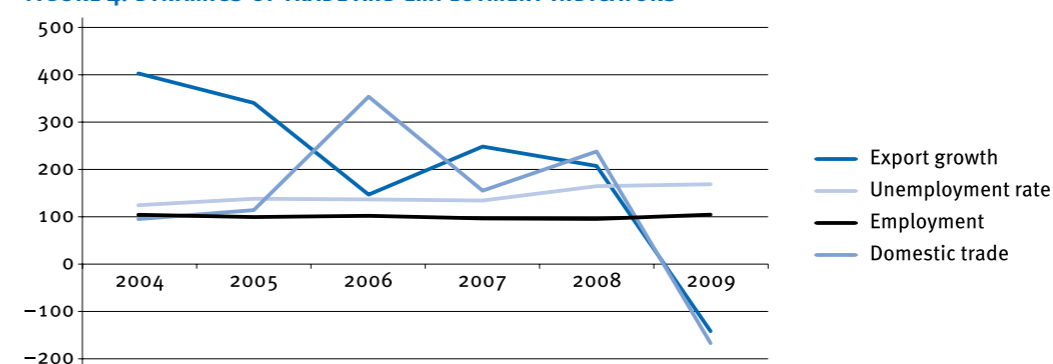
Due to EU enlargement from 2004 to 2007 and because of European Union common and uniform visa regulation policy, Georgian citizens lost visa free movement into the new EU member states. Open talks on the simplification of the visa regime for Georgia started after the 2008 conflict with Russia; this will certainly improve cooperation and exchanges between the EU and Georgia. The process is being implemented currently.

The basic conditions for the achieving of the visa facilitation regime are very broad and always the same for every third country. They include: approximation of laws in the area of migration, border control, asylum, fighting organized crime and corruption with the EU *acquis communautaire* and the obligations of the international law, promotion of democracy and the rule of law and strengthening institutional and technical capacities in all above mentioned areas. At the same time, however, it should also be stressed that there is no exhaustive list of conditions that have to be met and some of the conditions vary from country to country. The individual conditions are a negotiable process and depend on the readiness of the parties.

Trade and labour market efficiency

The government introduced a variety of incentives to promote open trade, which increased imports and raised the negative trade balance. Import growth has had a positive effect in terms of lowering and stabilizing prices, but it has had neutral effect in demand on the labour market (Figure 4). Labour has been little affected by the developments in the area of trade.

FIGURE 4. DYNAMICS OF TRADE AND EMPLOYMENT INDICATORS



Source: National Statistics Office of Georgia, www.geostat.ge.

Accelerated expansion of international trade and investment during recent years was associated with increasing labour productivity and demand for a highly qualified labour force. With trade growth, the productivity of the economy increased. In 2004–2009, value added per employed person doubled (Appendix, Table 15).

However, unemployment is still high.³⁵ Necessary institutional changes related to labour market efficiency were implemented rather slowly. This has delayed labour market growth. The qualification, knowledge, and preparation of the majority of people employed in the national economy do not meet the new requirements and it is not possible to make use of their skills in the conditions of new market economy without corresponding retraining and increased qualification. In order to improve the labour market the government introduced legislative changes in vocational education, rehabilitated infrastructure and supported programmes providing retraining courses.

³⁰ Among them are: Laws on General Education; On Free Trade and Competition; On State Control On Environmental Protection; On Licences and Permits; On Product Quality and Safety; On Struggle Against Human Trade (Trafficking); On Protection and Aid for the Victims of Domestic Violence; On National Parks; On Protection of New Species of Plants; On Protection of New Species of Animals; On Cultural Heritage; On Protection of the Population and the Territory from Natural and Man-made States of Emergency; On Struggle Against Terrorism; On Struggle Against Narcotic Crime; On Creation and Management of Borjomi-Kharagauli Protected Territories; On Status of Protected Areas; On Permission for the Impact on the Environment; On Ecological Experts; On Environmental Protection Service; On Arbitration; Criminal Code of Practice of Georgia.

³¹ http://www-wds.worldbank.org/external/default/WDSContentServer/WDS/IB/2009/08/20/000334955_20090820040116/Rendered/INDEX/489180CASop116101OfficialUseonly1.txt; <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/GEORGIAEXTN/0,,menuPK:301758~pagePK:141132~piPK:141105~theSitePK:301746,00.html>.

³² Human Rights in Georgia, <http://www.humanrights.ge/index.php?a=article&id=3797&lang=en>

³³ In 2000–2009 women held between 7 and 9 per cent of seats in the Georgian parliament.

³⁴ Council Mission to Georgia (2009). Report of the Representative of the Secretary-General on the human rights of internally displaced persons, Walter Kälin, United Nations, Human Rights, 13 February, 2009, Available from http://www2.ohchr.org/english/bodies/hrcouncil/docs/10session/A.HRC.10.13.Add.2_en.pdf

³⁵ According to Law of Okun, growth of unemployment on 1 per cent above natural level, reduces GDP by 2.5 per cent. (Prachowny, M. (1993). Okun's Law: Theoretical Foundations and Revised Estimates. *The Review of Economics and Statistics*, Vol. 75, No. 2. pp. 331–336).

On the other hand, Georgia faces a deficit in the number of specialists needed to meet the demands of the market economy, including those corresponding to market economy institutions and production and realization of goods.

Wages

A higher level of education is generally associated with higher output and productivity. It increases and enhances a country's growth potential. There is a well-known positive correlation between training and the productivity of the workforce on one hand, and economic growth and wages on the other hand.

During the period from 2003 to 2009 the average wage in all sectors increased by 4.8 times. Especially high growth of wages was achieved in wholesale and retail trade (8.4 times). Construction was the sector that showed both high growth in employment and higher-than-average wages. The sectors that employ the most workers and are generally those which offer the lowest average monthly wages are education, healthcare and social work. With regard to these sectors, McPherson and Ignatowski (2007) indicated that an important challenge for policy development is skills upgrading and reorganisation of work towards higher productivity and quality of outcomes. Since these sectors absorb mainly skilled employees, revamping their skills offers an opportunity to increase the productivity of a large proportion of professional workers.³⁶

The education sector has among the lowest average monthly earnings, together with agriculture and health. Growth in earnings in this sector lagged far behind that observed in public administration. Average salaries in the education sector stood at only 56 per cent of the country's average in 2009, despite an increase of over 3.5 times compared to 2003. The low level of average earnings is a problem that clearly needs to be addressed, given the strategic importance of the quality in the on-going education reform. Despite the stagnation in the labour market, wages have grown in the sectors unequally. Wages mainly increased in the sectors where capital inflow was high.

Competition

From the macroeconomic side, the incentives from lowering of tariffs on imported goods maintained competitiveness. Moreover, the opening up of the domestic markets resulted in greater competition and forced domestic firms to restructure and become more efficient. However from the microeconomic side, these incentives did not protect individual enterprises or sectors of economy from fierce competition from foreign firms with advanced production conditions.

At the same time, a free trade regime makes unequal trade relations when partner country applies protectionist policies. E.g., Turkey provides subsidies to support domestic cereals producers to export to foreign markets. It allows them to sell in Georgia at competitive prices. Consequently, Georgian producers' competitiveness has been reduced. In 2000–2009, imports of cereals increased by four times, but in the period 2006 to 2009 the value added in this sector increased only by 38 per cent. It is worth mentioning that in Georgia wheat products are among the top five imports.

Trade became beneficial for the firms which—thanks to low cost, high quality or effective strategy—were able to successfully compete with other firms, but it drove other less efficient firms out of business. The production of such enterprises has declined recently and local production has in these cases been replaced by imported goods; the textile industry, for example, as well as a large proportion of Georgian agricultural and food products, have been replaced by imports, due to the lower prices and higher quality of imported products.

In order to promote competition and enhance the efficiency of production and distribution of goods and services through the greatest possible transparency and equity of competitive conditions, the Government of Georgia prepared the 'Comprehensive Strategy in Competition Policy'.³⁷ This document reflects the Government's commitment to establish a modern competition policy and its intention to bring the legislation and institutions in compliance with the best international practice in this area.

³⁶ McPherson M., Ignatowski, C. (2007). Short Country Survey Findings – GEORGIA. Prepared by the Ministry of Education and Science of Georgia for The BFUG Employability Working Group.

Available at: www.ond.vlaanderen.be/hogeronderwijs/bologna/ActionLines/documents/Employability_Georgia.pdf

³⁷ Source: <http://www.geplac.ge/newfiles/Comprehensive%20Strategy%20in%20Competition%20Policy.pdf>

This document addresses the following issues:

- Support to free and fair competition through:
 - Prohibition of the abuse of dominant position
 - Concentration regulations
 - Regulation of restrictive agreements, concerted practices, decisions by undertakings and collusive tendering
- Definition of the relevant market
- Introduction of block exemptions
- Further development and streamlining effectiveness of special rules for the state aid granting procedures
- Independence and effective investigative powers of the competent authority
- Strengthening the competition authority's administrative capacity
- Ensuring effective enforcement of the competition legislation.

The state budget

Trade expansion significantly increased the state budget revenues. In parallel with trade reforms, revenues from the taxes on incomes, profits and goods and services increased, despite the fact that trade liberalization caused significant decline of tax revenues from the international trade and transactions. (Appendix, Table 17). These improvements allowed the Government of Georgia to radically increase its public expenditures in order to increase human benefits in the spheres of education and health care. Social expenditures on health, education and insurance services became main priorities of the state budget. Access to public services improved.

Barriers facing Georgian exports to EU markets

Trade relations were especially beneficial for exporters in the framework of GSP+. GSP+ made it possible for Georgian businessmen to be exempted from duties. For example, before 2006 nuts faced a 1 per cent duty and after the GSP+, nut producers have saved between USD 0.5–1.4 million each year. Georgia benefits from the trade with GSP+ with the USA too: while in 2006 a total of 116 million USD was exported to the U.S. and only 34.5 million USD was imported under GSP (30 per cent of all imports), in 2007 a total of 188 million USD was exported to the U.S. and 68.3 million USD was imported under GSP (36 per cent).

Therefore, GSP exports nearly doubled and saved 1.3 million USD in duties in 2006 (on average 3.7 per cent). And in 2007, 2.6 million USD in duties was saved (on average 3.8 per cent). In 2008 (January–July) exports to the USA totalled 166 million USD (up 154 per cent over the same period a year earlier) and 99 million USD in goods were imported (about 60 per cent of total imports) under GSP (up 410 per cent over the same period of the previous year).³⁸ This fact demonstrates the significantly positive impact of trade on incomes of trade partners as well as on the wages and skills of the workforce engaged in export sectors.

Georgia's exports to the EU have grown significantly. Since 2005, annual growth has been at 14–20 per cent, while with the USA growth exceeds 20 per cent.

At present, out of 3,400 products included in the generalized system of (trade) preferences, according to National Statistics Office, Georgia exports only nine to the USA, which totals only 37 million USD, 3 per cent of total exports (2009), that indicates underutilization by Georgian entrepreneurs of trade opportunities. The same goes for trade with the EU. It is an unexploited opportunity for Georgia to maintain and build a presence in the EU and US markets.

The basic problem facing Georgian exporters is that they have only limited working experience in foreign markets, they underperform in marketing, they exercise low control on the channels of sales, they do not conduct high quality research of markets, and their knowledge of sales channels and customers abroad is negligible. They do not possess marketing management experience in markets. What's more, their awareness of tax and customs regulations in foreign countries is low. On top of that, only a small portion of large and overseas investors are interested in Georgian products.

³⁸ Source: <http://www.georgia.gov.ge/?lang=2&event=list&topid=24&botid=0&page=1>

In export enterprises there is no strategy in the area of **qualification** trainings for EU markets. It has become clear that technical and practical assistance to Georgian exporters in agribusiness is urgently needed to help them recognize and take advantage of market opportunities through improving their skills and knowledge.

While participating in foreign markets, companies face a range of stumbling blocks due to the fact that enterprises are not in a position to assess market potential nor they do not know the requirements regarding quality and standards. They deal also with problems like **market research, logistics and technology**.

All these factors determine wholesale trade in Georgia, from which it is further taken to European Union countries and the USA by foreign companies. So, GSP+'s main beneficiaries from the start are EU companies. Domestic private companies have benefited little from foreign trade. And the free trade agreements have not changed Georgia's pattern of exports significantly.

The economic impact of a free trade agreement (FTA) between the EU and Georgia

Once Georgia achieves necessary progress towards democracy, the rule of law, respect for human rights, liberalization of trade, sustainable development and good governance, in order to achieve gradual economic integration with EU, negotiations on FTA between Georgia and EU has started in July 2010 in the framework of the negotiations on the respective Association Agreements.³⁹

According to an empirical study, the free trade agreement between the Georgia and EU will allow Georgia to be considered a trustworthy place to investment. It will help eliminate regulatory and behind-the-border impediments to trade, which may relate to customs procedures, product standards and certification procedures, competition policy, government procurement; it will help business' transformation from less efficient to more efficient sources of exports that may take place and it will allow for more specialization in niche goods, participation in the fine division of labour, creation of stable value chains; it will reduce trade risks attached to investment in Georgia, which could lead to additional welfare gains; will increase the solvency of the population, and GDP.⁴⁰

Georgia does not have a diversified export-oriented economy and application of EU standards will surely help to establish new product lines which might be competitive on European markets.

According to the conclusions of the research carried out by the group of experts,⁴¹ Georgia would receive limited welfare gains from a simple FTA because of existing low tariff levels. Indeed, Georgia's principal imports from the EU—vehicles, machinery and electrical equipment, pharmaceuticals, instruments and chemicals—are already exempted from tariffs. The same is true on the export side, where low levels of pre-FTA tariffs would bring relatively small economic gains.

The removal of existing non-tariff barriers would ensure higher welfare, including the removal of regulatory, institutional, and infrastructure impediments, along with the alignment of national standards to those of the EU compared to the gains brought about by a simple FTA. The effective implementation of the above would bring forth closer relations between Georgian and EU firms leading to technology transfer, the creation of effective supply chains, and the improvement of the business environment, which would result in the reduction of Georgia's investment risk premium, as well as the development of new industrial structures. This improved level of regulatory and institutional approximation with the EU is considered achievable, but only through deeper integration via a Deep FTA scenario. A Deep FTA with substantial investment in standards infrastructure may bring substantial benefits but only in the medium to long term. As the human resources of the government bodies are uneven in terms of education, qualifications, and international experience, this situation could be eased with technical assistance in the framework of EU-Georgia relations.⁴²

³⁹ EU also has launched Association Agreement negotiations with Armenia, Azerbaijan, Ukraine and Moldova.

⁴⁰ Economic feasibility, general economic impact and Implications of a free Trade agreement between the European Union and Georgia, (2008). *Final Report prepared for European Commission. Centre for Social and Economic Research. Global Insight*. May 8, 2008. Available from http://case.com.pl/strona--ID-publikacje_raporty_case,publikacja_id-20963282,nlang-710.html.

⁴¹ Ibid

⁴² Ibid

In conclusion, despite the fact that the Government concluded free trade agreements with main trading partners, much work is to be done to stimulate exports and take advantage of the preferences.

In order to enter the export markets and benefit from trade, it is necessary to effectively utilize the benefits of existing trade preferences. Recent events, such as political turmoil, political tensions with Russia and the global financial crisis, negatively impacted business undertakings and as a result the country went into recession. This also neutralized benefits that could have come about from the trade relations with other countries. At the same time the circumstances under which Georgian enterprises were forced to diversify export routes revealed a need to improve the skills and knowledge of the labour force, and technology, infrastructure and logistics of organizations.

Trade liberalization in Georgia affected prices. It was done in order to improve education and re-train the labour force. It permitted entrepreneurs to increase productivity and increase wages. Moreover, the state budget revenues were increased.

Furthermore, as statistics show, the employment rate in the export oriented sectors of goods remained unchanged, and the recent increase in the underemployment rate is evidence of the weak impact of foreign trade on the labour market of Georgia. While the government talks a lot about encouraging exports, in fact the country has more potential to make use of the trade more effectively.

2.3. Investment policy

In order to create favourable conditions for investors, the Law on State Support for Investment was adopted in 2006 aiming at improvement of procedures required for investing and entrepreneurial activities. It stipulates the rules and procedures for obtaining the status of 'Very Important Investment'.⁴³

At the same time, Georgia signed agreements with 26 countries and launched negotiations with nine countries to avoid double taxation and to promote investment.⁴⁴

In addition, new amendments to the law on entrepreneurship will reduce the burden on businesses. New laws on standardization and certification of goods and services were adopted. The number of licences required to start businesses was reduced drastically. The tax code was simplified, and the number of different taxes was reduced from twenty-one to six. As a result, despite drastic tax reductions, tax revenues increased approximately threefold from 2003 to 2008.

Deregulation became one of cornerstones of investment policy and in this way regulation power has removed this function from state agencies to new entrants, and has transferred property rights for infrastructure services from public to private ownership and control.

The recent institutional amendments and examinations and deregulation in infrastructure and some monopoly sectors should be considered an economic policy of liberalization with the aim of easing the bureaucratic burden and creating an attractive investment environment in Georgia.

Moreover, the privatization process has been intensified since 2004. In an effort to attract more foreign investments, the government opened all sectors of the Georgian economy for privatization, including energy, transport and communications. Almost all major state-run companies have already been privatized.

In order to ensure a favourable environment for economic activity and promote the inflow of capital and technologies to Georgia, **free industrial zones** are being created. The creation of FIZs is regulated by the Law of Georgia on Free Industrial Zones and the rules for the establishment, arrangement and functioning of a Free Industrial Zone are determined by a resolution of the Government of Georgia.

⁴³ According to the Law on state support for investment, an investor who thinks his investment qualifies for a Status of the Very Important Investment needs to send a letter to the Government of Georgia describing in detail the intended or actual investment in the Georgian economy. The Government of Georgia will review the application within one month from the submission date and will make a decision on granting of a Status of the Very Important Investment. Upon granting the status of special importance to an investment, an agreement shall be concluded between the Government of Georgia and the investor, specifying the conditions of the investment. From the point of granting the status of special importance to the investment, the investor shall be required to deposit the investment guarantee, totalling 2 per cent of the investment, or the submission of a bank guarantee with a view to ensuring the discharge of obligations under the agreement. The Georgian National Investment Agency shall maintain a registry of Very Important Investments.

⁴⁴ Grow with Georgia, November, 2009. http://www.georgia.gov.ge/pdf/2009_11_24_21_57_26_1.pdf

The government intends to turn Georgia into ‘a tax-free zone’ for information technology companies in order to attract IT giants to invest in Georgia and open branches in the country. According to the government proposal, which has yet to be approved by the Parliament, tax exemptions will also apply to local IT companies.

In order to make Georgia an attractive country for foreign investment, a special institution has been created – the **Georgian National Investment Agency (GNIA)**. At present the Ministry of Economic Development and the GNIA, which is subordinated to it, are responsible for the promotion of foreign direct investment (FDI).⁴⁵

This along with attractive business regulations, free movement of goods, private ownership on infrastructure services and favourable export regimes have allowed Georgia to raise its investment attractiveness and increase investment in the social and economic sectors. But due to the global financial crisis and its negative impact on the country and the 2008 armed conflict with Russia, foreign direct investments inflows to Georgia have dropped.

In 2009, FDI fell in the following sectors: industry – 21.2 per cent, real estate – 22.4 per cent, construction – 16.0 per cent, transport and communications – 15 per cent, agriculture – 3.4 per cent (Appendix, Table 18).

The largest investments come from the UAE, the United Kingdom, Panama, the Netherlands and Turkey and main sectors for the FDI are manufacturing, banking, transport and communication. (Appendix, Table 19).

Next to FDI, the state budget increased investments in healthcare and education. 2008 productivity levels compared with 2003 levels increased in manufacturing enlarged by 2.4 times, in banking sector—by 1.9 times, in health care—by 2.2 times and in education by 2.6 times. In these sectors, organizations were able to look toward improvement of workforce management tools and techniques to lower labour costs, and raise productivity of their existing assets, which allowed them increase the efficiency of their human resources.

In the period 2004–2009 annual growth of investments reached the highest level in 2006, but then decreased, though it had no negative impact on salaries, which continued to grow. In the short run the impact of investment was tangible on wages (especially in industry, the most profitable sphere for investments), and on economic growth and state budget revenues, however employment did not improve. The effect on the labour market from the investments can be tangible only in the long run.

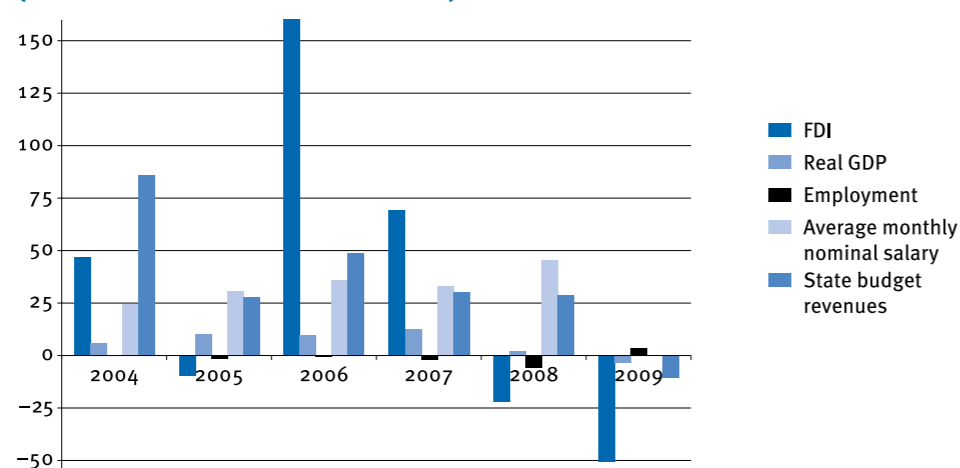
The fact that Georgia—up to 2008—had high economic growth and continuously increased wages and labour productivity demonstrates an improvement in the competitiveness of the country, though this period was short and was affected by external political and global events in 2008.

At the same time low standards of living, low savings, poor technology, high level of energy capacity,⁴⁶ prevalence of unskilled labour and insufficient investments in science and education create barriers to competitiveness.

In the period 2004–2009, public expenditure on education as a percentage of total government expenditures decreased from 13.1 per cent to 7.0 per cent. It is true that the same period saw increased private expenditures, and this trend will be maintained in future, but state investments in research and development have decreased drastically. The gap between the financing of education and science hinders the supply of skilled labour and development of new technology and innovations in the enterprises.

To summarize, in the recent period in Georgia streamlined business and trade regulations toward liberalization, contributed to substantial diversification of Georgia's international economic relations, including trade and investment. **Despite the fact that the flow of investments significantly increased**, underdeveloped human factors such as skills, experience, knowledge and limited opportunities for retraining were factors impeding the development of trade growth and the impact of investments on the labour market was relatively mild.

FIGURE 5. DYNAMICS OF FDI, GDP, SALARIES, STATE BUDGET REVENUES AND EMPLOYMENT (PER CENT GROWTH OVER PREVIOUS YEAR)



Source: National Statistics Office of Georgia, www.geostat.ge.

⁴⁵ GNIA acts as a ‘one-stop shop’ agency for investors, assisting them in setting up their businesses in Georgia, helping with project implementation, performing a liaison role with the Government, providing information on investment opportunities in the country, as well as investment-related regulations and laws. In its export promotion activities, GNIA helps to find markets for products, undertakes market studies and seeks out partners for joint ventures aimed at increasing the volume of exports and development of Georgian enterprises. GNIA organizes international conferences, business-forums, trade fairs and exhibitions. (http://www.investinggeorgia.org/doing_business/guideline_for_investors)

⁴⁶ In Georgia the share of energy resources in production (energy capacity) is twice more than in EU and by electro capacity – three times more. (IEA, Department of Statistics. 2009).

3. Opportunities for the further promotion of trade

3.1 Institutional efforts and obstacles to promote trade

Legislative reforms

Since 2005 new institutional reforms have been undertaken in Georgia and a new law on **‘free trade and competition’** was adopted. The antimonopoly service and the State Department of Standardization, Metrology and Certification were reorganized, price inspection agencies were eliminated, the phytosanitary (sanitation) service was subordinated to the customs department, and phytosanitary and veterinary certificates were eradicated.

The introduction of **standards liberalization** procedures was one of the steps aimed at the elimination of trade barriers. In practice, the obsolete GOST standards (standards of the Soviet Union) were used as Georgian standards until 2006. There were, altogether, around 26,000 GOST standards, available only in Russian. Up until 2005, approximately 30 new Georgian standards had been adopted. In order to enhance the EU standardization regime, Georgia dropped its state-controlled system of rigid, mandatory standards and founded institutional preconditions for the implementation of private-sector system of flexible, voluntary standards and the establishment of legal framework for a modern system.

At present, standardization is mostly optional. In addition, any company has a right to develop its own, specific standards and register them with the government. There is also an option to adopt and use either internationally or regionally/nationally acknowledged standards, which will be an asset for further marketing of a company's product to international markets.

Licensing, Permits and registering property. Until 2005 the large number of required licences and permits in Georgia was troublesome. The 30 state organizations issued 65 types of licences and permits. These regulations created barriers to market entry. So, the simplification of burdensome licence delivery procedures was an acute problem that had to be solved.

In 2005, a new law on licensing was adopted and the system of business licensing was modernized and simplified. The number of licences and permits necessary for doing business was reduced by almost 85 per cent. Only 150 licences and permits remain of the previous 950; this move was a step towards improving the business environment. Many unnecessary regulations, which were sources of corruption, were abolished and licensing procedures and duration of issuing them was reduced. The administrative body issuing licences is required to do so within 30 days and issue permits within 20 days. In some areas, the mandatory time frame for issuing licences and permits is even shorter.

The department for Foreign Trade and International Economic Relations issues licences and certificates of origin for exported goods within three working days free of charge. This greatly benefits exporters.

Moreover, the new law on licences includes a number of innovations in the field already well known in Europe. Primarily, a business licensing ‘One Stop Shop’ and ‘Silence is Consent’ principle was introduced. If the licensing office does not respond within a set period of time, the licence is issued automatically.

Institutions

In recent years the transaction cost on business was reduced drastically due to the reduction and restructuring of several state institutions and reduction of regulatory costs.

For ensuring voluntary standardization and certification, two independent institutions have been established: the National Agency for Standardization, Technical Regulations and Metrology, and a National Accreditation Centre. Other institutions that were less effective in promoting trade – such as the sanitary and phytosanitary service – were abolished.⁴⁷

⁴⁷ The abolishment of sanitary and phyto-sanitary services reduced costs for businesses but the same time is disputable for reasons of public health and food safety in Georgia, also of traded goods.

In 2005, the Georgian ‘National Accreditation Body on Accreditation – Accreditation Centre’ (GAC) was established. The GAC currently offers accreditation for Testing and Calibration Laboratories, Certification Bodies, inspection bodies. The Accreditation Centre's activity is based on ISO/IEC 17011 international standards and uses also standards on testing methodology level (such as OIV/ISO standards for wine testing, ISO standards for water testing and ASTM technical standards for materials, products, systems and services).

Accreditation is not obligatory but products which are exported to the EU market should be checked by the conformity assessment body. This particularly applies to products that can be hazardous for the health or the environment, which can be withdrawn from the market.

Costs linked with the accreditation assessment shall be paid by the appropriate applicant or accredited body on the basis of an invoice including fees (registration fee, annual fee for services provided to the accredited bodies) and costs linked with assessment activities (initial assessment of applicants, reassessment of an accredited bodies, surveillance of the accredited bodies and so on).

Obstacles

The majority of local companies are focused only on selling their products, rather than complying with the needs and requirements of the market's demand side.

One of the reasons that Georgia does not meet the European standards is lack of internationally certified laboratories. The laboratories need to comply with accreditation, which demands investment, qualification and expertise. Conformity Assessment Bodies (CAB) also need highly qualified personnel, which is rare in Georgia. Training staff abroad is also expensive. Government support to the CAB is required both in financial terms and with qualified personnel.

The government of Georgia, with support from the European Commission and a number of international organizations, recently approved amendments to legislation that would force almost the entire agribusiness sector to adopt and implement food safety standards. However, it was not clearly assessed and/or proposed how the private sector could actually do so. Only a small number of companies have managed to develop their own standards or meet existing international ones and the government has had to postpone enacting the law. Food safety standards were meant to enable companies and their clients to trace the end product back through the whole value chain in order to ensure compliance to the safety standards developed/used.

Businessmen argued that introducing EU standards is necessary for the following reasons: creating a technical requirement basis for Georgian mineral waters that corresponds to EU directives; supporting small and medium-size producers in producing high quality products and improving management and marketing; creating a normative document that prevents the production and distribution of falsified products and establishing EU technical norms in Georgian legislation.⁴⁸

It is clear that technical regulations, standards and the conformity assessment process will aim to bring Georgian legislation and food security system into line with EU technical regulations, standards and conformity assessment procedures. Sanitary and phyto-sanitary measures will aim at the gradual approximation of legislation in priority areas leading to the liberalization of trade. This could lead eventually to a veterinary and phyto-sanitary agreement which would do much to facilitate trade.

In the framework of the Deep and Comprehensive Free Trade Agreement's (DCFTA) preparation, the Government of Georgia has adopted the strategies on Technical Barriers to Trade (TBT), Competition and Food Safety (SPS).⁴⁹ These strategies represent a basic plan for reforms implementation in the relevant areas necessary for launching the negotiations on DCFTA between Georgia and the European Union.

A key document on TBT drafted by the Government of Georgia and approved by the EU Commission is the ‘Strategy in Standardisation, Accreditation, Conformity Assessment, Technical Regulation and Metrology and Programme on Legislative Reform and Adoption of Technical Regulations’.

The goal of this document is to create preconditions to further eliminating TBT, establish a modern technical regulation and quality infrastructure system, and ensure an adequate level of human

⁴⁸ EPF Newsletter, Eurasia Partnership foundation, http://www.epfound.ge/index.php?article_id=44&clang=0

⁴⁹ <http://www.geplac.ge/eng/>

health, life and environment protection. Another objective of this document is take into account the European Commission's views and observations regarding Georgia's preparedness for negotiations on a Deep and Comprehensive Agreement (DCFTA) with the EU.⁵⁰

The document outlines a set of guiding principles and sets guidelines, challenges, goals, methods and status for the each of the following issues: Technical Regulation; Quality Infrastructure; Integration into International Organisations; Market Surveillance; Introduction of Requirements of the Horizontal General Product Safety and Liability for Defective Products Directives; Introduction of the New Approach and the Global Approach Directives for Priority Industrial Sectors; Conformity Assessment Infrastructure; Standardisation; Metrology.

With the aim of further developing the legal and institutional framework in the food safety area and establishing a solid food safety system in Georgia in line with the EU and international standards, the Government adopted 'The Comprehensive Strategy and Legislative Approximation Programme in Food Safety'.⁵¹ Based on the recommendations of the European Commission this document should guide the Government's and the private sector's activities in the short and long term. The document addresses the issues of introduction and application of a solid food safety system in Georgia, establishment of food safety official control, the needs of the official and market institutions, timelines of Legislative Approximation with EU Legislation and Implementation and enhancement of capacity building measures.

3.2. Infrastructure to promote trade

Infrastructure services

Georgia's comparative advantage is its geographical location at the crossroads between Europe and Asia, two ports on the black sea, Poti and Batumi, ferry links with Ukraine, Romania, Russia and Bulgaria, two international airports (out of five total), international gas and oil pipelines that transport fuel from Central Asia and the Caspian Sea to Western Europe.

There are three Free Industrial Zones that allow international firms to operate their business. They serve the goal of improving logistics in Georgia for trade.

In terms of trade logistics, which encompass an array of infrastructure—from transport, warehousing, cargo consolidation, and border clearance to in-country distribution and payment systems—Georgia ranks 93 out of 155 countries with 51.8 per cent highest performance. This is higher than Russia, Ukraine, Belarus, but worse than Central Asian states, excluding Turkmenistan and Tajikistan.⁵²

In line with its WTO commitments, Georgia offers a very liberal investment regime in the services sector – in banking, insurance, security trade, legal services, etc. There are no foreign currency surrender requirements.

Despite the business reforms that have been undertaken, there is more room to improve infrastructure that will directly affect the competitiveness of firms and improve services for entrepreneurs as well as increase household revenues.

Currently, transportation represents approximately 9.4 per cent of the Georgian GDP, employing over 50,000 people. It is one of the fastest growing industries in Georgia. In 2009 alone, 20.2 per cent of all foreign investment was directed into this industry, demonstrating the sector's growth potential. In 2009, Georgia's airports, seaports, railway and highway system carried: 103.4 million metric tons of cargo and 624.7 million passengers.⁵³ Despite its location, transportation cost is high.⁵⁴

⁵⁰ <http://www.geplac.ge/newfiles/TBT%20Strategy.pdf>

⁵¹ http://www.geplac.ge/newfiles/Food_Safety_Strategy.pdf

⁵² It integrates: Efficiency of the customs clearance process; Quality of trade and transport-related infrastructure; Ease of arranging competitively priced shipments; Competence and quality of logistics services; Ability to track and trace consignments; Frequency with which shipments reach the consignee within the scheduled or expected time. (Connecting to Compete: Trade Logistics in the Global Economy. The Logistics Performance Index and Its Indicators. (2010). World Bank. Available from http://siteresources.worldbank.org/INTTLF/Resources/LPI2010_for_web.pdf)

⁵³ Invest in Georgia. National investment agency. www.investingorgia.org/?key_sectors/main/77/transportation_

⁵⁴ There is no special research on infrastructure cost in Georgia, but empirical evidence shows that travel by air from Tbilisi to any international EU airport costs 1.5-2 times more than travel inside of EU in the same distance.

Transportation problems are very problematic for Georgian producers, especially in agriculture. Many agricultural companies export to EU countries only in the period from November until February when, due to climate conditions, these countries cannot produce their own products. Around 60 tonnes of fresh herbs (purchased from 800 local farmers) are transported by vehicles each month.

The modernization of Georgia railway system would increase cargo turnover along with further rehabilitation of roads and construction of warehouses and other infrastructure for trade.

In future plans related to the full realization of the TRACECA corridor, revitalizing the national highway systems, rehabilitation and expansion of the national railway system, expansion of the cargo transit capacity at Batumi Port, Kulevi Port and Poti Port, rehabilitation of the rail ferry routes with Ukraine, Romania, Russia and Bulgaria, construction of the Baku–Tbilisi–Akhalkalaki–Kars Railway – Strategic Link, Integrating Georgian – Turkish Railways will significantly increase transport infrastructure, positively affect business and reduce transportation cost.

Border cost

As noted above, over the last two years, Georgia has also made significant efforts to reduce other trade-restrictive barriers, which are widely prevalent in other CIS countries, such as high transportation and border costs, costs associated with smuggling, bureaucracy and corruption and an out-dated transport infrastructure. All the administrative costs have gone down significantly. At the moment, all goods from Georgia that are exported and imported are stopped at the border for customs clearance. The border cost includes shipping, handling and warehousing for customs purchases. Export-import procedures and their costs are not high.⁵⁵

Moreover, custom and tax reforms radically reduced the business-related cost. For example, many items for wine manufacturing (bottles, etiquette, stoppers, boxes, etc.) are imported. Previously customs regulations for these imported items were free from customs duties if the items were used for manufacturing of export products during a 6-month period. If the product was not exported during this period then entrepreneurs were required to pay customs duties. These customs regulations forced businessmen to import small items to make their business look less attractive, time consuming and costly. According to the new tax code, this period for using imported items has been prolonged by 12 months and in some cases – by two years. The transaction cost for importers has been reduced significantly.

TABLE 15. TRADING ACROSS BORDERS IN SELECTED COUNTRIES, 2010

REGION OR ECONOMY	DOCUMENTS TO EXPORT (NUMBER)	TIME TO EXPORT (DAYS)	COST TO EXPORT (USD PER CONTAINER)	DOCUMENTS TO IMPORT (NUMBER)	TIME TO IMPORT (DAYS)	COST TO IMPORT (USD PER CONTAINER)
Eastern Europe & Central Asia	6.4	26.7	1,651.7	7.6	28.4	1,845.4
Armenia	3.0	13.0	1,665.0	6.0	18.0	2,045.0
Azerbaijan	9.0	43.0	2,980.0	14.0	46.0	3,480.0
GEORGIA	4.0	10.0	1,329.0	4.0	13.0	1,316.0
Russian Federation	8.0	36.0	1,850.0	13.0	36.0	1,850.0
Turkey	7.0	14.0	990.0	8.0	15.0	1,063.0
Ukraine	6.0	31.0	1,560.0	8.0	36.0	1,580.0

Source: <http://www.doingbusiness.org/ExploreTopics/TradingAcrossBorders/?direction=Desc&sort=0>

⁵⁵ This is an empirical estimation based on the World Bank/ IFC 2010 'Doing Business' Report on Georgia where it moved from the 85th to the 30th place among 183 countries on 'trading across borders'.

Please see: <http://www.doingbusiness.org/ExploreTopics/TradingAcrossBorders/>

In addition, the indices of investment and financial freedom indicate an investor-friendly environment. Georgia has a friendlier environment than the CIS and central and East European countries, except Armenia, Estonia, and Latvia. These indicators capture different dimensions of fundamental rights to work, produce, consume, and invest, and indicate to what extent labour, capital and goods can move freely.

TABLE 16. ECONOMIC FREEDOM INDICES

COUNTRY	2009 OVERALL	BUSINESS FREEDOM	TRADE FREEDOM	FISCAL FREEDOM	GOV'T SPENDING	MONETARY FREEDOM	INVESTMENT FREEDOM	FINANCIAL FREEDOM	PROPERTY RIGHTS	FREEDOM FROM CORRUPTION	LABOUR FREEDOM
Armenia	69.2	83.4	80.5	89.3	90.9	72.9	75	70	30	29	70.6
Azerbaijan	58.8	74.6	77.1	79.5	77.5	62.7	55	40	20	19	82.5
Estonia	74.7	83.1	87.5	80.2	62.2	71.1	90	80	80	66	47.0
Georgia	70.4	87.9	89	89.1	65.3	70.2	70	60	40	39	93.7
Latvia	66.2	72.9	87.5	82.7	57.4	67.0	80	50	55	50	59.1
Russia	50.3	52.2	68.4	82.3	66.5	62.6	25	40	25	21	59.6
Turkey	63.8	68.9	86.4	78.1	82.9	70.0	65	50	50	46	41.1
Ukraine	46.4	38.7	82.5	77.9	41.1	61.1	20	30	30	25	57.7

Source: <http://www.heritage.org/index/>

Financial services

Despite the rapid growth of **banking services**, difficulties in taking out bank loans are still an important economic barrier. High interest rates persist and remained constant in the range of 17–25 per cent. The overwhelming majority of SMEs and more than half of large companies never apply to banks for credits.⁵⁶

Recent positive developments in the Georgian banking sector include the creation of a **credit information bureau** in 2006 that helps banks with risk assessment. Since the start of the financial crisis more than 250,000 people with outstanding debts have been recorded in the credit bureau and while other lenders were able to sell their property to pay off their debts. Therefore, high interest rates and severe conditions of crediting recently deteriorated the social environment and negatively influenced human development.

Georgia has 38 credit unions, working mainly in rural areas, and some small finance companies that lend to SMEs. The business environment is not significantly affected by these funds because they are relatively modest in size (total about 4 to 5 million GEL).

One of progressive steps in the reform process was that Georgian banks were allowed to control corporations. During recent years they have begun to amalgamate with **insurance** and stock companies. This model is prominent for its strong connection between banks and firms, which facilitates banks' control over companies. Banks are in a position, as shareholders and creditors, to monitor a firm's management and they can interfere, when necessary, to prevent failure.

By the end of 2009 there were 14 insurance companies in Georgia, of which six have registered pension schemes; of those six, only three are active. Similar to banking, the insurance market is highly concentrated and 80 per cent of all insurance products are offered by only five companies.

Medical insurance was one of main items in the structure of insurance activities in 2009 (over 80 per cent), followed by vehicle insurance, insurance on aviation risks, cargo insurance, personal accident insurance, maritime risk insurance, property insurance and credit insurance.

The Georgian **stock exchange** is small, and accounts for less than 1 per cent of total financial intermediation in the country; it will likely remain a minor factor in the finance system of Georgia.

⁵⁶ Data from the National Bank of Georgia.

Human resources

Before the 'rose revolution' the employment institutions could not assist employers to retrain and provide the qualified labour force that was necessary for restructuring enterprises. Today this function is placed on enterprises completely.

In general, the strategies of enterprises to improve their staff's qualifications differ. Enterprises, where the number of people employed is declining are less interested in retraining staff, while enterprises (machine building, light industry) where the labour force is increasing, are more seriously regarding the question of retraining staff. Staff reduction takes place at the expense of low qualified labour, while better qualified staff is retained.⁵⁷

The dismissed labour force is unprotected. There is no institution which could have protected their rights. However, expected educational reforms should increase overall human capital further.

At present, with rising foreign investment, conditions for the transfer of managerial knowledge from foreign-owned firms do exist in Georgia, although currently they are limited to certain sectors.

In general, business strategy is still passive on the labour market. Their main strategy is to rationalize the labour force and adapt it to the working conditions. Radical changes in the use of the labour force potential are planned in the more distant future.⁵⁸

While participating in global markets and within a competitive environment, Georgian companies also deal with problems like market research and lack of marketing skills. At the same time Georgian companies' low capacity to use online social networking is one of the barriers to communicating with and searching for partners. The Georgian news website The Financial held an online survey among leading Georgian companies. The majority of companies questioned, failed to answer even the most basic questions about their use of the internet and online social networking for external communication. The survey shows that companies are still unfamiliar with the advantages of the internet.⁵⁹

It is obvious that there are serious opportunities for deepening trade and economic relations between Georgia and the rest of the world. The timely implementation of some practical measures, such as trade capacity building, familiarization of Georgian entrepreneurs with new managerial skills, updating of technology development of infrastructure and other possibilities could make a difference.

To participate in global markets one needs not only a much improved production process but improved management as well. The main target is to turn enterprises into members of the global value chain. To achieve this, enterprises need support in building up effective logistics – this entails necessary infrastructure and a conducive institutional environment, and also essential business development services. Consequently, purposeful cooperation with industrial associations, government agencies, and training and consulting institutions should be the key to grasping the opportunity to take part in the global value chain and raise the chances of Georgian companies of engaging in international markets.

⁵⁷ Kozarzewski P., Pykovich S., Synitsina I., (2002). Problems of Privatizing Enterprises in Georgia. CASE – Centre for Social and Economic Research, Studies and Analyses. No. 243, Warsaw. pp.56.

⁵⁸ Ibid, p.85.

⁵⁹ Chkhikvadze K., (2009). Study Shows Georgian Companies Not Using Social Networking. Finchannel, 09 September, 2009. Available from http://www.finchannel.com/Main_News/Geo/51442_Study_Shows_Georgian_Companies_Not_Using_Social_Networking/

THE MAIN CHARACTERISTICS OF THE TRADE AND INVESTMENT ENVIRONMENT IN GEORGIA:

<p>STRENGTHS</p> <ul style="list-style-type: none"> • Political and liberal economic reforms • Attractive macroeconomic environment • Competitive and liberal trade regime • Liberal Tax Code • Simplified customs regime • No quantitative restrictions on trade. • Zero tariffs on the majority goods. • Simplification of licences procedures and requirements • Modernized business licensing System • Reformed technical regulation system • Low labour cost • Access to education • Access to healthcare 	<p>WEAKNESSES</p> <ul style="list-style-type: none"> • Less diversified trade structure • Poorly applied standards for the domestic market • Underdeveloped infrastructure • Undeveloped SME sector • Logistics costs, poor technology • Low savings, high interest rates • Unskilled labour force • Growing poverty level • High level of unemployment • Protection of human rights • Developing environmental regulations • Increased number of IDPs
<p>OPPORTUNITY</p> <ul style="list-style-type: none"> • On-going institutional reforms • Strategic Geographic Location • Privatization of State Property • WTO membership since 2000. • GSP+ Scheme • Free trade agreements with number of countries • Infrastructure and logistics projects • Engagement with EU on free trade, visa facilitation • Creation of FIZs 	<p>THREATS</p> <ul style="list-style-type: none"> • Global financial crisis • Political tensions with Russia • failed investment inflow risks • Large current account deficit • Fluctuation of national currency

To summarize, at present, economic growth significantly depends on the country's ability to diversify the national economy. Foreign market sensitivity and demand for Georgian products are different. Therefore, by adapting to the new market requirements Georgia would ensure a sustainable increase of exported goods, in accordance with international standards.

It is crucial that the government of Georgia continues the process of preparing a strategy and programme of TBT (Technical Barriers for Trade) in the framework of preliminary negotiations on an FTA (Free Trade Agreement) and Visa Facilitation agreement with the EU. This programme will include some changes regarding accreditation, standardization and other measurements on the legislative level, in order to approach the EU market requirements.

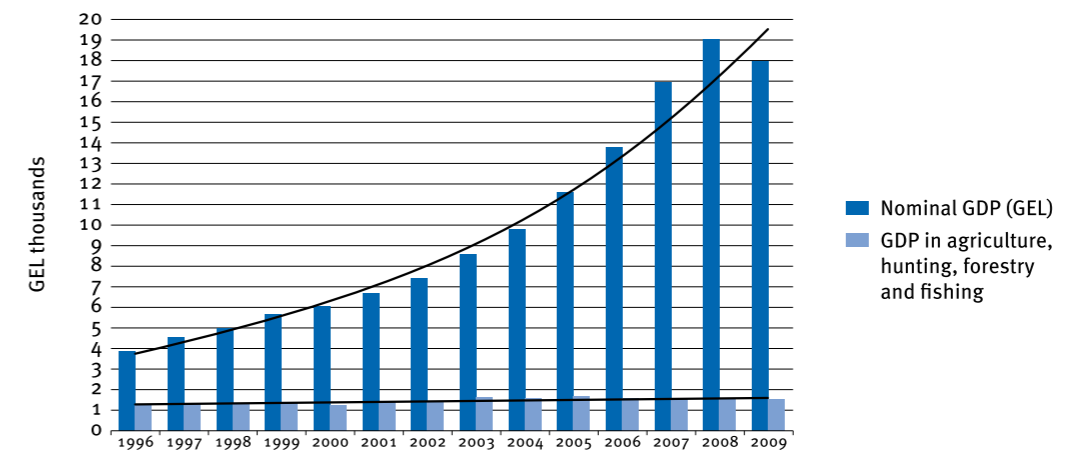
4. Impact of trade on human development in selected sectors

4.1. Agriculture and food industry

Agriculture is the key sector of the Georgian economy. More than half of the population lives in rural areas and farmers comprise half the total labour force. The climate creates favourable conditions for the production of a wide range of annual and perennial crops. Nevertheless this sector experienced structural difficulties.

Between 1999 and 2009, annual crops yields were fluctuating and showed a downward trend. Since then the share of agriculture in GDP has declined every year, reaching 9.6 per cent in 2009, compared with 34.1 per cent in 1996. In 2003–2009 years nominal GDP in average increased by 13.7 per cent, but in agriculture – growth comprised only 0.8 per cent, because the productivity level did change. As a result, the agriculture sector has progressed only slightly compared to its 1990 level.

FIGURE 6. OVERALL GDP AND GDP IN AGRICULTURE



Source: National Statistics Office of Georgia, www.geostat.ge

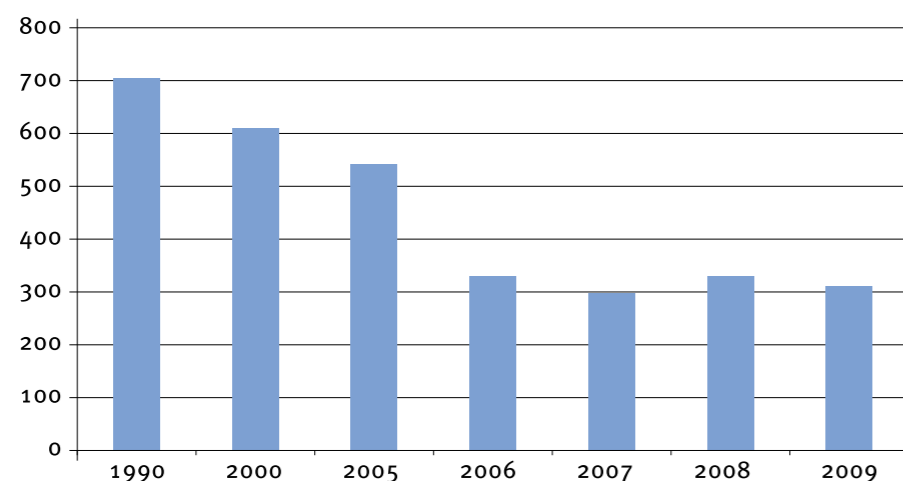
Since the 1990s, the output structure of the agricultural sector has changed. While in 1992, grapes ranked first place in food and agricultural production,⁶⁰ in 2007, production of grapes has been nearly halved and ranks second. Conversely, production of cow milk increased by 1.5 times, hazelnuts will shell – more than twice.

Actually, every year agriculture growth has shown a declining trend in comparison with the previous year. This has greatly affected food production within households. Food production is strongly dependent on seasonal fluctuation of agriculture production. Nevertheless, in recent years, the food industry has performed better than primary agriculture. However, growth in this sector was also slowing down. In 2002–2009, the output of primary products, such as wheat, grapes, tea, maize, oranges, potatoes, tobacco and vegetables, decreased substantially. Production of other products, such as beans and eggs, was maintained at the same level (Appendix, Table 20).

It is not surprising that in parallel with production, use of agriculture lands has dropped as well.

⁶⁰ The following figures are taken from FAOSTAT. They are calculated based on 1999–2001 international prices.

FIGURE 7. USE OF AGRICULTURE LANDS (1000 HA)



Source: Natural Resources and Environment Protection in Georgia 2008. (2009). Statistical Publication National Statistics Office of Georgia, p.15.

Agriculture in Georgia relies mainly on small-scale farming with low production efficiency. On average 0.88 ha of arable land is owned by one farmer. These small farms produce more than 80 per cent of the total production. Only 8–10 per cent of this production makes it to the market. Large scale farms produce about 10 per cent of the total agricultural production and almost all is destined for the market. At present small farms dominate the agricultural sector. They operate mainly for domestic consumption. The small size of land plots does not promote the increase of labour productivity.⁶¹ In addition, the share of farms that have privately owned farming equipment and agricultural machinery, is a little more than 20 per cent. In fact, in Georgia on average 53.2 tractors and 0.4 harvesters-threshers were employed per 1000 ha. This figure is less than one 35th of the relevant indicator in Slovenia, and is among the lowest in post-communist states (Appendix, Table 21).

Accordingly, approximately 85 per cent of Georgia's rural population is entirely dependent upon their farms for subsistence and they consume approximately 75 per cent of their own production.

Investing

The agriculture sector, despite climate advantages, seems less attractive to banking investors. The share of the agriculture sector in total banking loans varies from 1 to 2 per cent. The domestic banking system is very reluctant to give long-term credits to farmers. Banks are preferentially focusing on short-term trade financing.

Foreign direct investment's share in agriculture in Georgia today is also small. Agriculture in total FDI in 2007 amounted to 0.8 per cent, in 2008 to 0.5 per cent and in 2009 to 1.2 per cent, this as a result of the high risk and low profitability of the sector. Improving the environment for foreign direct investment as an alternative to short-term bank credits has become crucial.

At present FDI enters the nut industry (the Italian confectionery company Ferrero started operation in 2007), winemaking (Italy, Russia, Korea) and water bottling sectors (Turkey).

Trade

There is a huge gap in the export-import balance, despite strong growth in exports. In the beginning of the 1990s, Georgian food imports exceeded export by around 70 per cent. Since then, the situation has changed, during last decade, the shares of agricultural goods (foods) in total imports decreased much faster than the shares of agricultural (food) exports. At present Georgia still depends on imported

⁶¹ Until 2005, 75 per cent of agricultural land and 2.5 million hectares of forests were under state ownership. In 2005, the Law on Privatization of State-Owned Agricultural Land was adopted in order to promote efficient use of land through private ownership and thus increase efficiency in the agricultural sector. Forests and other natural resources are being transferred more actively to private hands under long-term tradable licences.

agricultural products. Imported food products amount to more than 50 per cent of the total consumer market, resulting in a low food self-sustainability rate.⁶²

The main agriculture export products include beverages, spirits and vinegars, (10.9 per cent of total food export), edible fruit and nuts; peel of melons or citrus (7.9 per cent), oil seeds and oleaginous fruits; industrial or medicinal plants (2.1 per cent). Among the main imported products are: wheat and wheat flour (2.6 per cent in total food import), sugars and sugar confectionery (1.4 per cent), tobacco and manufactured tobacco substitutes (1.8 per cent), meat and edible meat offal (1.4 per cent) (Appendix, Table 22–23).

This structure of trade results from the favourable climate for agriculture production of wine, fruits and citrus and of mineral water. Inherited from Soviet period trade relations, especially with Russia, ranked as the first trade partner, favoured export of wine and spirits and mineral waters, fruits and vegetables. The tense of Russia-Georgian relations, as well as the export restrictions of several Georgian products to the Russian Federation, resulted in a reduction in exports of these goods. At present the agriculture and food sector exports to Russia have seen a great reduction.

In 2005, before the Russian embargo, Russia consumed 77.5 per cent of the total wine export, 72 per cent of mineral water and 21 per cent of fruits and subtropics culture.⁶³

The problem is that Georgia lost its wine, mineral water, fruit and subtropics culture market share in Russia and could not reorient quickly enough to other markets because of the high competition (e.g. in EU markets) and due to poor marketing policy of Georgian producers.

The main obstacles for Georgian companies include supply constraints, satisfied EU regulations on safety (mineral waters), the recognition of Georgian brands (wines, mineral waters) by EU (except for the Baltic States and Poland) and USA consumers, non-tariff requirements, lack of resources and skills for marketing and different preferences of the foreign consumers in comparison with those of traditional markets, mainly the CIS. The brand names of Georgian mineral waters have been decisive in their ability to reach foreign markets. People in the Baltic countries mainly buy Georgian mineral water because they remember the brand from Soviet times.⁶⁴

For further improvement of trade, there is a need to modernize agricultural technology, equipment and infrastructure, change out-dated irrigation and drainage systems, develop livestock feed and seed production businesses, attract skilled labour, as well as packaging and sorting technologies. The current absence of these attributes creates barriers to farmers who want to produce for export.

For the agro-food sector, it is well known that the most important constraints on trade are not tariffs, but product standards and regulations. With regard to the agro-food sector, there is a need to increase incentives to adopt regulations and higher quality standards.

Trade promotion programmes

In a show of support for farmers, a programme of 100 new enterprises was launched in 2007. It provided funding for export-oriented branches, like canned food product enterprises and initial production facilities in agriculture. A project of 'cheap credit' has been worked out to finance export-oriented enterprises in agriculture. Their expansion facilitated the standing of farmers as suppliers of raw products. One of the tangible results was the export, for the first time, of vegetables and tea to the EU. Despite these support measures, state investment in agricultural infrastructure, and promotion of trade, is very limited (around one per cent of the state budget).

In 2006–2007 the Ministry of Agriculture adopted a number of technical regulations concerning importing, labelling, packaging, storage, transportation, sale, use and testing of pesticides and agricultural chemicals. The regulations are broadly in line with international standards and EU rules. All these undertakings were aimed to improve the business environment, as well as export potential, facilitate Georgian farmers to become more competitive and replace imported products with local produce.

⁶² Because according to UN General Assembly adopted resolution in 1974 the minimum level of food security ranges between 80 and 85 per cent, a country's food security is at risk when more than 15–20 per cent of food products consumed domestically are imported.

⁶³ COMTRADE database

⁶⁴ Georgian wine producers claim that they are facing fierce competition on the EU market from local producers, who receive subsidies through the EU's Common Agricultural Policy (CAP). (EPF Newsletter, Eurasia Partnership foundation, http://www.epfound.ge/index.php?article_id=44&clang=0)

Social issues

Between 60 to 70 per cent of the population depends on agriculture for their livelihood. But in 2009 agriculture generated only 8.3 per cent of Georgia's GDP. These figures reflect an economic and social reality and demonstrate the difference in incomes between the rural and urban areas.

In 2009, according to data from the National Statistics Office, gross output of goods and services per capita in Tbilisi was three times higher than the national average, compared to 2.4 times in 2003. Guria, the country's poorest region, has a gross output of goods and services per capita of just 15 per cent of the national average.

In rural areas low productivity and routine and manual work lead to low household incomes and mass poverty.

It is therefore not surprising that, in agriculture, earnings increased slowly in comparison with other sectors. At present (2009) it comprises 47.7 per cent of average monthly earnings of employed persons (Appendix, Table 13). On the other hand, 85 per cent of the total number of unemployed persons are concentrated in the cities, mainly in Tbilisi. This strengthens the increased regional redistribution and transfers, and increases economic disparities between urban and rural areas.

The breakdown of the old system of marketing and trade operations, geographical isolation, and dilapidated infrastructure constitute the main reasons for the problems faced in rural areas. The majority of families in villages still have problems accessing the market. This obstacle and limitation is especially severe for the poor. They are more geographically isolated and have less capacity to take their produce or goods to local markets for sale. Many poor rural families have never gone to the market to sell agricultural products.

The rural economy in the years of crisis played the role of a safety net and became an important source of employment. The rural population had wide and universal access to land and it could attract great amounts of labour, therefore unlike the cities rural areas had no unemployment problems. Villages had a high capacity to employ people and occupy a dominant place among the employment segments in the current situation.

Moreover, due to the low labour productivity and taking into consideration that the majority of families have small plots of land (less than 1.0 ha) it is not surprising that we see intensive migration from rural areas, mainly from the young population. From some regions of Georgia especially, from mountainous regions, there are villages with an overwhelming majority of elderly population.

The situation has been developing rather dramatically recently as the process is acquiring a gender colouring where women, especially young women, are prevailing among the migrants.⁶⁵ This may create long-term demographic problems in future.

SWOT – AGRICULTURE SECTOR

STRENGTHS

- favourable conditions for the production of a wide variety of annual and perennial crops;
- more than half of economically active population is employed in agriculture;
- low cost labour resources;
- recognition of the agriculture as a top priority sector for development by the Government;
- availability of simple and cheap agriculture processing technologies;
- existing trade preferential agreements with US and EU countries;
- WTO membership.

WEAKNESSES

- low productivity, low yields and inefficient production processes;
- high costs of raw materials;
- lack of knowledge of modern agriculture technologies resources;
- insufficient mechanization and technical equipment, fertilizers;
- lack of packaging and processing facilities;
- lack of financial resources;
- poor marketing, financial and general management;
- low capabilities of exporting;
- small size of the local market.

OPPORTUNITIES

- increasing market shares at domestic markets;
- expansion at new markets;
- FTA agreement with the EU;
- expansion of global demand for food and agricultural products;
- increase in world prices on food and agricultural products;
- developing new innovative products for new markets and market segments;
- shift to production of high value-added products.

THREATS

- macroeconomic threats (poverty; low incomes; inequality; unemployment; fluctuation of exchange rates);
- possible increase in energy costs;
- possible droughts and other climate-related problems;
- trade and customs policies that facilitates importing of competitive products from abroad;
- fluctuations of market prices;
- high barriers of entry on global markets;
- high level of competition from foreign products at local market;
- low level of investments in agriculture.

⁶⁵ Jashi Ch., and M. Tokmazishvili (2009). Gender Dimensions of the Financial Policy of Georgia. UNDP, Tbilisi. p. 106.

4.2. Wine sector

Analysis of recent developments in the wine industry and their impact on human development

The wine industry is one of the most important and competitive sectors of the Georgian economy. Totally there are 218 registered enterprises in the alcoholic beverages branch in Georgia, though less than half of them are currently operating.⁶⁶ All these companies are untied under the aegis of Samtrest—the wine institution that is responsible for certification of the quality of wine and its place of its origin.

According to the data presented in Table 17, after the Russian ban the number of operating wine companies in Georgia decreased significantly (by almost 32 per cent from 2006 to 2008). Moreover, there was a substantial downsizing within the companies, as the shares of large and medium enterprises in the total number of operating wine companies reduced remarkably during the period under review. In 2008 small enterprises accounted for almost 80 per cent of the total enterprises, while large and medium-sized companies for 17 and 4 per cent, respectively.

TABLE 17. NUMBER OF OPERATING WINE COMPANIES IN GEORGIA, 2003–2008

Nº	SIZE OF ENTERPRISE	2003	2004	2005	2006	2007	2008
1	Large	14 (12.4 per cent)	17 (15.4 per cent)	25 (17.5 per cent)	14 (9.4 per cent)	13 (11.8 per cent)	17 (16.8 per cent)
2	Medium	32 (28.3 per cent)	30 (27.3 per cent)	42 (29.4 per cent)	56 (37.6 per cent)	24 (21.8 per cent)	4 (4 per cent)
3	Small	67 (59.3 per cent)	63 (57.3 per cent)	76 (53.1 per cent)	79 (53 per cent)	73 (66.4 per cent)	80 (79.2 per cent)
4	Total	113	110	143	149	110	101

Source: calculations based on data from National Statistics Office of Georgia, www.geostat.ge

Similarly, the production levels reduced almost three times during the period of 2005–2007, while the output of medium-sized enterprises decreased by more than six times (Table 18).

TABLE 18. PRODUCTION LEVEL IN THE GEORGIAN WINE INDUSTRY, 2003–2008, THOUSANDS OF GEL

Nº	TYPE OF ENTERPRISE	2003	2004	2005	2006	2007	2008
1	Large	73,018.3	84,562.4	139,045.0	51,036.6	53,181.5	63,780.5
2	Medium	19,520.5	17,698.1	27,267.4	46,792.5	7,851.7	7,957.3
3	Small	6,964.2	8,202.9	8,656.1	7,542.6	7,299.9	16,206.0
4	Total	99,503.0	110,463.4	174,968.5	105,371.7	68,333.1	87,943.8

Source: calculations based on data from National Statistics Office of Georgia, www.geostat.ge

Such a sharp decrease in the number of enterprises and volume of production can be explained by recent developments in export markets. The total export volume of the wine industry amounts to 90–92 per cent of the total production of wine, while local demand for wine does not exceed 10 per cent. The recent trends in wine export activities are illustrated in Table 19.

TABLE 19. WINE EXPORT VOLUMES, 2003–2009, (THOUSANDS OF USD)

COUNTRIES	2003	2004	2005	2006	2007	2008	2009
EU	1,136.5	1,554.6	2,411.8	3,668.1	4,796.6	7,177.4	6,054.4
USA	1,930.6	1,927.1	2,436.4	1,587.0	1,584.2	1,462.0	1,477.0
CIS	7,010.9	8,702.8	12,983.7	18,409.6	21,394.1	26,901.3	22,791.0
Russia	31,811.2	36,000.9	62,975.9	16,619.2	0.0	141.4	0.0
Asia	332.0	393.8	447.4	552.1	1,073.8	906.5	1,301.2
Other	390.5	140.2	73.7	214.6	348.6	274.1	373.3
Total	42,611.8	48,719.4	81,328.9	41,050.6	29,197.4	36,862.8	31,997.0

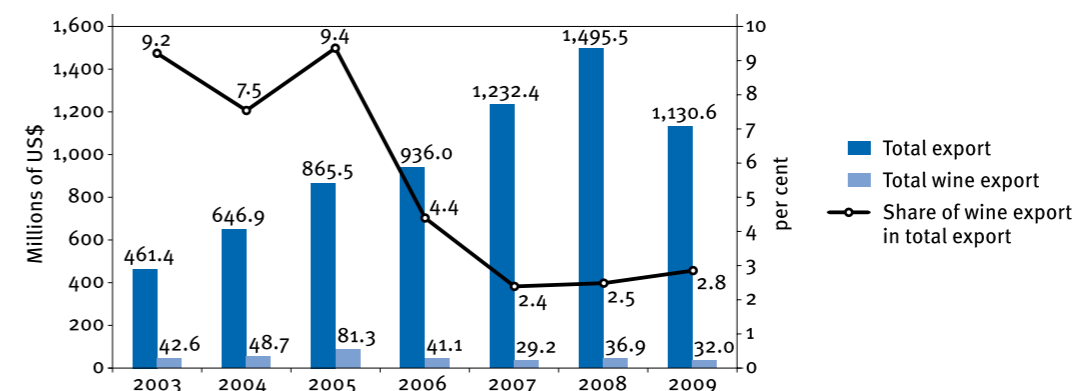
Source: calculations based on data from National Statistics Office of Georgia, www.geostat.ge

Data indicate that there was almost a hundred per cent increase in the wine export in 2005 as compared to the previous year. Such a rapid growth was driven mainly by the penetration on the Russian market, where the Georgian wine export volumes almost doubled. Generally in 2005 Russian wine market accounted for almost 78 per cent and of the total Georgian wine export. The rest of the wine export was divided by other CIS countries (15 per cent), EU (3 per cent), USA (3 per cent) and other countries. By 2006 Russia was the main market for Georgian wine. Thus it was not surprising that the ban of Georgian wines on the territory of Russia caused a substantial drop of total wine export to 41 million USD in 2006 and further to 29 million USD in 2007. The increase of exports to CIS (mainly Ukraine) and EU countries (mainly Poland) compensated only to a very small extent for the loss of the Russian market. As a result the Georgian wine export volume in 2007 comprised only 36 per cent of its sales in 2005. However, in 2008 there was a slight increase of total export volumes. After the ban the major export markets for Georgian wine become other CIS countries (71 per cent), EU (18 per cent), USA (5 per cent) and Asia (4 per cent).

Among EU countries, Poland (23 per cent), Lithuania (14 per cent) and Latvia (13 per cent) had the biggest share in Georgian wine export in 2009.

In the recent period there was also a significant drop in the share of wine export in total exports. In 2005 this indicator peaked at 9.4 per cent, however, after the ban it was more than halved in 2006 and further went down to 2.4 per cent in 2007. During 2008–2009 there was a slight increase in wine export's share in total export. Still wine remained among top ten exported Georgian goods during 2003–2009 with more than 2 per cent share of the Georgian export in value terms (Figure 8).

FIGURE 8. WINE EXPORT, TOTAL EXPORT AND SHARE OF WINE EXPORT IN TOTAL EXPORT, 2003–2009



Source: calculations based on data from National Statistics Office of Georgia, www.geostat.ge

⁶⁶ Source: National Statistics Office of Georgia

Analysis of recent developments in the Georgian wine industry reveals the serious negative impact of Russian ban on the performance of this sector. There are substantial grounds to consider this decision of Russian authorities as politically motivated. Still some problems with the quality of Georgian wine existed that time that hampered expansion of this product at global markets. During the last 3–4 years, serious attempts have been undertaken to improve the quality of wine. Special laboratories for testing wine quality were established. One example of the measures toward increasing of quality control is laboratory testing project supported by the German donor GTZ (Gesellschaft für Technische Zusammenarbeit).

Moreover special measures were implemented to formalize the micro-zone system of production through state-sanctioned certificates that guarantee the authenticity of origin. The Georgian government has recently passed a series of laws that lay the foundation for an AOC-type appellation quality control system. Also there was an appeal to the international community to support and recognize these attempts on the international market. It should be mentioned that recently Georgia and EU have signed an agreement on reciprocal recognition and protection of names based on geographical origin.

The developments at export markets had a serious negative influence on the employment in wine sector. In total the Georgian wine industry lost almost 40 per cent of the number of employees after the Russian ban (Table 21). Medium-sized enterprises were harmed by the ban most severely. The number of people employed at medium enterprises reduced almost ten times. The number of employees at large companies also declined though not so drastically.

TABLE 20. NUMBER OF EMPLOYEES IN THE GEORGIAN WINE INDUSTRY, 2003–2008

Nº	TYPE OF ENTERPRISE	2003	2004	2005	2006	2007	2008
1	Large	1,786	1,945	2,504	1,891	1,834	1,788
2	Medium	829	864	1,095	1,485	737	129
3	Small	547	521	507	644	540	673
4	Total	3,162	3,330	4,106	4,020	3,111	2,590

Source: calculations based on data from National Statistics Office of Georgia, www.geostat.ge

However, the decline in employment has been more severe than the decrease in production volumes. Therefore, all types of enterprises substantially increased their productivity (value added per employee), which led to an overall enhancement in the performance of this industry (Table 21).

TABLE 21. PRODUCTIVITY (VALUE ADDED PER EMPLOYEE) OF THE GEORGIAN WINE INDUSTRY, 2003–2008, THOUSANDS OF GEL

Nº	TYPE OF ENTERPRISE	2003	2004	2005	2006	2007	2008
1	Large	8.5	9.5	11.9	5.9	10.5	14.9
2	Medium	4.9	2.2	5.3	4.0	3.5	43.8
3	Small	1.1	2.0	2.0	2.7	6.8	17.3
4	Total	6.3	6.4	8.9	4.7	8.2	17.0

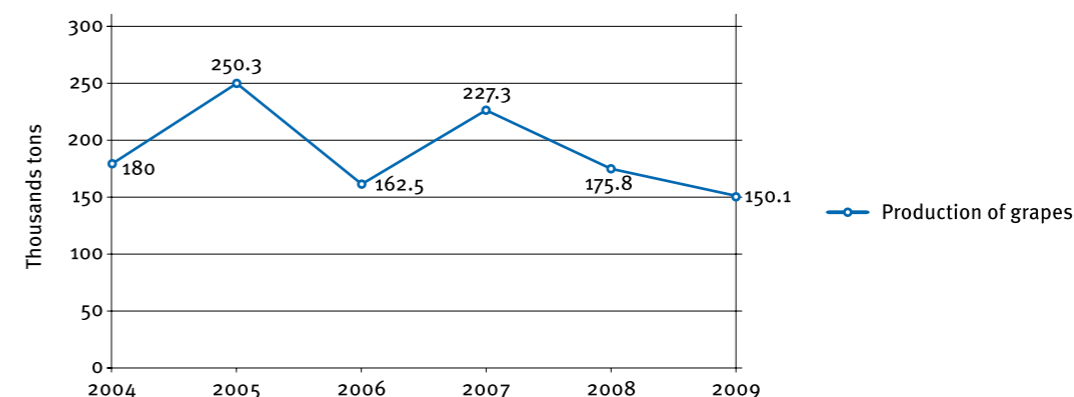
Source: calculations based on data from National Statistics Office of Georgia, www.geostat.ge

The developments in the wine production sector also had a strong impact on the developments upstream in the vine growing sector. According to the data presented in Figure 12, production of grapes was continuously decreasing during the last two years. It should be mentioned that vine growing represents an important sector of agriculture in Georgia. According to the Agricultural Census⁶⁷ vineyards area comprises 37,419 ha or 4.45 per cent of total agricultural land. By estimates 30,000 families are

⁶⁷ National Statistics Office of Georgia, www.geostat.ge

involved in grape farming⁶⁸ and on average more than 90 per cent of grape harvest comes to family holdings.⁶⁹ Thus reduction of production volumes in this sector can substantially reduce employment and income variables and hamper human development.

FIGURE 9. PRODUCTION OF GRAPES, 2004–2009, THOUSANDS OF TONS



Source: National Statistics Office of Georgia, www.geostat.ge

The support provided by the Government to vine growers made it possible to soften the impact of the Russian ban in the short-run. This support to a great extent explains the increase in grape production in 2007. However, this measure cannot be considered as a sustainable policy in the long-run. To avoid a worsening of social variables in the vine growing sector, a steady demand for grapes must be established through the increase of competitiveness of wine producers and expansion of their exports at global markets.

⁶⁸ International Financial Corporation (2009). *Georgia Sector Competitiveness Overview*, IFC, June 2009. Available from [http://www.ifc.org/ifcext/georgiasme.nsf/AttachmentsByTitle/1GeorgiaManufacturingSectorCompetitivenessAssessmentEng/\\$FILE/1GeorgiaSectorCompetitivenessAssessmentFinalReportEng.pdf](http://www.ifc.org/ifcext/georgiasme.nsf/AttachmentsByTitle/1GeorgiaManufacturingSectorCompetitivenessAssessmentEng/$FILE/1GeorgiaSectorCompetitivenessAssessmentFinalReportEng.pdf)

⁶⁹ *Agriculture of Georgia 2009*. (2010). Statistical Publication, National Statistics Office of Georgia. Tbilisi.

Competitiveness analysis of the Georgian wine industry

The loss of the main export market had a disastrous impact on the whole wine industry and negative human development consequences. To overcome the harmful effect of the Russian ban and survive in the long-term the Georgian wine industry must substantially expand its export performance at global markets. However, to exploit this opportunity wine producers must ensure the global competitiveness of the industry. Below, based on the analysis of existing studies,⁷⁰ we present a brief overview of the main competitive advantages and disadvantages of the Georgian wine industry.

Competitive advantage

- The first advantage is that winemaking has a long tradition and is one of the ancient fields of agriculture and farming in Georgia. The history of Georgian winemaking has a tight connection with the entire history, culture and religion of the country.
- Another big advantage of Georgian wine industry is the terroir which reflects specific natural (soil and climate) and cultural (historical and social) resources.⁷¹ The physical dimensions of Georgian terroir such as altitude, inclination, exposure to sunlight, geology, soil type and soil depth, and climate create excellent conditions for growing grapes. Georgian wine grapes are unique to the region and the country of Georgia. These wine grapes are: Aleksandrouli, Chinuri, Chkhaveri, Dzvelshavi, Khikhvi, Kisi, Mtsvane, Mujuretuli, Oljaleshi, Tavkveri, Tsitska, Tsolikauri, Usakhelauri, etc. Georgian wine producers are involved in the production of a specific terroir wine that could be among the finest in the world with a distinctive and unique taste.
- For a long time Georgian wine brands enjoyed a high awareness level and strong preferences in CIS countries, which provides a good basis for export expansion at these markets.
- The Georgian wine industry benefits from availability and relative low input costs, in particular, costs of grapes and labour (mainly low-skilled labour).
- The enhanced Georgian business environment (in terms of starting a business, dealing with licences, employing workers, getting credit, protecting investors, enforcing contracts and etc.)⁷² eases doing business for entrepreneurs including those in the wine sectors and thus lowers their costs and promotes export activity.
- Recent Government investments in improving infrastructure (roads, energy, telecommunications, etc.) could also have a positive impact on costs reduction and thus stimulate export performance.
- The Georgian wine industry is attractive for foreign investors, which along with financial resources bring advanced technologies and skills and thus enhance the competitive potential of the industry.
- The agreement on reciprocal recognition and protection of names based on geographical origin recently signed by Georgia and the EU will protect unique brand names of Georgian wines at European markets.

⁷⁰ Berulava G. (2008). *The Impacts of the Free Trade Agreement with the European Union on the Georgian Wine Industry: the Competitiveness Analysis*. GEPLAC research papers, December 2008; Available from <http://www.geplac.ge/newfiles/law/Berulava.pdf>.

International Financial Corporation. (2009). 'Georgia Sector Competitiveness Overview', IFC, June 2009. Available from [http://www.ifc.org/ifcext/georgiasme.nsf/AttachmentsByTitle/1GeorgiaManufacturingSectorCompetitivenessAssessmentEng/\\$FILE/1GeorgiaSectorCompetitivenessAssessmentFinalReportEng.pdf](http://www.ifc.org/ifcext/georgiasme.nsf/AttachmentsByTitle/1GeorgiaManufacturingSectorCompetitivenessAssessmentEng/$FILE/1GeorgiaSectorCompetitivenessAssessmentFinalReportEng.pdf)

⁷¹ Ditter, Jean-Guillaume. (2005). *Reforming the French wine industry: Could clusters work?* Cahiers du CEREN, 13, pp. 39–54.

⁷² Source: *Doing of Business 2011: Making a Difference for Entrepreneurs*, Available from <http://www.doingbusiness.org/reports/doing-business/doing-business-2011>.

Competitive disadvantages

- The terroir advantage is not utilized fully by Georgian wine industry. The reason is that terroir - wines are distinguished not only by the location where a wine has been produced but also by the process and the inputs used in its production. For instance, with the respect to the practices employed in wine and vineyard management, such as the choice of varieties and clones, spacing and directions of rows, use of fertilizers, pesticides and irrigation, pruning, defoliation, harvesting techniques, and some other production details, the Georgian wine industry lags significantly behind.⁷³ These deficiencies limit the ability of the industry to obtain a competitive advantage at global markets despite favourable natural conditions. Taking this into account the terroir factor has only moderate impact on the industry's competitiveness.
- After the ban of Georgian wines in Russia, which accounted for almost 80% of total exports, the strong brand image advantage of Georgian wines at CIS markets has been weakened. Expansion to other CIS countries could hardly compensate for the loss of the Russian market.
- At global markets Georgian wines have neither a high awareness level nor strong brand image. Huge marketing investments are needed to secure a strong position on the global wine market.
- While Georgia apparently has an advantage in low-skilled labour both in terms of cost and availability, there is a substantial disadvantage with regard to availability, quality and cost of skilled labour. First of all there is a big lack of highly qualified wine technologists, vineyard managers and marketing specialists. Actually the deficiency in the skilled labour force is highly interrelated with poor vineyard management and inability to fully exploit Georgian terroir advantages.
- In Georgia there is no well-established wine cluster, which would allow for an increase of specialization and promotion of efficiency. The Georgian wine industry is comprised mainly of winegrowers and wine producers.
- Unlike wine clusters in other countries (Chile, Australia, California and etc.) Georgian wine industry relies heavily on the international suppliers for materials and components. For instance, such inputs as fertilizers, pesticides, herbicides, grape harvesting and winemaking equipment, irrigation technology, barrels, bottles, caps and corks, labels, are not produced domestically and are imported from abroad. As a consequence, the costs of these inputs are high that makes Georgian wine industry less competitive.
- There are significant obstacles in providing advanced scientific research and educational services for wine industry needs. Though there are special research institutes and some special educational institutions in Georgia, their impact on the efficiency of the wine industry is very low. The more successful companies prefer to train specialists and to get advanced knowledge and technologies from abroad. This partially explains the deficiency of the Georgian wine industry in such factors as skilled labour force, advanced technologies and vineyard management practices.
- There is a lack of cooperation between Georgian wine producers in promoting and marketing their products at global markets, ensuring quality standards, and providing advanced research and education.
- There is also a big problem in the winegrowing industry. The typical grape suppliers in Georgia are small individual farms that are very inefficient and usually don't keep up with technologies of winegrowing. The efficiency of agricultural production of these households is reduced substantially as the usage of fertilizers, special vehicles and equipment by small farms is negligible. To secure the quality of grapes the winemaking companies have to integrate winegrowing facilities, thus losing benefits of specialization and efficiency.
- The strategies of Georgian wine companies (with some exceptions) generally don't rely on high investments in human resources, the production of affordable high quality products, employment of quality technology, services and processes, the production of environmentally friendly products, high expenses on R&D and continuous innovation.

⁷³ It should be mentioned that some Georgian wine companies employ advanced wine and vineyard management practices.

Conclusions and recommendations

The analysis presented above shows that recently Georgia has implemented serious institutional reforms and attained high rates of growth. Priority has been given to reducing barriers to trade and creation of a hospitable business environment. However, the quality of economic growth remains low with respect to social sustainability and innovation. Improving the business climate had a positive influence on the increase in gross output; the growth in Georgia was associated with excess absorption and credit expansion, and foreign investment mainly in non-tradable sectors.

During the course of 2006, Russia—then Georgia's main trading partner—imposed a series of trade and transit barriers on products from Georgia. This contributed to a sharp slowdown in export growth, especially in the agro-food sector. Georgia has lost his main agro-food market and reorientation to EU markets has not been easy because of the low competitiveness of Georgian enterprises.

Recommendations

Enhancement of trade competitive proficiency should be promoted, on the one hand, by the government building up institutional mechanisms, and, on the other hand, through partnership relationships and joint efforts of private companies. To ensure long term economic development, and stable growth rates, the social impact of growth must be improved alongside the elimination of barriers for producers who want to produce for export.

The Georgian government must encourage entrepreneurship and pursue export-oriented support to development of the agro-industrial sector. Implementation of such policy requires:

1. Effective implementation of the TBT, Competition Policy and Food Safety Strategies elaborated under the framework of DCFTA negotiations. A potential Free Trade Agreement, like Georgia's obligation deriving from the Partnership and Cooperation Agreement and European Neighborhood Policy Action Plan, demands that legislation in partner states be in line with the European system of competition and advocacy of consumer rights where Georgia should introduce amendments in its legislation.⁷⁴
2. The government should further promote a favourable business environment, which will encourage the emergence of efficient market mechanisms through stimulating competition processes and the processes of developing competition policy institutions and empowering them with sufficient authority and status necessary for the efficient implementation of competition policy.
3. Identification of the sectors that will represent the basis for industrial development. These must be non-traditional export-oriented sectors, involving new technologies and knowledge. To promote these sectors, it is necessary to carry out assistance for development of trade related infrastructure and capacity that will support through adaptation to new market requirements and ensure export diversification and minimization of risks caused by fluctuations focusing on individual markets. In this respect, the European market is important for the 'future', more developed Georgian export.
4. Support to the development of certification bodies' infrastructure. There is a critical need to modernize sanitary and phyto-sanitary services, and develop international certification bodies in order to ensure a compliancy with international norms and standards. Information on procedures, requirements, and fees for certification should be easily available, including online. Furthermore, Georgia should collaborate with the EU to obtain recognition of Georgian certification. Georgian products could be more easily sold on EU market if GAC were a member of European Accreditation system, which means that production is certified by a conformity assessment body accredited according to international standards.
5. Within governmental programmes, modern systems of food safety should be introduced gradually and improve the institutions that guarantee its standards. In collaboration with European

⁷⁴ At present Georgian government works out 'Comprehensive Strategy in Competition Policy' to meet the international obligations.

partners, Georgia has taken steps to control the quality of natural spring water and sell it appropriately. This development should be continuing and expanded to other food products.

6. The publication of a primer on investors' trade requirements abroad, guidelines for export, and how to trade with EU for firms to improve trade infrastructure and increase business partnership awareness for them will develop trade culture and discipline among entrepreneurs.

7. **In the wine sector** 'Samtrest'—the National Wine Agency—should further coordinate efforts of various stakeholders in carrying out of the following activities:

- **Improving practices employed in wine and vineyard management and bringing them into compliance with international standards.** This will make it possible to capitalize on the excellent soil and climate conditions and take advantage of production of terroir wines. In this context the following measures are of high importance: identification and registration of existing facilities, vineyards, types and clones of vines, composition of vineyard maps; planning of vineyard planting across the country; performing clone selection work; introducing advanced wine and vineyard technologies.
- **Enhancing scientific and educational institutional capacities** in order to have highly qualified specialists, such as wine and vineyard technologists, oenology experts, and marketing specialists and ensure advanced knowledge and skills gained from scientific research and experiments. These will substantially facilitate the implementation of the activities mentioned in the above paragraph.
- **Stimulating emergence of supporting industries.** A special incentives programme aimed to stimulate the emergence of supporting industries (producers of fertilizers, pesticides, herbicides, grape harvesting and winemaking equipment, suppliers of irrigation technology, barrels, bottles, caps and corks, labels, etc.) must be elaborated. The functioning of these industries will allow for better specialization and for reduction in the costs of wine production. Moreover, the inefficiency of grape suppliers is one of the key weaknesses that hamper the implementation of a high-quality strategy at global wine markets. To overcome this weakness, a special support programme aimed at enhancing the efficiency of winegrowing farms must be developed. This programme should involve support in such areas as mechanization, use of fertilizers and irrigation, vineyard management practices and organization.
- **Promoting Georgian wines at global markets.** First, the realization of this strategy requires establishing the identity of Georgian wine brand and promoting it at global markets. A differentiation strategy focused on creation of strong brand awareness, positive attitudes and preferences for Georgian wine must be implemented. Second, the productivity of wine production must be increased substantially, through utilizing better technologies, equipment and management processes, as well as employing high-qualified specialists. Third, this strategy must rely on continuous innovation, substantial investment in R&D, marketing activities and human capital, improved performance of scientific and research institutions.

The implementation of the above-mentioned strategies will create the necessary preconditions for the sustainable competitive advantage of Georgian industry at global markets in the long-run. However, much of the activities mentioned above and required for successful performance of Georgian producers at global markets will have a spillover effect. Thus ensuring the collaboration between the main stakeholders is badly needed in order to attain a competitive advantage for the whole economy.

From the financing aspect:

1. Support to entrepreneurs and foreign investors to establish ties should be carried out by means of relevant associations and agencies that will improve exchange of information, quality control and maintenance service. The principal direction of such institutions' activities should be representation of business people in dealings with the government and international organizations, market education, system of distribution and advertising, support of such actions which are good commercials for Georgian companies and products. Its activities entail publication of marketing materials, papers, brochures, regular information bulletins for embassies of foreign countries; interaction with international credit/technical assistance agencies and commercial organizations; missions of foreign buyers and investors within the country; assistance in participation in foreign commercial markets; support for industry exhibitions in Georgia; research and development support; programmes aiming at ensuring high quality, productivity and expense monitoring, and others.
2. The Georgian government should stimulate the development of the market of financial resources by ensuring the accessibility of capital for business and allowing the monitoring of the behaviour of managers, including the establishment of the securities market, development of the institution of financial brokerage, creation of the conditions for competition in the banking sector, realization of the package of measures to reduce the systemic risks; development of information systems.
3. Banks which provide credits to entrepreneurs need incentives. The preferential policy of crediting business for commercial banks should be based on the improvement of relevant regulations, especially when the activity of the banking sector targets financing of clusters and innovation of enterprises.
4. A system of credit guarantees for trade should be created in order to decrease credit risks. Regulations which could significantly simplify access to credits and strengthen the system of credit safety for entrepreneurs within the value chain development can be based on direct provision of loans between entities in this system, as well as on trust loans on the terms of fund providers. Expansion of financial supply channels for trade is also possible through creating a special mechanism of their participation in the stock market.
5. To decrease the risk of return of credit by companies, conditions should be set up to use harvest as collateral, relationships with sellers (for example, retail network), introducing partnership agreements, . Introduction of a system of credit risks oriented towards partnership relations will strengthen competitive powers of trade partners and will make it possible to use the mechanism of risk transfer.
6. Household capital should be increased at the expense of credits or savings. In rural areas, savings are not in monetary form but in kind (for example, increase of amount of foodstuffs in household). Land and pastures are means of living for villagers. Land enables them to grow products for their own use and for sale. The deficit of pastures and small agricultural machines for cultivation of land in Georgia makes the labour invested in households ineffective. The villagers are poor and have no access to credits, as there is higher risk involved for banks to issue credits to the poor. A liberal policy is needed for the development of financial institutions while the establishment of a land exchange will reduce credit risks and increase the number of creditors.

Support of international donors

Support of donors is a must in the sphere of reforms. The main field of their activity should be coordination among business groups, development of projects of technical assistance and representation of their entities in clusters and associations.

Action Matrix

ACTION	TARGET INDICATOR	TIMELINE FOR COMPLETION OF ACTION	RESPONSIBLE ENTITIES	REQUIRED RESOURCES	REQUIRED DONOR SUPPORT
1. Support Government of Georgia in national trade policy-making development	1.1. Support foreign trade and investment promotion policy in Georgia	Medium term	MoED, MoA, Research institutions and universities;	Local resources for trade development support; participation of the competent authorities and institutions	Technical cooperation support, external support budget TBD
	1.2. Perform monitoring and evaluation of external markets	Medium term			
	1.3. Capacity building of trade policy entities at the MoED and MoA	Short term	MoED, MoA		
	1.4. Institutional strengthening of competition agency.	Medium term	MoED, MoA, Research institutions and universities; business associations		
2. Strengthen capacity of public and private trade development institutions, develop the Georgian Accreditation centre (GAC) and sanitary and phytosanitary (SPS) capacity	2.1. Launch campaign to raise awareness of quality assurance, food safety and quality compliance among producers	Long term	Government, business associations, business and farmers' service centres	Participation of the competent authorities and institutions	Technical cooperation support including tours and investment funds, external support budget TBD
	2.2. Support to provision of extension services to producers to introduce Good Management Practices (especially along value chains for selected agriculture sectors and processed foods).				
	2.3. Strengthening institutions responsible for SPS activities				
	2.4. Development of institutional capacities of the Georgian Accreditation Centre (GAC) and Georgian National Agency for Standards, Technical Regulations and Metrology (GNASTRM)				
3. Improve trade promotion services	3.1. Provide trade information services on the local and state levels, strengthen trade analysis and data support institutions	Long term	Government, civil society, universities, research institutions, self-governmental bodies,	Trade support Institutions participation, participation of the competent authorities and institutions, participation by the national and regional entities concerned	Technical cooperation support, external support budget TBD
	3.2. Conduct comprehensive review of regulatory framework governing entry and operation of trade logistical services providers				
	3.3. Consultation, R&D on export competitiveness, trade policies, and trade agreements for private sector bodies and Government representatives				
	3.4. Improve access to credits and support for insurance institutions in agro-food sectors				
	3.5. Strengthen contract enforcement				
					As above

4. Transportation and logistics	4.1. Further improvement of transportation logistics and infrastructure	Long term	Government, civil society, universities, research institutions, self-governmental bodies	Participation by the national and regional entities concerned	Technical cooperation support, including investment funds, external support budget TBD	
		Medium term				
5. Technical and institutional support for business and farmers associations and exporting companies	Increase productivity in export sectors of agriculture and food number of product and technology innovations; develop human resources; provide employment opportunities; development of rural areas.	Medium-term	MoED; MES; Research institutions and universities; business associations, farmers centres	Participation by the national and regional entities concerned	Technical cooperation support including study tours, external support budget TBD	
6. Promote Georgian wine export and sector development (Establishing and promoting 'Brand Georgian Wine' (BGW) at global markets)	Offices opened; brand awareness and image increased;	Long-term	Ministry of Agriculture; MoED Research institutions and universities	Participation by national and regional entities concerned	Technical cooperation support, external support budget TBD	
		Medium-term				
		Short-term				
6.1. Acquiring and disseminating of relevant information among main stakeholders;	exported wine meets the product standards of the importing country					
6.2. Enhancing capacities and efficiency of institutions for quality assurance						

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Appendix

TABLE 1. GROSS DOMESTIC PRODUCT (GDP)

	2004	2005	2006	2007	2008	2009*
GDP at current prices, mil. GEL	9,824.3	11,620.9	13,789.9	16,993.8	19,074.9	17,986.0
GDP at constant 2003 prices, mil. GEL	9,065.9	9,935.6	10,868.0	12,208.8	12,491.4	12,019.7
GDP real growth, per cent	105.9	109.6	109.4	112.3	102.3	96.2
GDP deflator, per cent	108.4	107.9	108.5	109.7	109.7	98.0
GDP per capita (at current prices), GEL	2,276.7	2,689.1	3,133.1	3,866.9	4,352.9	4,101.3
GDP per capita (at current prices), USD	1,187.6	1,483.5	1,763.5	2,314.6	2,921.1	2,455.2
GDP at current prices, mil. USD	5,124.7	6,411.0	7,761.7	10,171.9	12,800.5	10,767.1

Source: National Statistics Office of Georgia, www.geostat.ge

TABLE 2. STRUCTURE OF GDP BY ECONOMIC ACTIVITY OF NATIONAL ECONOMY, 2003–2009 (GROSS VALUE ADDED AT CURRENT PRICES, % OF GDP)

INDICATOR	2003	2004	2005	2006	2007	2008	2009
Agriculture, hunting and forestry	20.6	17.9	16.7	12.8	10.7	9.4	9.4
Industry	14.2	13.2	13.8	14.2	13.3	12.5	12.1
Processing of products by households	4.6	4.4	4.0	2.8	3.2	2.9	3.4
Construction	6.8	8.8	9.1	7.9	7.8	6.4	6.5
Trade	14.1	13.9	13.5	15.6	14.8	16.2	15.1
Transport and communications	14.8	14.6	14.0	13.2	12.1	11.0	11.4
Public administration	3.8	6.4	7.3	9.7	14.9	17.3	15.8
Education	3.5	3.8	3.7	4.2	3.8	4.1	4.9
Health and social services	4.3	3.8	3.9	5.0	4.7	5.1	6.6
Other services	13.3	13.1	14.0	14.5	14.7	15.2	15.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: National Statistics Office of Georgia, www.geostat.ge

TABLE 3. MONETARY SECTOR INDICATORS, 2003–2009

INDICATOR	2003	2004	2005	2006	2007	2008	2009
Credit-to-GDP ratio (end of period)	8.8	9.5	14.6	19.2	26.6	30.6	27.8
Credit growth (% over previous year)	22.5	24.9	83.2	55.8	70.8	31.0	-14.0
Deposit to GDP ratio	7.2	9.1	10.1	13.5	16.8	16.9	19.1
Bank assets to GDP ratio	15.6	17.3	21.9	30.7	42.4	46.5	46.2
Broad money (in per cent of GDP)	12.5	15.5	16.6	19.5	23.7	22.6	25.95
Deposit rate (%)	8.9	8.0	7.0	7.6	8.5	9.2	10.0
Lending rate (%)	21.5	20.2	17.9	17.3	17.7	18.6	19.3
Consumer prices (average), percentage points	4.8	5.5	8.2	9.2	9.2	10.0	1.7
Consumer prices (end period), percentage points	7.0	7.5	6.2	8.8	11.0	5.5	3.0

Source: calculations based on data from National Bank of Georgia.

TABLE 4. CREDIT BY INDUSTRIES, 2003–2009

	2003	2004	2005	2006	2007	2008	2009
(IN PER CENT OF TOTAL LOANS)							
Agriculture, forestry, fishing	1.39	1.11	0.49	0.57	1.68	2.47	1.97
Industry	28.39	29.28	18.99	20.22	19.23	17.56	21.03
Trade	7.34	7.93	7.67	10.81	10.15	11.30	8.63
Construction	44.73	43.99	41.52	52.51	55.56	54.03	49.14
Hotels and restaurants	0.82	1.80	0.75	0.67	1.11	1.19	0.63
Transport and communications	3.29	3.62	2.36	2.53	1.42	1.81	6.25
Financial intermediation	6.89	6.21	8.20	4.47	1.68	1.55	2.03
Transactions in real estate	0.49	0.61	1.30	1.90	1.89	3.51	1.54
General administration and defence	2.92	0.06	0.00	0.00	0.00	0.01	0.01
Education	0.04	0.02	0.11	0.07	0.15	0.07	0.18
Health care and social services	0.25	0.22	0.27	0.57	0.47	0.83	0.98
Other services	3.44	5.14	18.35	5.68	6.65	5.66	7.61
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: calculations based on data from National Bank of Georgia.

TABLE 5. FISCAL SECTOR PERFORMANCE INDICATORS, 2003–2009.

INDICATOR	2003	2004	2005	2006	2007	2008	2009
(IN MILLION GEL)							
Total revenue	1,345.0	2,266.9	2,828.9	3,850.2	4,972.7	5,854.2	5,264.5
Tax revenue	1,005.9	1,530.2	1,982.8	2,646.6	3,669.0	4,752.7	4,388.8
Total expenditures and net lending	1,261.4	1,835.8	2,425.9	2,978.7	4,379.0	5,410.9	5,397.0
Budget operational balance	83.6	431.1	403.0	871.5	593.7	443.3	-132.5
Budget total balance	-75.3	78.3	162.2	366.4	52.7	-383.4	-1,173.9
(IN PER CENT OF GDP)							
Total revenue	15.71	23.07	24.34	27.92	29.26	30.69	29.33
Tax revenue	11.75	15.58	17.06	19.19	21.59	24.92	24.45
Total expenditures and net lending	14.73	18.69	20.88	21.60	25.77	28.37	30.07
Budget operational balance	0.98	4.39	3.47	6.32	3.49	2.32	-0.74
Budget total balance	-0.88	0.80	1.40	2.66	0.31	-2.01	-6.54
Debt	53.8	43.84	35.08	27.96	23.06	27.02	34.69

Source: calculations based on data from Ministry of Finance of Georgia, www.mof.gov.ge

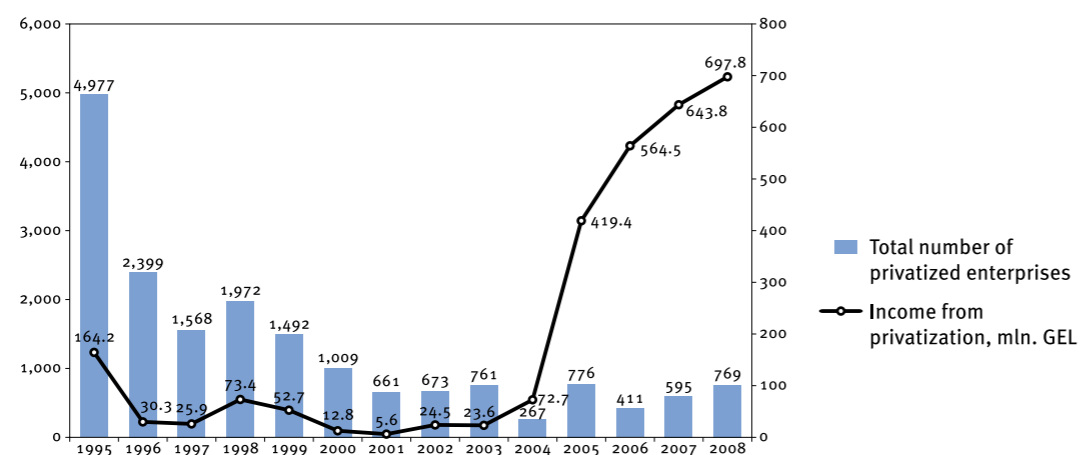
TABLE 6. EXTERNAL SECTOR INDICATORS, 2003–2009

INDICATOR	2003	2004	2005	2006	2007	2008	2009*
(IN THOUSANDS OF US\$)							
Current account	-383,832.9	-353,874.9	-709,202.0	-1,175,250.6	-2,009,965.2	-2,912,275.1	-1,259,024.1
Trade balance	-577,303.6	-846,222.0	-1,130,312.4	-1,861,568.4	-2,734,675.0	-3,812,223.4	-2,067,254.7
Export of goods and services	1,288,509.9	1,646,873.4	2,187,480.7	2,551,559.9	3,182,355.0	3,688,405.8	3,199,649.7
Import of goods and services	-1,865,813.5	-2,493,095.4	-3,317,793.1	-4,413,128.3	-5,917,030.0	-7,500,629.1	-5,266,904.4
Transfers	179,998.6	413,877.3	359,037.6	523,943.4	688,453.8	1,060,354.9	958,137.9
Capital and financial balance	388,943.0	342,847.2	683,248.2	1,239,846.6	2,045,034.3	2,948,378.2	1,205,276.7
Net FDI	330,886.6	482,758.9	542,229.6	1,185,908.8	1,673,898.6	1,494,068.4	765,318.3
Change in internat. reserves	18,503.7	-177,879.1	-110,570.1	-438,637.1	-377,027.1	-130,705.1	-616,422.3
(IN PER CENT OF GDP)							
Current account	-9.6	-7.5	-12.9	-19.2	-27.5	-34.7	-17.5
Trade balance	-14.5	-17.9	-20.6	-30.4	-37.4	-45.5	-28.8
Export of goods and services	32.3	34.8	39.9	41.7	43.5	44.0	44.5
Import of goods and services	-46.8	-52.7	-60.5	-72.1	-81.0	-89.5	-73.3
Transfers	4.5	8.8	6.6	8.6	9.4	12.6	13.3
Capital and financial balance	9.7	7.2	12.5	20.3	28.0	35.2	16.8
Net FDI	8.3	10.2	9.9	19.4	22.9	17.8	10.7
Change in internat. reserves	0.5	-3.8	-2.0	-7.2	-5.2	-1.6	-8.6
Real effective exchange rate (REER) (index to December 1995)	94.9	107.0	110.2	110.1	110.6	121.3	116.7
NER GEL/US (end of the year)	2.0750	1.8250	1.7925	1.7135	1.5916	1.6670	1.6858
GDP at constant prices in million USD	3,990.8	4,729.1	5,481.2	6,117.1	7,307.8	8,382.5	7,183.4

Source: calculations based on data from National Bank of Georgia

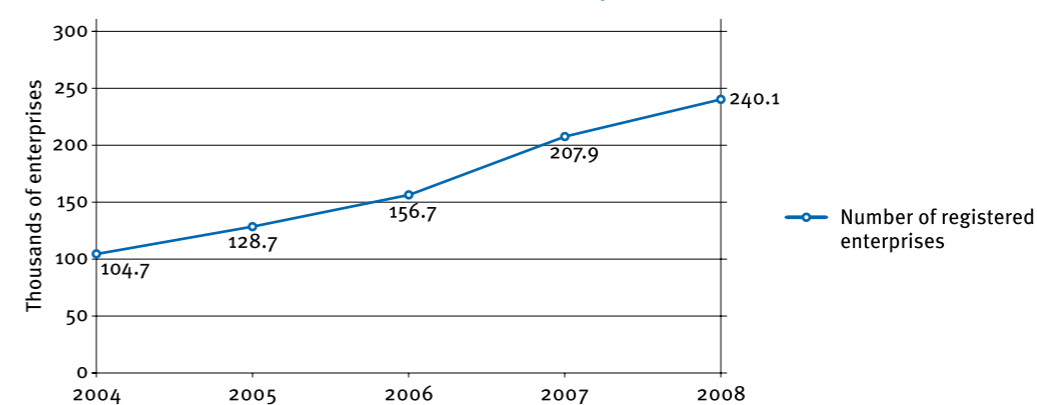
*preliminary data

FIGURE 1. NUMBER OF PRIVATIZED UNITS AND INCOME FROM PRIVATIZATION IN GEORGIA, 1995–2008



Source: own calculations based on data from National Statistics Office of Georgia, www.geostat.ge

FIGURE 2. NUMBER OF REGISTERED ENTERPRISES, 2004–2008



Source: own calculations based on data from National Statistics Office of Georgia, www.geostat.ge

TABLE 7. DYNAMICS OF GIN INDEX BY INCOME, EXPENSES AND CONSUMPTION, 1997–2008

YEAR	BY GROSS INCOME	BY GROSS CONSUMPTION	BY GROSS EXPENDITURES
1997	0.46	0.38	0.39
1998	0.47	0.39	0.40
1999	0.50	0.40	0.41
2000	0.49	0.39	0.42
2001	0.45	0.4	0.39
2002	0.46	0.39	0.41
2003	0.47	0.38	0.40
2004	0.44	0.38	0.41
2005	0.44	0.39	0.41
2006	0.45	0.39	0.41
2007	0.46	0.41	0.42
2008	0.48	0.41	0.43

Sources: Statistical Yearbook of Georgia 2009, National Statistics Office of Georgia, www.geostat.ge

TABLE 8. PENSIONS IN GEORGIA, 1998–2009

INDICATOR	1998	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Average wage, GEL per month	55.4	72.3	94.6	113.5	125.9	156.6	204.2	277.9	368.1	534.9	556.8
Average pension, GEL per month	15.0	15.9	16.1	16.2	16.5	18.0	37.3	39.7	44.6	70.9	77.6
Ratio of average pension to average wage%	27.1	22.0	17.0	14.3	13.1	11.5	18.3	14.3	12.1	13.3	13.9
Number of pensioners, thousands:	967.8	900.4	896.0	903.6	899.8	895.1	902.1	985.4	836.9	842.2	838.5
OF WHICH											
by age	665.3	594.8	590.3	588.9	573.6	570.2	549.9	589.7	611.8	658.3	660.0
by disability	136.6	126.9	126.8	129.7	130.4	135.8	128.6	213.0	160.6	137.8	139.9
survivors pensioners	50.8	60.5	58.1	55.9	53.9	49.6	51.9	75.8	55.9	41.9	35.5
social pension	71.0	70.5	75.1	82.5	87.9	100.5	150.6	85.0	*	*	*

Source: National Statistics Office of Georgia, www.geostat.ge

* According to the laws of Georgia 'On State Pensions' and 'On State Compensation and State Academic Scholarship' starting from the year 2006 categories such as 'Working pension', 'Social pension', 'Special Pension' were abolished. These groups are shown) in the categories 'Pensioners by age' and 'Pensioners by Disability'.

TABLE 9. POPULATION OVER 15 YEARS OLD AND EMPLOYMENT IN GEORGIA, 2003–2009

INDICATOR	2003	2004	2005	2006	2007	2008	2009
(Thousands)							
Economically active population – total	2,050.8	2,041.0	2,023.9	2,021.8	1,965.3	1,917.8	1,991.8
OF WHICH:							
employed	1,814.9	1,783.3	1,744.6	1,747.3	1,704.3	1,601.9	1,656.1
OF WHICH:							
hired	618.5	600.9	600.5	603.9	625.4	572.4	596.0
self-employed	1,195.2	1,180.8	1,143.3	1,141.6	1,078.8	1,028.5	1,059.0
Not stated	1.3	1.6	0.8	1.8	0.1	1.1	1.2
Unemployed	235.9	257.6	279.3	274.5	261.0	315.8	335.6
Non-participants	1,048.4	1,105.9	1,136.1	1,228.0	1,138.6	1,145.2	1,139.3
(in per cent)							
Unemployment rate	11.5	12.6	13.8	13.6	13.3	16.5	16.9
Participation rate	66.2	64.9	64.0	62.2	63.3	62.6	63.6
Employment rate	58.6	56.7	55.2	53.8	54.9	52.3	52.9

Source: National Statistics Office of Georgia, www.geostat.ge

TABLE 10. EMPLOYMENT STRUCTURE BY TYPE OF ECONOMIC ACTIVITIES (FULL-TIME / PRIMARY AREA OF ACTIVITY), 2003–2009

INDICATOR	2003	2004	2005	2006	2007	2008	2009
Engaged – total, of which:	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture, hunting and forestry	54.8	54.0	54.3	55.3	53.4	55.1	54.5
Industry	6.1	6.5	6.7	6.0	6.3	6.5	6.7
Transport and communications	4.9	4.2	4.0	4.5	4.2	4.8	5.1
Construction	2.2	2.4	2.5	3.1	4.2	4.2	3.4
Trade, repair of motor vehicles and personal and household goods	10.9	11.0	10.8	9.6	9.9	10.8	10.5
Hotels and restaurant	0.9	1.1	0.9	1.0	1.1	1.0	1.1
Financial intermediation	0.5	0.7	0.8	0.8	1.0	1.4	1.2
Real estate, renting and business activities	1.8	1.6	1.5	1.5	2.0	1.4	2.0
Public administration	5.0	4.9	4.7	4.5	3.8	3.2	3.2
Education	7.5	7.5	7.5	7.6	7.8	7.2	7.1
Health and social work	2.7	3.1	3.3	3.0	3.5	3.6	3.5
Other	2.7	3.0	3.0	3.1	2.8	0.8	1.7

Source: National Statistics Office of Georgia, www.geostat.ge

TABLE 11. DISTRIBUTION OF GROSS AVERAGE MONTHLY WAGES BY KIND OF ECONOMIC ACTIVITY (IN GEL), 2001–2009

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total	94.6	113.5	125.9	156.8	204.2	277.0	368.1	534.9	556.8
Agriculture	33.2	42.3	47.6	68.0	128.9	148.1	184.9	299.3	264.0
Mining and quarrying	153.8	192.2	218.7	179.5	210.8	352.3	657.7	808.9	677.7
Manufacturing	120.8	143.4	152.5	183.8	212.1	260.5	357.7	510.5	447.9
Electricity, gas and water supply	212.1	214.9	250.2	259.2	341.5	398.2	533.8	738.3	766.8
Construction	145.9	176.1	206.2	264.5	296.4	391.0	494.5	597.3	626.1
Trade	57.4	72.8	85.5	107.9	173.6	246.4	355.5	510.6	517.7
Transport and communications	141.1	171.7	191.1	229.1	265.7	391.3	492.3	667.7	729.3
Hotels and restaurants	50.1	51.5	56.6	70.3	108.2	196.5	238.4	333.6	364.7
Financial intermediation	430.2	429.6	530.5	739.3	1,049.2	779.0	1,014.5	1,343.5	1,319
Real estate	88.2	92.0	110.3	125.5	210.8	284.2	405.8	540.1	640.3
Public administration	105.9	141.2	132.0	192.4	342.4	448.0	585.4	869.5	888.8
Education	45.5	56.5	68.5	88.7	92.5	122.1	153.0	243.7	269.3
Health	45.6	55.6	76.8	80.3	99.5	143.3	206.4	305.8	366.7
Community, social and personal service activities	75.3	82.1	72.2	123.5	113.4	175.6	260.6	408.7	411.1

Source: National Statistics Office of Georgia, www.geostat.ge

TABLE 12. DISTRIBUTION OF GROSS AVERAGE MONTHLY WAGES BY TYPE OF OWNERSHIP (IN GEL), 2000–2009

INDICATOR	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Public sector	66.6	85.7	104.1	114.5	144.3	193.6	249.2	312.3	481.3	512.2
Private sector	94.8	123.5	145.1	167.1	190.9	227.6	316.3	437.8	603.4	608.5

Source: National Statistics Office of Georgia, www.geostat.ge

TABLE 13. STRUCTURE OF HOUSEHOLD INCOMES, 2004–2009

	2004	2005	2006	2007	2008	2009
Total incomes, million GEL, per month	285.5	309.2	340.7	371.8	465.1	508.3
INCLUDING, % OF TOTAL:						
Cash Income and transfers, of which:	67.8	73.9	75.9	80.0	81.4	83.5
Wages	24.0	28.8	31.7	35.7	35.7	36.8
Income from self-employment	13.0	13.0	12.0	11.4	11.4	11.0
Sales of agricultural products	12.2	10.6	9.5	7.3	6.5	5.8
Income from property (lease of property and interest income)	0.8	1.1	0.4	1.0	0.7	0.8
Social assistance and other transfers (pension, stipends, family allowances, benefits)	5.6	8.4	9.6	11.1	13.5	14.8
Remittances from abroad	4.4	4.6	4.4	4.7	4.1	4.3
Remittances from relatives	7.7	7.5	8.3	8.8	9.3	9.9
Non-cash income	31.2	26.1	24.1	19.9	18.6	16.5

Source: National Statistics Office of Georgia, www.geostat.ge

TABLE 18. FOREIGN DIRECT INVESTMENTS BY SECTORS

SECTORS	2007	2008	2009
IN MILLION USD			
Total	2,014.8	1,563.9	658.4
OF WHICH:			
Agriculture, fishing	15.5	7.8	22.2
Industry	398.2	207.3	139.8
Energy sector	362.5	294.8	-2.1
Construction	171.8	56.7	105.2
Hotels and restaurants	242.0	181.9	37.5
Transport and communications	416.6	422.6	98.4
Real estate	30.5	277.8	147.4
Other services	140.7	101.2	51.5
Financial sector	136.9	8.5	49.6
IN PER CENT			
Total	100.0	100.0	100.0
OF WHICH:			
Agriculture, fishing	0.8	0.5	3.4
Industry	19.8	13.3	21.2
Energy sector	18.0	18.9	-0.3
Construction	8.5	3.6	16.0
Hotels and restaurants	12.0	11.6	5.7
Transport and communications	20.7	27.0	15.0
Real estate	1.5	17.8	22.4
Other services	7.0	6.5	7.8
Financial sector	6.8	0.5	7.5

Source: National Statistics Office of Georgia, www.geostat.ge

TABLE 19. FOREIGN DIRECT INVESTMENT (MILLION USD)

YEAR	2003	2004	2005	2006	2007	2008	2009
Total	340.0	499.1	449.0	1,190.3	2,014.8	1,563.9	658.4
COUNTRY:							
Azerbaijan	29.6	69.0	66.9	77.8	41.3	23.9	29.8
Austria	18.1	23.1	14.7	10.7	11.3	51.4	29.7
Virgin Islands, British	6.2	6.8	4.9	58.5	187.8	156.8	35.4
Cyprus	0.6	21.3	47.5	40.0	148.6	26.1	-1.6
Czech Republic	0.2	0.2	1.2	15.3	227.9	34.8	45.6
France	16.7	22.8	14.3	17.2	43.7	8.1	11.9
Germany	4.1	5.1	5.0	20.3	56.9	40.5	21.3
Italy	15.8	32.4	22.8	47.2	15.2	6.0	1.6
Japan	8.6	12.0	16.6	34.4	34.3	11.6	-30.8
Kazakhstan	-	-	-	152.3	88.4	65.9	-31.9
Netherlands	-	-	0.4	18.5	299.2	135.8	32.5
Norway	11.2	37.4	23.6	77.8	34.2	2.6	1.0
Russia	42.6	43.7	38.7	34.2	88.9	26.2	10.2
United Arab Emirates	0.2	-	0.2	0.4	130.8	306.5	162.7
Turkey	17.2	33.9	21.8	129.7	93.8	164.5	97.9
Ukraine	1.4	1.2	1.7	1.0	24.3	-6.4	-1.5
United Kingdom	37.6	87.8	132.9	186.8	145.4	148.9	72.3
USA	72.0	81.1	15.0	182.6	84.4	167.9	-10.0
International organizations	-	-	-	8.7	14.2	23.6	30.7

Source: National Statistics Office of Georgia, www.geostat.ge

TABLE 20. GROSS HARVEST OF AGRICULTURAL CROPS (THOUSAND TONNES), LIVESTOCK AND POULTRY NUMBERS, 2002–2009

INDICATOR	2002	2003	2004	2005	2006	2007	2008	2009
Wheat	199.7	225.4	185.8	190.1	69.7	74.9	80.3	53.9
Barley	57.5	48.3	61.3	65.4	30.6	40.3	49.3	19.9
Maize	400.1	461.9	410.6	421.3	217.4	295.8	328.2	291.0
Haricot beans	10.6	12.1	16.4	23.0	7.6	10.5	11.6	10.2
Tobacco	2.1	1.4	1.5	1.1	0.3	0.1	0.1	0.1
Sunflower seeds	21.2	25.5	22.3	22.3	12.3	16.1	15.1	...
Soybeans	1.9	3.7	2.2	10.7	3.7	2.8	2.3	1.0
Potatoes	415.3	425.2	419.5	432.2	168.7	229.2	193.4	216.8
Vegetables	405.6	430.1	400.5	436.7	179.7	190.3	165.0	170.3
Melons	125.1	125.0	109.5	119.6	37.8	73.5	52.8	43.7
Annual grasses for hay	48.8	48.6	46.6	37.4	26.5	20.5	5.0	14.6
Perennial grasses for hay	86.1	130.8	103.8	100.7	25.8	8.8	30.2	23.0
Fodder roots	–	–	4.4	2.9	1.5	1.2	0.2	3.2
Fruit	172.6	260.0	160.2	264.9	153.3	227.5	157.6	181.2
Citruses	33.1	59.2	38.2	122.4	52.2	98.9	55.2	93.6
Grapes	90.0	200.0	180.0	250.3	162.5	227.3	175.8	150.1
Tea leaves	24.0	25.5	20.0	22.8	6.6	7.5	5.4	5.8
Eggs, million pieces	408.8	458.1	496.6	504.6	249.2	438.1	437.5	430.6
Meat (slaughtered weight)	106.9	108.9	104.1	104.7	83.3	73.0	57.3	54.3
Milk	742.1	765.1	749.7	755.7	606.1	624.8	645.8	551.4
Wool	2.0	2.0	2.2	2.2	2.0	2.2	1.9	1.8
Poultry, million heads	8.9	9.2	9.8	7.5	5.4	6.1	6.7	6.7
Cattle and buffaloes	1,216.0	1,242.5	1,177.9	1,190.6	1,080.3	1,048.5	1,045.5	1,014.7
Pigs	446.1	473.8	483.9	455.3	343.5	109.9	86.4	135.2
Sheep and goats	699.5	722.2	804.9	815.3	789.2	797.1	769.4	673.8

Source: National Statistics Office of Georgia, www.geostat.ge

TABLE 21. NUMBER OF TRACTORS AND HARVESTER THRESHERS PER 1000 HA OF ARABLE LAND

COUNTRY	TRACTORS			HARVESTERS THRESHERS		
	2004	2005	2006	2004	2005	2006
Armenia	33.2	33.3	36.4	3.2	3.2	3.5
Azerbaijan	14.7	8.4	8.4	1.9	0.8	0.8
Belarus	10.0	9.7	9.5	2.3	2.3	2.4
Bulgaria	9.6	10.8	10.5	2.5	2.6	2.7
Croatia	217.8	222.4	215.8	8.1	8.2	8.0
Czech Republic	29.2	28.6	28.6	3.9	3.8	3.8
Estonia	71.8	54.6	60.5	8.3	7.1	7.5
Georgia	32.0	42.7	53.2	2.5	1.5	0.4
Hungary	25.9	26.2	26.5	2.6	2.6	2.6
Kazakhstan	2.1	2.0	2.0	0.9	0.9	0.9
Kyrgyzstan	15.8	15.7	19.1	2.1	2.3	2.8
Latvia	55.2	51.4	46.9	6.3	6.1	5.8
Lithuania	68.6	63.7	65.0	9.6	9.2	9.4
Moldova, Republic of	22.2	22.3	22.4	3.3	3.3	3.3
Russian Federation	4.4	3.9	3.6	1.2	1.1	1.0
Slovakia	15.8	15.7	15.8	2.6	2.6	2.5
Slovenia	598.0	582.9	571.4	15.8	15.1	14.5
Tajikistan	29.0	28.8	29.6	1.4	1.4	1.5
Ukraine	11.4	10.9	10.6	1.8	1.8	1.8
Uzbekistan	37.8	38.6	39.1	1.6	1.6	1.6
World	20.0	20.2	20.2	2.9	2.9	2.9

Source: FAO Statistical Yearbook, 2009. Statistics Division FAO.

TABLE 22. EXPORT OF MAIN AGRICULTURAL PRODUCTS AND FOODS (THOUSAND USD)

	2003	2004	2005	2006	2007	2008	2009
Total Exports	461,405.6	646,903.0	865,454.2	936,172.1	1,232,371.0	1,496,060.4	1,134,926.2
of which:							
Fish, crustaceans and molluscs	348.9	213.9	992.3	904.4	1,948.5	6,081.0	4,484.2
Dairy products; birds' eggs; natural honey	159.4	4,425.5	2,625.5	742.3	1,565.8	629.8	1,316.9
Edible vegetables and certain roots and tubers	385.5	1,126.4	1,053.6	1,151.4	852.2	1,435.9	2,599.1
Edible fruit and nuts; peel of melons or citrus	15,948.5	21,284.2	76,937.3	61,668.8	72,181.3	43,498.4	90,087.8
Coffee, tea, mate and spices	5,534.1	5,161.3	5,199.5	3,195.0	3,376.0	3,634.2	4,763.3
Cereals	10,945.2	22,995.0	6,152.6	11,822.2	12,732.4	5,208.0	4,591.2
Oil seeds and oleaginous fruits; industrial or medicinal plants	993.6	1,027.7	2,579.0	1,954.1	2,319.5	4,120.6	23,310.0
Sugars and sugar confectionery	34,339.6	35,920.1	30,571.4	19,241.9	29,047.1	8,457.6	980.4
Preparations of vegetables, fruit, or other parts of plants	2,078.7	2,294.5	5,445.4	6,829.3	15,681.3	1,156.1	3,844.9
Miscellaneous edible preparations	730.4	849.8	829.9	1,014.7	468.1	9,872.9	8,356.9
Beverages, spirits and vinegar	88,591.5	101,336.7	164,356.7	119,557.8	143,412.3	138,444.0	123,776.4
Residues from the food industries, prepared animal fodder	162.6	149.3	782.8	3,702.9	6,531.4	6,954.8	11,490.1
Tobacco and manufactured tobacco substitutes	1,555.8	1,089.3	1,345.8	59.6	62.0	1.1	9.5

Source: National Statistics Office of Georgia, www.geostat.ge

TABLE 23. IMPORT OF MAIN AGRICULTURAL PRODUCTS AND FOODS (THOUSAND US\$)

NAME OF GROUP	2002	2003	2004	2005	2006	2007	2008	2009
Total Imports	795,539.1	1,141,164.7	1,845,554.9	2,489,953.4	3,677,744.7	5,214,883.4	6,304,557.3	4,378,084.4
of which:								
Meat and edible meat offal	14,927.3	14,497.8	16,694.1	21,135.3	41,630.6	60,358.2	78,241.9	62,614.6
Fish, crustaceans and molluscs	1,338.2	2,014.2	4,325.5	8,109.4	21,686.0	27,984.8	31,029.3	25,888.1
Dairy products; birds' eggs; Natural honey	4,512.2	6,348.8	22,144.4	26,814.2	31,508.9	31,677.4	33,293.4	24,556.1
Edible vegetables and certain roots and tubers	2,405.5	3,127.0	3,670.5	4,515.6	17,916.1	32,867.9	23,706.3	19,529.4
Edible fruit and nuts; peel of melons or citrus	2,726.7	2,838.1	5,270.9	4,462.9	8,606.0	12,493.7	12,887.2	16,573.9
Coffee, tea, mate and spices	1,845.8	2,408.4	5,671.2	7,178.6	9,811.4	14,454.7	17,375.1	16,903.3
Cereals	21,011.6	28,556.8	77,464.4	50,000.1	109,639.7	150,012.8	120,639.7	116,992.8
Oil seeds and oleaginous fruits; industrial or medicinal plants	470.7	337.8	1,037.5	3,770.8	2,365.2	7,694.7	6,096.1	33,096.2
Animal or vegetable fats and oils and their cleavage products	8,183.6	10,298.2	23,595.4	32,472.3	36,785.8	46,713.1	71,944.4	49,915.3
Sugars and sugar confectionery	36,599.8	57,046.0	60,212.2	87,141.1	76,570.4	103,871.5	80,959.7	62,702.9
Cocoa and cocoa preparations	5,968.8	10,503.6	19,994.7	25,247.1	34,202.9	42,023.5	50,301.3	43,495.1
Preparations of cereals, pastry cooks' products	4,880.4	5,594.2	14,042.0	20,219.9	24,999.5	33,336.4	45,657.2	34,959.4
Miscellaneous edible preparations	6,126.3	6,094.7	10,174.5	17,844.1	23,033.0	41,004.1	59,940.7	53,685.3
Beverages, spirits and vinegar	3,275.2	7,666.8	11,404.8	20,384.0	40,733.2	36,376.7	49,564.4	33,257.0
Tobacco and manufactured tobacco substitutes	29,219.3	25,506.6	38,293.1	23,268.5	38,086.0	56,273.6	80,774.9	79,310.9

Source: National Statistics Office of Georgia, www.geostat.ge



United Nations Development Programme

Regional Centre for Europe and the CIS

Grösslingova 35

811 09 Bratislava

Slovak Republic

Tel: +421 2 5933 7111

Fax: +421 2 5933 7450

<http://europeandcis.undp.org>

Georgia Country Office

UN House, 9 Eristavi Street

0179 Tbilisi Georgia

Tel: +995 (32) 251126

Fax: +995 (32) 250271

E-mail: registry.ge@undp.org

www.undp.org.ge



United Nations Development Programme

Regional Centre for Europe and the CIS
Grösslingova 35
811 09 Bratislava
Slovak Republic
Tel: +421 2 5933 7111
Fax: +421 2 5933 7450
<http://europeandcis.undp.org>

Georgia Country Office
UN House, 9 Eristavi Street
0179 Tbilisi Georgia
Tel: +995 (32) 251126
Fax: +995 (32) 250271
E-mail: registry.ge@undp.org
www.undp.org.ge

