Summary of a Georgia Working Group with

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Georgia: Rebounding from the Russian Economic Collapse

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In a CSIS Georgia Working Group meeting on April 1, the Georgian Minister of Economy Vladimir Papava gave a broad overview of Georgia's economic development since independence, characterizing the endeavor as much more than a transition and no less than "nation-building."

As stability slowly began to return in 1994-despite domestic conflicts in Ossetia and Abkhazia and other regional conflicts-Georgian leaders realized that economic and political reforms would be essential to ensure future stability. With the help of the International Monetary Fund (IMF) and the World Bank, they embarked on a series of reforms.

In 1995, the country gradually began to achieve economic recovery. Georgia introduced its currency, the lari, which remained relatively stable until September 1998, with an exchange rate of 1 U.S. dollar to 1.3 lari. The new constitution and the inaugural round of presidential and parliamentary elections laid the groundwork for a stable political environment, and Georgia's first budget was adopted after consultations with the IMF and the World Bank. Political and economic reforms resulted in rapid economic gains as Georgia's gross domestic product (GDP) growth rebounded to 11 percent while inflation decreased from 53 percent in 1995 to 8 percent by 1997.

Just, however, as financial stabilization was increasing confidence in Georgia's economic growth potential, 1998 ushered in a very difficult period. The February assassination attempt on President Shevardnadze and the heavy political and economic toll caused by the Gali refugees left Georgia vulnerable to the Russian crisis.

The Russian Economic Collapse

The Russian economic crisis had an immediate impact on the Georgian economy. Official bilateral trade plummeted, prompting a serious currency shortage as illegal trade bypassed the Georgian banking system. This problem was compounded by the fact that the salaries of Russian troops in Georgia were sent directly from Moscow, causing further drains of the lari in favor of the rapidly shrinking ruble. Georgia experienced one of the driest years of this century and a resulting decrease of 11 percent in agricultural production, a sector that accounts for approximately 20 percent of the nation's GDP.

In September, the IMF suggested that the Georgian National Bank discontinue its currency intervention and adopt free-floating currency. Fearing social unrest, the Georgian government preferred to scale down its intervention gradually, unlike the devaluation of the Russian ruble. While the Georgian National Bank lost U.S.$60 million of its reserves, the government was able to prevent most citizens and business people from losing their savings. By the end of 1998, GDP growth fell to 2.9 percent while the inflation rate had climbed to only 10.4 percent.

By the first quarter of 1999, the Georgian economy was back on track. The lari is fairly stable at an exchange rate of 1 dollar to 2.3 lari, and agricultural production has regained most of its losses. Although the economic crisis nearly destroyed the Georgian economy, there is now increased awareness of the even-more-urgent need for reforms and incentive packages to bring in investment and new technology.

Economic Outlook

The inability to collect revenues due to inadequate tax implementation and trade regulation is still at the heart of Georgian economic difficulties. While the estimated share of the "shadow economy" has dropped from almost 80 percent to nearly 30 percent, it still accounts for a significant portion of the nation's trade. Many imported products that are difficult to monitor, such as wheat, continue to cross the border illegally, further undermining the domestic agricultural sector. This will continue until Georgia tightens its border controls, especially between Russia and South Ossetia.

At the end of March, Georgia adopted its 1999 budget and, with the help of the IMF, also introduced excise taxes on products that can be easily monitored, such as alcohol and cigarettes. These new taxes have already increased revenues significantly, with more than 4 million lari on cigarette taxes alone collected within a few weeks. Georgian officials have also initiated reforms on customs and import-export controls with the help of the World Bank and will soon select a company to tighten border control after July 1. With these reforms and Georgia's expected agricultural growth, Papava predicted GDP growth of no less than 5 percent in 1999, as opposed to the IMF prediction of 2 percent, and an annual inflation rate of less than 10 percent.

Hope in the Transportation Corridor

Recognizing Georgia's location as its main attraction for potential foreign investors, Papava stated that "Georgia's key to economic success lies in its strategic geographical position." The Caspian oil projects have the potential to restore Georgia to its traditional role as a key country on the transportation corridor along the Silk Road. Papava said that the Baku-Supsa early oil pipeline would produce U.S.$8 million annually in transit revenues. Georgia has to avoid becoming overdependent on transit revenues, however, and instead use the pipelines as a catalyst for further trade and transportation deals that might eventually provide it with the infrastructure necessary to attract badly needed foreign investors.