



## IMF Resident Representative Office in Georgia Monthly News Bulletin [www.imfgeorgia.caucasus.net](http://www.imfgeorgia.caucasus.net)

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This special edition of the Monthly News Bulletin summarizes the *Public Information Notice* issued at the request of Georgia, following the conclusion of the Article IV <sup>1</sup> consultation in April 2000. PIN's are intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies.

### Summary Economic Background

Despite five consecutive years of positive output growth, Georgia still faces pressing economic problems. The fiscal position—with significant payment arrears and high indebtedness — is the most immediate concern. Problems of governance and corruption have undermined fiscal stability, and discouraged investment and saving. Economic activity remains significantly below potential while poverty indicators have not shown improvement in recent years.

Internal and external macroeconomic imbalances were brought to the fore by the financial crisis in Russia. Macroeconomic performance faltered in 1998-1999, with growth decelerating to an annual rate of 3 percent. After increasing by 10.6 percent during 1998, prices rose by 10.9 percent in 1999 reflecting in large part the lagged impact on prices of the devaluation of the lari in December 1998. The 12-month rate of inflation declined to virtually zero in April 2000. The current account deficit declined from 17.5 percent of GDP in 1998 to an estimated 14 percent of GDP in 1999, due primarily to the slowdown of construction-related imports following the completion, in early 1999, of the “early oil” pipeline connecting Azerbaijan to the Black Sea. Gross international reserves stood at 1.5 months of imports of goods at

end-1999. Georgia's public debt (internal and external) has risen steadily to about 75 percent of GDP at end-1999.

With little fiscal adjustment relative to 1998, the fiscal stance for 1999 was significantly looser than envisaged in the budget. The overall deficit of the general government on a commitment basis was estimated at 6.7 percent of GDP in 1999, compared to a targeted fiscal deficit of 2.8 percent of GDP and a deficit of 6.5 percent of GDP in 1998. The expected improvement in revenue collections did not materialize; at about 14 percent of GDP, Georgia continues to have one of the lowest tax-to-GDP ratios in the Baltic's, Russia, and other countries of the former Soviet Union. With a further accumulation of expenditure arrears in 1999, the stock of expenditure arrears reached an estimated 4.2 percent of GDP at end-1999.

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

External arrears on debt repayments of principal amounted to US\$113 million at end-1999.

There was further progress in terms of structural reforms in 1999. Prompt action on the part of the National Bank of Georgia helped the banking system weather the Russia crisis. As capital requirements were raised, there was a further consolidation of banks. With the majority of equity in large-scale enterprises still in state hands, there was moderate progress in large-scale privatization. Most notably, Telasi, the electricity distribution company of Tbilisi, was privatized at end-1998. The energy sector is in a weak financial position and continues to face significant difficulties; there are frequent power cuts due to lack of rehabilitation of energy infrastructure. There was progress in the areas of land privatization and judicial reform; however, significant challenges relating to governance and corruption remain.

### **Executive Board Assessment**

Directors observed that, while progress had been made in macroeconomic stabilization and structural reform, the momentum of the reform program had flagged, growth had slowed, and little headway had been made in addressing deep-seated fiscal problems since the end of 1997. Although the external environment had been difficult, the main sources of weakness had been policy slippages. Directors observed that weak governance and widespread corruption had played a major role, and stressed that these problems needed to be addressed urgently. They noted that the economy continued to face large external and internal imbalances that posed a significant threat to macroeconomic stability.

Directors emphasized that a significant strengthening of fiscal policy was crucial for placing the economy on a

sustainable path. In addition to undermining growth prospects, the persistence of a large fiscal deficit has steadily built up a debt overhang which, in the absence of a concerted and coordinated adjustment program, would eventually have adverse consequences for inflation and the exchange rate. Directors noted with concern that interest payments now accounted for one-third of central government revenue. Directors also noted that the failure to pay adequate attention to the equity issues raised by the tax and spending policies of the government had implications for the sustainability of economic reforms.

Against this background, Directors regretted that the 2000 budget fell well short of the required fiscal adjustment and, in particular, that the tax administration and enforcement measures needed to generate a sustainable increase in revenues had not been implemented. Some Directors also expressed regret about the reduction in tax rates on petroleum products, which had more than reversed the increases on fuel excises introduced under the ESAF-supported program.

With the ratio of tax revenue to GDP being one of the lowest in the region, Directors stressed the urgent need to address Georgia's failure to collect adequate tax revenues. Moreover, as the level of tax rates on income, goods, and services was broadly appropriate by international standards, the emphasis should be placed on improved tax administration and collection.

Directors expressed regret that the chronic shortfall in revenue in the face of limited checks on spending had led to further accumulation of expenditure arrears. In welcoming an initiative aimed at establishing an expenditure control system, they emphasized that the key components of a policy to alleviate poverty were the elimination of arrears on wages, pensions,

and social expenditures, and the need to remain current on new outlays. In order to do so, Directors urged the authorities to undertake a comprehensive review of government expenditure with the objective of rationalizing its operations, achieving efficiency gains, and improving targeting.

Directors emphasized the importance of maintaining prudent monetary policy as a key condition for price and exchange rate stability. They noted that the floating exchange rate regime had served Georgia well and remained appropriate, given the low level of gross international reserves and the uncertainty about the competitiveness of the tradable goods sector. Directors welcomed the authorities' steps in strengthening the banking supervision and prudential regulations, including the recent increase in the minimum capital requirement. They stressed that continuing reforms of the banking system remained important.

Directors stressed the importance of pressing ahead with the authorities' agenda for structural reforms. The execution of the outstanding agenda for large-scale infrastructure privatization, including in the telecommunications and energy sectors, and the completion of the overhaul of the legal and regulatory frameworks were viewed as important.

Directors stressed that a bold and front-loaded strategy to tackle corruption and improve governance would be essential not only to improve revenue and expenditure performance, but also to attract the long-term capital needed for restructuring the economy and to bring about sustained high-quality growth. Much still remains to be done to develop the institutional and legal underpinnings of a market economy and provide a reliable framework for improving governance and strengthening the rule of law. Directors urged the authorities to use

their strong political mandate to press ahead with the needed reforms.

Directors welcomed the recent efforts by the authorities to improve basic macroeconomic statistics, including the revisions in the national accounts. At the same time, they urged the authorities to improve the compilation and coverage of the balance of payments as well as the national accounts.

Directors noted that Georgia's external outlook remained difficult and that a combination of a strong adjustment and structural reform program and international financial support would be required to close the large external financing gaps. On the basis of such a program, Directors would support Georgia's request to bilateral creditors for exceptional financing for a new multilateral rescheduling agreement, in which they would encourage Turkmenistan also to take part. Directors noted that the Fund stood ready to assist the authorities in designing an appropriate economic program that could attract the support of the international community, and stressed that such a program would include strengthened fiscal adjustment and strong anti-corruption and governance-improving measures. In view of the sizable slippages in fiscal policy implementation recently, there was a need for Georgia to establish a track record on revenue collection, expenditure management, and governance issues, which would help in establishing the basis for a resumption of Fund financial assistance.

**I. GEORGIA: SELECTED ECONOMIC AND FINANCIAL INDICATORS, 1996-99**

	1996 Actual	1997 Actual	1998 Actual	1999 Estimate
	(Percentage change, unless otherwise indicated)			
<b>A. National income and prices</b>				
GDP at constant prices	10.5	10.8	2.9	3.0
Consumer price index, end-period	13.7	7.3	10.6	10.9
<b>B. Money, credit, and interest rates (end-period)</b>				
Reserve money	36	33	-6	15
Credit to enterprises and households (banking system) 1/	-15	38	38	38
Broad money (including forex deposits)	42	46	-1	21
Velocity, level 2/	14.7	12.1	13.0	12.6
Money multiplier, level	1.23	1.35	1.42	1.44
	(In percent of GDP, unless otherwise indicated)			
<b>C. General government</b>				
Revenue (excluding grants)	12.2	14.5	15.4	14.7
Tax revenue 3/	10.9	13.0	13.4	14.0
Tax revenue (in percent of current expenditure)	55.6	65.9	64.5	67.9
Expenditure and net lending 4/	21.5	21.8	22.9	22.4
Fiscal balance, commitment basis	-7.4	-7.0	-6.5	-6.7
Fiscal balance, cash basis	-7.2	-6.3	-5.1	-4.9
<b>D. External sector</b>				
Trade balance	-11.6	-16.1	-20.0	-18.9
Current account balance				
Excluding official transfers	-13.8	-16.5	-17.5	-14.1
Including official transfers	-9.2	-10.8	-11.3	-7.9
Debt service due (in percent of exports of goods and non-factor services)	9.2	6.0	17.0	21.9
External debt stock (end-period)	44.9	43.6	47.9	62.7
<b>E. Gross international reserves</b>				
In months of imports of goods	2.5	2.0	1.2	...
In millions of US\$	158	173	118	129
Exchange rate, lari per US\$ (end-period)	1.27	1.30	1.79	1.96

Sources: Georgian authorities; and IMF staff estimates.

1/ The sharp fall in 1996, reflects the provision made for non-performing loans from commercial banks portfolio in the context of the bank restructuring program. Inclusive of this adjustment, credit to enterprises and households would have grown by about 30 percent in nominal terms during 1996.

2/ Annual GDP divided by end-period M3.

3/ Includes central government tax revenue and special state funds. The latter include the Pension, Employment, and Road Funds. Privatization proceeds are excluded.

4/ On a commitment basis; cash expenditures differ by the change in expenditure arrears.