



ასოციაცია “მწვანე ალტერნატივა”
Association “Green Alternative”

Decade of Independence

Effects of Economic liberalization in Georgia

country report

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The Association “Green Alternative” is non-governmental organization dedicated to support sustainable development of Georgia, while the rapid globalization process takes place in world. Its mission is to develop and promote economically viable and socially desirable alternatives to protect environment of Georgia, protect biological and cultural heritage.

“Green Alternative” is a part of CEE Bankwatch Network, environmental campaigning organisation. We closely collaborate with various “green” or “grey” organizations worldwide. Association is a member of the NGO network monitoring of “Poverty Reduction and Economic Growth Programme in Georgia”.

Contents

Introduction - page 4.

Chapter I. The Effects of Economic Liberalization - page 5.

Chapter II. Strategy and Vision for Country Development – page 9.

Chapter III. Joining WTO: Who Benefits? – page 10.

Chapter IV. Business Environment Development – page 11.

Chapter V. Shadow Economy and Corruption – page 16.

Chapter VI. Social Effects of Transition – page 18.

Chapter VII. Agriculture – page 22.

Chapter VIII. Power Sector – page 28.

Chapter IX. Environment Protection – page 32.

Chapter X. Recommendations - page 42.

Introduction

Since declaration of Independence¹, Georgia experienced the deep social-economic crisis as a result of collapse of the centralized economic system. However, unlike most other republics the Caucasian Republics faced acute political turmoil's as results of civil war and ethno-conflicts, increasing number of refugees and poverty.

Through the recommendations of IFIs and donor countries it was carried out country transition towards the market economy, elaboration of legislation framework, and various structural changes. All this was added with accelerated process of integration with western countries, that includes ratification and adoption of international agreements by Georgia. Situated between the oil-rich Caspian countries and consumers markets, Georgia has been recognized as a transit route by the International Financial Institutions and International Donor Community. In 1992, Georgia became a member of International Monetary Fund (IMF) and World Bank. Since 1993, those institutions have been developing the loans and strategy documents for Georgia, that has been recognized by the government as the only alternative for further development.

The International Financial Institutions, namely World Bank, IMF, European Bank for Reconstruction and Development and EU Tacis program have allocated loans to Georgia, particularly for the energy, transport, agriculture and environmental sectors. Described by IFIs as "one of the most liberal trade and exchange regimes among transition economies"² Georgia has been strongly encouraged to join the WTO. The government of Georgia began negotiations at the end of 1998 and due to the accelerated process, in April 2000, Georgia officially became the member of the WTO.

The paper aims to evaluate developed reforms, implemented policies and programs of various International Financial Institutions (IFI) in Georgia and the benefits of Georgian population from the rapid integration in global economy systems, especially in fields of agriculture, energy and environment that experienced most significant transformation.

Nowadays, after ten years of transition Georgian population's standards of living remain to be far below, then at the start of transition. There is about 4,5 million people living in Georgia and about 60% are living under the extreme poverty line.

¹ Georgian Parliament declared the Independence in April 1991.

² Georgia: Policy Framework paper 1998-2000, IBRD, Sec M98-614, July 17,98

Chapter I. The Effects of Economic Liberalization

Georgia has started its independent development in the conditions, which seemed relatively favorable at that time. However, in the following years of independence, due to the political changes the Georgian economy fully collapsed. The vacuum of power, civil war and ethnic conflicts played a disastrous role additional to the purely economic effects of the breaking down of the command economy. Before the breaking down of the Soviet Union, Georgia had a well-developed industrial sector. Food processing accounted for about two fifths of industrial activity in 1990, followed by light industries (consumer goods, such as textiles and shoes). Electronics and electric engineering was the new, fast growing sector. Other principal economic activities were production of chemicals, cement, Ferro-alloy, fuel pipes, fertilizers, construction, machinery, together with agriculture, mining, tourism and services.

Agriculture had been the leading activity, in the past highly specialized in citrus fruit, tea, and quality wines, tobacco and flowers fields, in accordance with the Soviet State Central Planning System decisions. In 1990, over one third of net material product was derived from agriculture, much of it in private hands, even before the transition to the market economy. Trade within the USSR played the large role in Georgia's economy, with import and export together amounting the almost half of GDP in 1989-90. Employment was divided fairly even among agriculture, industry (including construction) and services. The proportion of employment in agriculture (about one third of the labor force) was high as far as agricultural activity in Georgia was labor intensive, producing relatively highly priced outputs.

Following the example of the other post-Soviet Republics, Georgia was characterized by over-specialization and largely has been dependent for its industry on other suppliers for energy, raw materials, spares and market. For instance in 1989 were imported 15% of consumed electricity, about 100% fuel and gas, over 80% of timber and almost 90% of raw materials used in light industry. Such kind economy was not able to withstand the Soviet Union break down; Georgia has lost supply as well as production markets.

In addition, the situation was aggravated by physical damage caused by the civil war and ethno-conflicts, corruption, lack of rule of law and order and deteriorating infrastructure, combined with failure of government in appropriate measures implementation.

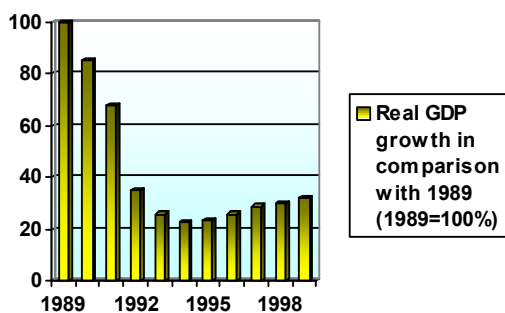
Since mid-1994 the Georgian government has been implementing a bold stabilization and structural reform program in order to halt hyperinflation, address the country's large domestic and external imbalances and put the economy back on a sustainable growth path. The Structural Adjustment Programs, implemented by IMF and World Bank, prescribed recommendations for privatization, liberalization and economic stabilization measures, reorienting investments towards the "modern" agriculture, transport and energy system, strengthening natural resources exports, cutting social spending on health and education, freezing of wages and reducing the number of pensioner.

Prescribed on-going reforms and followed structural programs in 1994-1999 have received quite good remarks from the IFIs for achievements in transition. The financial support of IFIs "have been instrumental for the successful implementation of the economic reforms program. In addition, strong government ownership of the reform program and intense technical assistance from various

International Financial Institutions and donor countries have allowed the government to establish and strengthen basic institutions for economic management. ³.

In the middle of 1998, the IMF reported a success story⁴ on the achievements of reforms in Georgia and adopted Enhanced Structural Adjustment facility (ESAF). The Board of Directors at the same time required the adoption of the same rate of taxes for local and imported products, together with the imposition of taxes on local agrarian production. All this was negatively viewed by society. Experts predicted that these measures would only decrease local production and increase poverty. According to the IMF, the main success was that “In its IMF-supported programs, Georgia has gradually raised revenues from virtually zero, five years ago, to 10% of GDP today.” However, after a few months, the Russian crisis clearly showed that the increase of GDP was not a long-term result of economic reforms.

The GDP was raised on the base of natural resources export, rather than local industry development. Inexperience and corruption in the Government during the rapid privatisation pushed forward by the IMF and World Bank, resulted in the creation of private monopolies in several sectors and increased poverty rate.



After the Russian crisis, Georgia lost 70% of its export market for natural resources, and at the same time imports from Russia were increased. All goods and services became expensive. For compensation of state budget losses and maintenance of strict fiscal policy, the government decided simply do not pay pensions and salaries. Under the ESAP for reducing state costs, reduction of civil servants was implemented several times, the staff of scientific institutions and state enterprises were reduced, rather than

reducing or redefining enlarged governmental structures.

High taxation, non-payment of salaries and public assistance for marginal groups, non-existence of guarantees from the government, unemployment, forced majority of economically active population to migrate from country or be involved in shadow economy.

The existence of shadow economy is positively identified by various International organisations (among them the IMF and World Bank)⁵. According to the opinion of these institutions, the shadow economy plays a vitally important role in the survival of the poor population. Even though the state will not identify the shadow economy due to its own improper economic and political process, the sector would facilitate economic crimes and corruption growth, create obstacles for attracting investments, and finally will have a negative impact on the population and producers. According to official data, 35% of economic activities are informal⁶. The rapid increase of the shadow economy is caused by following factors (1) high rate taxes (2) a clannish system of economy and patronage from the Governmental Senior officials that creates a non-competitive environment (3) Corruption in relevant structures.

The privatisation of public services is designed as one of the main condition for fast economic

³ Georgia—Enhanced Structural Adjustment Facility Policy Framework Paper, 1998-2000, IMF staff report

⁴ “As a result of its International Monetary Fund-supported economic reform program, the country of Georgia is a winner, as Gary S. Becker states in "A free-market winner vs. a Soviet-style loser" (Economic Viewpoint, Aug. 3)” – An IMF Success Story? – Try Georgia Business Week, Aug 13, 1998. John Odling-Smee, director, European II Dept. International Monetary Fund

⁵ Georgia, Joint staff Assessment of the Interim Poverty Reduction Strategy, December 4, 2000

⁶ Georgian department of Statistics

growth and even as a core anti-corruption measure. It was an essential mistake to present privatisation as an anti-corruption measure⁷. According to George Soros, “There is always somebody who pays and international business is generally the main source of corruption”⁸. There is a clear correlation between privatisation and the growth of corruption. The cause of this are inflexibility, hasty deadlines set by the World Bank, the non-transparency of the process, weak regulatory institutions and high corruption among senior governmental officials.

The indirect role of the IFIs in spreading corruption could not be underestimated, refraining in creation of effective mechanisms for own programs monitoring. For instance, for the last five years the corruption issue in the energy sector was the leading subject of various independent researches, widely elucidated by the media. Several times the state prosecutor started criminal cases to investigate the problems in the energy sector. The concerns on mismanagement of funds of IFIs several times has been raised by the NGOs especially in energy sector, however last five years the amount of the credits in the energy sector from MDBs has only increased.

The IFIs not only supported and strengthened the corrupted system indirectly, but at the same time setting up double standards for “creation of favorable atmosphere for important western investors” and designing contradictory conditions in the state policy for initial restriction of local small and medium size development. The main emphasize was shifted for creation of “favorable atmosphere” for Transnational Companies through the tax reduction to prejudice of domestic ones as these latest have to pay all taxes⁹.

Additional problem of the Georgian Economy in the recent years is permanent growth of foreign debt. Foreign debt service, which itself belongs to protected articles, had been hard carriage of years for the poor Georgian Budget. By January 2001 Georgian foreign debt comprised USD 2,039 billion, which is 49,2% of country’s total GDP¹⁰. The foreign debt for each Georgian had been increasing without fail for years. At the end of 1999 it encompassed 425 US\$ per person.

Only, at the end of 2000 Donor community started to speak about failure of the programs, problems in debt servicing, protectionism towards specific business companies and officials’ family representatives. As the main condition for further IMF tranch was preparation and publication of State Anticorruption program¹¹. Surprisingly, at the same time IFIs discovered the misspent credits in various fields. However, only at the beginning of the year 2002 the World Bank decided to cut amount of support to Georgia, based on annual analysis of economic situation in country and governmental performance.

In 2000-2001, GDP of Georgia did not increase at all. Georgia was the only CIS economy to report declining industrial output during the 2001.¹² Domestic production decreased and with the same proportion, the import increased. Industry, Agriculture and transport sectors experienced deep crisis and population, in regions with no circulating bulks of money, lost the working incentive.

According to the UNDP estimation about 60% of population are living under the poverty level and Gini coefficient for money income¹³ is about 37, that could be easily compared with Latin America

⁷ 2.1 Fast and Steady Economic Growth⁷, PRGF Discussion Document, November, 2001

⁸ “Fund management Guru reveals doubts” Financial Times, 8 December 1998

⁹ In 1999 the US based AES corporation starts to lobby Georgian Government to abandon VAT from electricity payments. The IMF representative Mr. Emmanuel van der Mensbroogh agreed with company requirements and says that state should create favorable atmosphere for important western investors. IMF abstained from giving the same recommendations to the state owned Georgian International Oil Company when it asked for tax exemptions. AES Group & World Bank Partnership 2000, www.bankwatch.org

¹⁰ Georgian Economic Trends, 2000 Q3-Q4, Taxis, www.geplac.org

¹¹ The Government make program public only after the IMF pressure, in October 2000

¹² Economic Survey of Europe, 2001 No. 2, Economic Commission for Europe, Geneva

¹³ World Bank, poverty update, July 2001

countries.

Finally, the British Government proposed Georgia as one of the candidates for inclusion in HIPC¹⁴ list, directly before the G-8 summit in Genoa, 2001. Despite the fact that Genoa Summit does not include Georgia in HIPC list the reasons of the proposal still in force.

¹⁴ Highly Indebted Poor Countries

Chapter II. Strategy and Vision for Country Development

After ten years of independence, there is still lack of the vision for country development in Georgia. What Georgia, as a country, would like to achieve in terms of socio-economic development? What are the main priorities for a country's economic development - development of transit capacities of the country, through the various global and regional projects, or development of local industry and agriculture? Those two models are very different and could even be called contradictory from poverty reduction and equity points of views.

The strategy of economic development designed by the Government together with IFIs, EU, USA and other Donor countries make full use of Georgia's geography and rely heavily upon natural resources exploitation that, as they said, will facilitate rapid improvement of the Economy. Considering the Caspian Sea's reserve at least as large as those in the North Sea, Georgia was designed as more appropriate route of vast oil transit. In the bottom of this strategy there are definite political reasons however the government tries to represent it purely as economic one..

Georgia was identified by the European Commission as one of the key countries for Transport Corridor Program for Europe, Caucasus and Central Asia (TRACECA), reconstruction of the Great Silk Road. In the implementation of the program that represents "an ambitious [program] seeking to raise close to USD 1 billion for the upgrading of road and rail connections, port facilities, ferry lines and terminals, etc. an estimated USD 350 million has already been invested"¹⁵. Recently, finished Baku-Supsa pipeline (with EBRD and IFC involvement) was promoted as the country's survival event, "the project of the century", that should bring prosperity for Georgia. Only after its completion, it became publicly known that the annual income of the pipeline would not exceed USD 6-10 million USD. "Georgia at present receives US\$ 0.18 for each barrel of oil transported, quite small in comparison with the usual price of about US\$2 per barrel ... however, for Georgia the political significance of the pipeline is even more important than its economic value, as it has put Georgia on the map as a strategically important location"¹⁶.

Despite, the abovementioned independent researchers admitted "while western oil companies and financiers strut around Tbilisi, this state remains heavily agrarian. Agriculture accounts for a fifth of its production, according to official data, and a 10% jump in agricultural output helped the economy grow 5.2% so far this year [2001]."¹⁷ The Government of Georgia successfully implemented the World Bank and IMF recipes to "roll back" the state in economic and social activities through the liberalization of trade and cost recovery from privatized public services. At the same time Georgia takes political decision for harmonization with the EU legislation. Despite the fact that no single EU model exists, all countries are giving preference to free public services, a state social security safety net, full employment, and sustainable development principles incorporated in all sectors of social-economic development, as it is defined under the Amsterdam treaty.

¹⁵ Energy and Transport in the Black and Caspian Sea regions – barriers and gateways to regional integration, Annual General Meeting, May 2000, EBRD

¹⁶ EBRD Georgia 2000 Country Investment profile

¹⁷ Mixed progress, lurking problems: a roundup of regional GDP results, Alec Appelbaum, 8/28/01; www.eurasianet.org

Chapter III. Joining WTO: Who Benefits?

Under the hard pressure of the IMF Georgia trading regime has become open and free, with just two tariffs levels of 5 and 12 %. Georgia as a country that sees itself as an important transit and trade route, underline essentialness of such openness. Low tariffs greatly helped to accession to the World Trade Organization. The supporters of accession underlined that membership would greatly improve Georgia's access to markets outside the region, increase competition among business and reassure foreign investors. Indeed, the government believes that WTO membership will improve the country's economic fortunes, help improve its industrial and textile sectors.

Georgia became the 137-member country of the WTO at 14 June 2000. It has applied for the WTO membership on 3 July 1996 to start negotiations with the WTO working party on its terms of accessories. Georgia joined the WTO voluntarily, without transitional period available for new members, willingly agreed to adopt all rules, more than WTO compulsory package requirement.

Georgia joined the WTO as a country in transition (only developing countries under the 18 article of GATT have possibility to define high tariffs and quotas). According to the expert's opinion, "during the negotiations between Georgia and WTO, Georgia failed to incorporate the internal protective mechanisms for market and establish supporting regime for national industry development that invisibly will significantly diminished economic sovereignty of the country"¹⁸¹⁹

According to the official sources, the membership of the WTO will make Georgia more attractive for foreign investors, achieve its full trade and transit potential, modern legislation in the spheres of trade in goods and services, strengthen public finance by enlarging the tax base, diversifying foreign economic and financial relations of Georgia.

However, Several Transnational Companies admitted that joining the WTO will be beneficial for the companies that import goods into Georgia, as already existing low custom rates are scheduled to drop even lower. However, even these companies recognize that "if Georgia does not improve its existing agriculture sector, industrial sector, and improve its tourist trade, foreign goods will flood the Georgian market and debilitate domestic product and service industries. From an overall perspective, this [joining the WTO] should not have been the first priority of the Georgian economy."²⁰²¹

The boarders would be open for 96% of worldwide produced goods and commodities (agricultural – 79%, industrial – 99%), 29% of which will be fully tax-exempt. This will deteriorate national industry and agriculture as well as local entrepreneurial activities and even deprive them of any chance for further development. It is fact that Georgia still has no legislative base for implementation of safety measures under the GATT mechanisms. Only article 7 (Law of Georgia on Custom Tariffs and Taxation) generally regulates "specific Custom taxes, that includes (a) special, (b) antidumping and (c) compensation taxes. According to the experts²² opinion, due to the high administrative, research and legal costs, this provision is not enough for enforcement of GATT agreement in Georgia

¹⁸ Report on Georgia entrance into WTO, Budget Office of Georgian Parliament, 2000

²⁰ Government, Business Leaders Disagree on Benefits of WTO Membership to Georgia; WTO Reporter, Tuesday, June 6, 2000. ISSN 1529-4153

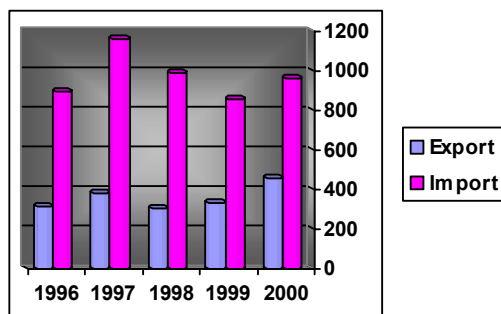
²² Local Industry Protection under the Safety Measures Agreement of WTO, A.Barnevic, "Georgian Legal Review" v3; 1999, Georgian-European Consultation Center, Taxis

Export –Import

Georgia has trade deficit since transition period. However, the figures of registered trade probably differ from the real picture.

According the US ITC Trade Database Georgia's exports to the USA amounted to USD 24 million (compares with USD 6.4 million registered by SDS), and Georgia's imports from USA amounted to

USD 106.1 million (compare with USD 70.9 million) in 1999. The same picture can be observed in the case of the Georgia's trade with Turkey, Russia, Germany, Armenia and Azerbaijan main partner countries. These countries together represented about 50 per cent of Georgia's registered trade turnover. A lot of the exports to the partner countries are not registered in Georgian statistics. The share of the ten main trade partners in the total registered trade turnover remains unchanged and equal to 74.3 per cent. The neighboring countries of Turkey, Russia, Azerbaijan, and Armenia still remain the main markets for Georgia's exports. However, there is growth of exports to EU countries. In that respect, Germany is one of the largest importers of Georgian products. In structure of Georgia export leading is scarp metals, Ferrous scrap and ferroalloys, Precious metal ores and concentrates, copper ores and concentrates, Copper waste and scrap, Petroleum oils and oils from bituminous minerals, Aluminum waste and scrap-7602- about 70%, Agricultural products-wine and nuts, and mineral products – about 30%. In 2000 the new item as aircrafts export has been included in this list (about 5%). In import structure leading role has oil and natural gas, (about 20%), as well as medicine, electricity, Tobaccos, cars, machinery, wheat flour, vegetable oil and others.



Chapter IV. Business Environment Development

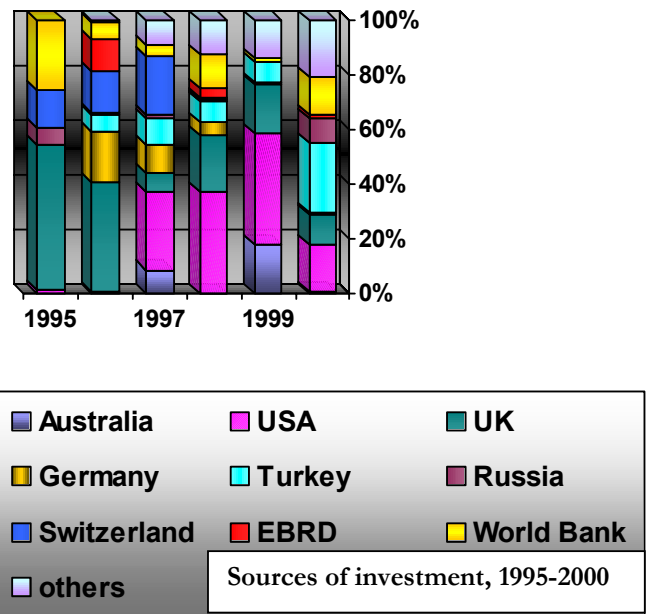
Legislation, Taxation Policy and Local Industry

As one of the achievements of Structural Adjustment Programs is usually named creation of legal framework for private sector development. Together with sectoral codes and law on taxation, Custom Codes, law on Custom tariffs, on Commercial Banks, on manufacturer, on investment, Civic Code etc. were elaborated with direct involvement and participation of IMF and World Bank. At a glance, these laws are corresponding international standards and it was highly evaluated by the foreign experts. However, according to the local business representatives, due to the high taxes these laws and Codes create obstacles for development of small and medium size business. However, at the same time the foreign experts do not share the aforementioned point of view²³. The permanent decline in tax collection was explained by low enforcement of law, rather than ability of local business to pay taxes²⁴.

High taxation benefits only corrupted governmental officials, which have adopted the laws that are essentially known as impossible to implement. Since 1995 the percentage indicator of tax collection is lowered, however, for Ministry of Finance and its “consultants” seems that it is much easier to keep tax collection at the same level and destroy the whole state budget, than create favorable taxation system for local businessmen and ordinary people. At the same time, often Transnational or large Georgian²⁵ Companies are getting taxation holidays or tax restructuring upon request ²⁶ (e.g. AES Telasi).

According to the World Bank Survey, one-third of the private businesses in Georgia in the summer of 1999 felt hampered by the mishandling of fund within the Central Bank and by what they felt was the purchase of legislation from parliament. About 24 percent of the Georgia's business community said presidential decrees were influenced by elite private interests²⁷.

In the year 2000, about 46 thousand of totally registered 76 000 companies did not function and it was forecasted that more 10-15thousand will join them²⁸. According to the official statistic, 15 divisions of national industry do not operate and there is no plan to revive them in the nearest future. Because of the tax burden, inequity in business and expanded smuggled goods, legal small and medium size business has become non-profitable. Together with inefficient tax system and widespread smuggling the ratio of shadow



²³ UNDP Human Development report 1998, chapter 2. www.undp.org/ge

²⁴ In January 2002 the new Tax Code development process starts.

²⁵ Mainly running by relatives of Georgian President

²⁶ President decree N390, 2001, 27 September is one clear examples of this kind attitude.(The tax debt was restructuring for Georgian-american Oil refinery “GAOR”, Telecommunication company “Megacom” and others.

²⁷ World: World Bank Reports On Corruption, Names Worst Offenders, By Ron Synovitz Prague, 27 September 2000 (RFE/RL)

²⁸ What’s going on? or considering how did we live in 2000 and will do in 2001, Journal of Macro-Micro Economics, 2001

economy is increasing. Experts consider that ratio of shadow economy to the legal one became 3/2 in 2000, while in 1999 it was 2/3.

Foreign Direct Investments

Georgia still lacks Foreign Direct Investments to develop economy of the country. Existing political and economical instability in whole Caucasus region, particularly in Georgia, is one of the main but not only decisive force for low FDI in the country.

The Georgian Government failed in attracting of the Foreign Direct Investment in Georgian Economy. The cumulative net foreign direct investment from 1994 to end of 2000 is about 700 million. This level is very low in light of Georgia's economic potential, as well in comparison with other transition countries. In 1999 on per capita basis, FDI in Georgia was about USD 20, compared to USD 91 in Azerbaijan and USD 28 in Armenia. The amount of FDI inflow as a share of GDP in Georgia was about 3,7 per cent (17,5% in Azerbaijan and 5,4 % of GDP in Armenia).

The weak rule of law and problems with enforcement of investment regulations is one of the main obstacles. Despite the fact that legislation on investment has evolved rapidly since 1995 and conforming to internationally accepted norms and principles to create favorable conditions for foreigners. The enforcement of the legislation is hampered by ambiguity of legal texts, imprecise and contradicting definitions of terms and drafting. "The other, and one of the most damaging elements is the tax system, in which instability, a heavy burden, and arbitrary enforcement are major deterrent to foreign investors. Moreover, the need to stepped up efforts in dealing with crime, corruption, lack of security of property and persons and enforcement of contracts. Even when appropriate legislation exists, the courts are unable to enforce procedures and outcomes. It is important to strength the legal/judicial framework to allow for credible property and adequate contract enforcement."²⁹

Despite the abovementioned, according to the western experts' opinion "Georgia nevertheless benefits from a favorable geopolitical position between the oil and gas rich Caspian sea and Europe, which may have made foreign critique against corruption milder than would otherwise been the case"³⁰. This is clearly case as the principal sectors for foreign direct investments have included oil and gas exploration, electricity power distribution and activities connected with TRACECA development. About 150 million USD has been invested in Oil&Gas exploration. Drastic increase of FDI in 1997-1998 was connected with construction of Baku-Supsa pipeline.

However, the confidence of foreign investors also depends on the attitude of multilateral lenders such as the IMF and World Bank. In Georgia main investments are made by US, UK and Australian Companies backed through MDBs private lending arms (IFC, EBRD) in abovementioned sectors of economy.

The small amount of medium size investments and cheap prices for imported products creates unfriendly environment for local Business development. In addition the weak control on borders of Georgia creates lots of opportunities for smuggling.

²⁹ Determinants of Foreign Direct Investment in Georgia, Jacek Cukrowski , Giorgi Kavelashvili, Center for Social and Economic Research www.case.org

³⁰ Fighting corruption in Georgia - The need for a long term and comprehensive perspective, Dr. Daniel Linotle and Gianluca Ra.pole, 25 April 2001, Central Asia & Caucasus Analyst, www.cacianalyst.org

FDI flow in Georgia by Sectors (%)³¹

Fields	1995	1996	1997	1998	1999
oil exploration	70,4	24,5	19,05	0,5	3,96
Food processing	5,9	3,7	2,4	5,2	6,64
Power distribution	-	17,0	5,6	22,7	-
Non-ferrous metallurgy	-	-	5,0	0,01	13,35
Chemical Industry	-	1,2	3,6	0,01	-
Engineering industry	-	3,1	-	-	-
Glass manufacturing	-	-	-	0,8	-
Building sector	14,6	9	3,4	0,05	-
Telecommunication	0,8	16,9	14,4	-	3,19
Trade	0,07	3	2,6	1,4	0,19
Transport	-	18,5	39,6	64,8	66,15
Household sector	-	1,7	2,4	0,7	-
Others	-	0,5	1,1	2,1	6,52
Total	100	100	100	100	100

*Privatization*³²

Privatization is one of the key elements of donors and IFIs lending and policy advice to transition. The privatization itself is not good or bad target, it is just a tool to achieve increased incomes that will bring benefit to all stakeholders.

However, what happens in Georgia could not be evaluated as the positive changes and should be recognized that the number of privatized enterprises is not a good indicator enough to evaluate process positively.

The original idea of the first stage of privatization was wide participation of population in privatization of medium- and large- sized enterprises through special voucher auctions. However, due to the weak control of the process by the state all ordinary holders of vouchers have been defrauding. As a result, the Georgian population undergoes the privatization process without any benefit.

The second stage of privatization process, aimed auctions, was artificially speeded up by the IFIs. In result, almost 100% of already implemented privatizations were carried out with rough violations of the law (for example, direct purchases, only candidate that always satisfy tender commission). As a result of improper privatization, the most of the privatized enterprises especially in industry sector has been either totally destroyed, or working with limited capacities.

According to the official statistics about 80% of state owned objects in different sectors are already privatized. The highest figures are in social sphere –(98%) and industry –(96%). In other sectors, this figure is about 85%; exception is energy sector - 8%.

³¹ State Department of statistics, 2000

³² Land privatizations are fully discussed in Agriculture section. Hereby we will touch privatization of public services and industry.

The privatization neither brings revenues for state budget, nor create conditions for future development of business. In 1999, when 50 medium and large enterprises has been privatized revenue encountered USD 25 million, that was explained by the IFIs as the “lack of attractive investment opportunities, companies high debts and poor state of equipment³³” As a result of rapid and improper state privatisation policy it have not brought new jobs, legal conditions for development, and growth of privatised objects .

Privatization of Public services

There is only one point where all stakeholders agreed: there is a need for reforms in public services, especially in energy and water sectors. However, the World Bank and IMF prescribed solution, increased consumer fees and privatization, responds more to concerns about fiscal deficits and foreign debt than to citizens’ need to energy security and access to safe water.

“Evidence that public utilities privatisation or liberalisation helps the poor or the environment is virtually non-existent. At best, the available studies don't cover a very long time period, thus making claims of benefits very tenuous”.³⁴ The privatisation of power sector in Georgia is best illustration of above-mentioned (See chapter Power Sector).

Nowadays, it is planned to privatise public water system. However, till now, the analysis of impact of this activity does not exist. At the same time, in the PRSP discussion materials³⁵ the public water system privatisation is identified as one of the key issues and there is the hopes that public water privatisation schemes won’t hurt the poor and will have a positive indirect impact on the population. However, the hopes are not a substitute for affirmative programs to bring public services to the poor and for affirmatively taking into account the needs of the poor. There is quite big threat that situation will replicate the non-transparent process of privatisation in the energy sector, that results the switching off vitally important objects as hospitals and health care centres, boarding schools and retirement houses.

³³ EBRD Investment profile 2001

³⁴ Friends of the Earth International, Checklist for Privatization

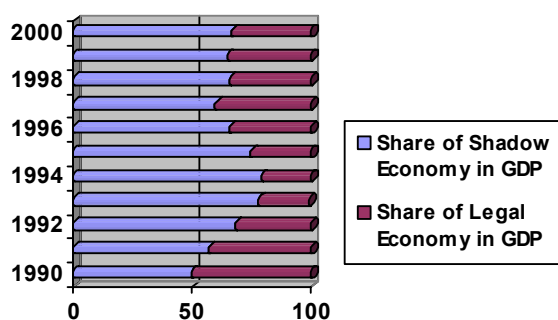
³⁵ PRSP discussion materials, November 2001

Chapter V. Shadow Economy and Corruption

According to the World Bank, the scales of the shadow economy in newly independent states accounts for 70% of their gross domestic products. According to the Georgian Department of Statistics this figure is about 35% of GDP and trend is growing, however according to the experts opinion it contributes to approximately 70-80% of real GDP. The considerable share of the Georgian economically active population is involved in the “shadow” economy.

The shadow economy itself may be criminal or non-criminal³⁶. Even the high level increase of non-criminal shadow economy represents negative phenomenon of the national economy, which adversely affects the security of the state³⁷. Among those negative consequences are: permanent shortfall of the budget revenues, increase of crime and corruption, structural deformation of the economy is on the upsurge, the nation is degraded morally and physically. Of course there are

positive sides of the shadow economy recognized by experts and IFIs, such as reducing the unemployment rate, meeting of consumer needs on services and goods.



However, we should underline the one of the highest threats of shadow economy that is usually missed in those reports. Shadow economy, especially in areas of natural resources exploitation and industry are highly damaging. The deviation of the standards that usually is recognized as exceptional flexibility and efficiency of shadow economy represents the most significant threat for

nature and environment.

In Georgia, there is no practice widely accepted by various developed and developing countries where governments try to stimulate the self-employment and countries pursue economic policy conducive to the rise of their income.

However, in Georgia small business, mainly represented with self-employees or family business, have no guarantees and they are running on their own risk. Additionally, high taxes forced almost all-small business hide their incomes. This kind of household economies are quite flexible to the structural reforms, give impetus to its progress, increase number of jobs and reduce unemployment. There is a wide range of the self-employed, mainly in retail business and social services.

Instead of speaking on methods how to legalize this small business often anticorruption measures directly try to affect those peoples.

At the same time, illegal economy of higher level is flourished. According to the World Bank, figures show that the frequency of corruption is lower in Georgia than in other transition economies, although severity of corruption – i.e. the relative importance of bribes – is much greater in Georgia

“It is commonly recognized that major business groups have close ties to the Government and the ruling party, and promote their interests through these ties. Several close relatives of president

³⁶ General methodological guidelines for the statistical study of hidden economy, Tbilisi, 1997.

³⁷ Shadow Economy in Georgia, Corruption Research Centre, Tbilisi, 1999

Shevardnadze run successful businesses and are widely believed to enjoy unfair advantages over their competitors.³⁸ "Fictitious economy"³⁹ is a driving force of corruption and promotes illegal distribution of the national wealth in favor of various clans.

Corruption was widely inherited in Georgia from Soviet Union and several services have been deeply corrupted. Nowadays, these services has been commercialized, official fees have replaced bribes. At the same time, the additional bribes are still often extorted. Extremely low salaries in the public service encourage corrupt activity. In 2000, a government minister's salary was 165 *lari* (about US\$85). However, due to the fiscal crisis of 1998-2000, even those salaries had not been paid for months. Many government agencies have so-called extra-budget incomes from their activities. The failure to account such income is a problem of public finance management. For years the Ministry of Interior reported that payment of salaries has delayed for an eight-nine months, at the same time purchasing expensive cars from special accounts.

Till there are almost no cases of high-level corruption prosecution. In the worst cases after the long-term campaigns from the side of the NGOs, the most corrupted official has been dismissed, either by political motivations. E.g. The Minister of Communications, was forced to resign in 1998 under severe criticism from NGOs and parliament from his position to create a network of companies owned by him, his family, and his associate to dominant the communications business in Georgia. A criminal case against him, however, was only filed in late 1999, when prior to elections he openly challenged the government as a parliamentary candidate from the opposition party.

Since 1996, there were permanent accusations and reports on mismanagement of public funds in Energy Sector of Georgia. Several times Prosecutor office has been required from various state agencies to start criminal case. However, only in year 2000 several former high-ranking officials of the Ministry of Energy were arrested and charged with embezzlement of public funds.

³⁸ Nations in Transition, Georgia report 2000, Freedom House, www.fredomhouse.org.

³⁹ Inefficient management and squandering of property, various writings, discrepancies in the account, unconformity with standards

Chapter VI. Social Effects of Transition

At the beginning of the transition process, the Georgian population faced high and steep inflation, rapid increase of revenue inequity and crime. However, the people believed that all of these are inescapable challenges of transition towards market-led economy.

After the passed years, even hope that the state will survive does not exist. It should not be surprising. Inclination of production and deepening of social crisis still continue, main reason of that is the fact that demolish of administrative system swallowed the process of market formation. Enrichment of bureaucratic layer transforms into the enlargement of semi-criminal elements and Mafia. More and more people are raising the question of how and why their children must repay the environmental and economic deficit that government together with its “consultants” are instigating.

Poverty

During the mid 90s, the Georgian Economy continued to breakdown. While only two percent of the population had lived in poverty even at the end of the dismal soviet period, “reform” saw poverty rates to almost 60 %, by official statistics. In addition, standards of living in year 2000, after the 10 years of reform remain to be far below then they used to be in the beginning of the transition. The Gini index of incomes distribution reached 0,61 in Georgia⁴⁰, which can be compared with the indexes of the countries with extremely unequal distribution as Honduras and Brasil. Inequality of incomes promotes spreading of poverty and migration.

According to the official statistics “More than 2,5 million citizens of Georgia consume less than 2 USD per day” (PRSP interim document). According to the World Bank, absolute poverty index is one USD per day, but poverty is also relative measure and depends on expectations and access to the other facilities. For Eastern Europe and former Soviet Union World Bank has used a level of four USD per day. According to PRSP Intermediary Document “By the end of the first half of 2000, in various sectors of economy the average monthly salary constituted 72 GEL, which is just 64.2% of the minimum wage for a man with the working capacity. It should also be noted, that during the past several years the minimum salary has a tendency to increase, whereas the actual average salary remains unchanged”. The subsistence minimum in Georgia is designed as 102 GEL (51 USD), in 1999-2000 there were many efforts to reduce the subsistence minimum to 54 GEL, to decrease the amount of poor. According to the UNDP, Human Development Report 1998, “for an average consumer the poverty line according to the subsistence minimum is thus approximately USD 2.35 per day. The other two poverty lines (60% of national median consumption and 40% of national median consumption) are of course relative measures and useful more for identifying the poorest members of society that judging the extent of poverty in Georgia. They work out at about GEL 70 and 46 for 1997, the latter verging on absolute poverty even by African Standards “. It seems that situation in last three years became increasingly worse, despite the undertaken measures.

According to the official statistics, the number of families living under the poverty line is 74%, including 6.4% that existed without any regular incomes and are surviving due to the begging. The richest part of society with incomes more than 1000 GEL is about 1.5%. Middle incomes (from 300-to 1000) – 24,5%.

Unemployment

According to the official statistics, unemployment rate is 16,8%, but independent research shows that it reach 25,6%. However, it still does not replicate reality. About 55% of population represents

⁴⁰ UNDP 1998 report

self-employs (78% are people granted by the State with less than one ha of land). The part of unemployed persons do not pass registration, as the public assistance is very low and there is no opportunity to be employed.

However, from 912 000 employed in agrarian sector 98% are self-employees. The decline in output from the agrarian sector clarifies that the biggest part of agrarian self-employs still represent unemployed people, because they could not afford to purchase fuel or equipment for their activities.

The urban poverty raised significantly. The biggest rate of unemployment is in capital city (30% of economically active population) that survived through the pedlary and retail trade with cigarettes, second hand clothes, etc.

Actually, the average salaries in state and commercial sector are not enough for satisfaction of minimal consumption. The minimal consumption basket is characterized with growth tendency, while the real salaries do not increase.

Pensions

From the human development point of view , one of the most worrying aspects of expenditure problem is the effect on the social safety net. State old age pensions are now practically the only operating form of social insurance in Georgia, and where they are paid, they fall far below any minimum subsistence level. Standard pensions now stand at GEL 13 per month, of which GEL 1.8 is transferred directly to Sakenergo for electricity payment. Slightly over 50,000 war veterans receive a marginally more realistic GEL 35 to 45. Dependency rates are unfeasibly high. There are over 900,000 state pension recipients, and as stated in Chapter 5, only about 750,000 people in conventional salaried employment, of which about 600,000 are in the state sector. A negligible proportion of the self-employed, and very few of the private sector employed, pay contributions. In the absence of individual pension accounts, or any link between contributions and benefits, there is very little incentive to report true wage levels.

At the same time the pensions arrears continue to grow. At the end of 1998 the officially declared arrears equaled USD 25,15 million, in 1999 it increased by USD 12,3 million. The whole amount on social assistance arrears totaled about USD 123,15 million to year 2000. While, the sums for the year 2001 is unknown yet, the situation has not been improved, taking into account the amount of strikes organized by pensioners.

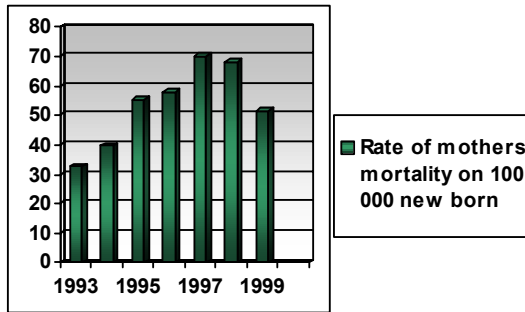
Health System

The critical changes have been developed in social security policies. The main aims of World Bank health project was to 1) reorient the health system towards cost-effective public health interventions like preventive and primary health care, assuring, in particular, better quality care for women and children, and focusing the Ministry of Health's (MOH) activities on regulation of public and private providers; 2) rehabilitate selected facilities and equipment that were down-sized and dedicated to cost-effective provision of maternal, perinatal and pediatric care; 3) develop human resources to support health reform, through continuing education for public health doctors, family practitioners, nurses, health administrators, and other personnel; and 4) support the development of an independent health fund with regional branches, in order to finance a package of basic clinical services in a cost-effective and equitable manner⁴¹.

⁴¹ Health project, Georgia, ECA region, P008414, project cost 19,7 million SDR

However, the reality today is totally opposite. Reforms itself and their implementation significantly reduced the access to the healthcare for vulnerable groups and increase corruption in this sector⁴². According to the experts opinion the real national spending on health care totaled 406.6 million GEL in 1997, of which 87 percent represented out-of-pocket payments and it was forecasted that by the year 2000 these expenses will reach 550.3 million GEL, with out-of-pocket expenditures representing a significant 90 percent. Analysts estimate that 70 percent of this amount does not enter the formal economy.

There are about 35 state health programs that are adopted in state budget. However, it is a tradition that deficit is more than half. e.g. 1999 the deficit was about 58% , that negatively impacted on the state guaranteed healthcare for population.

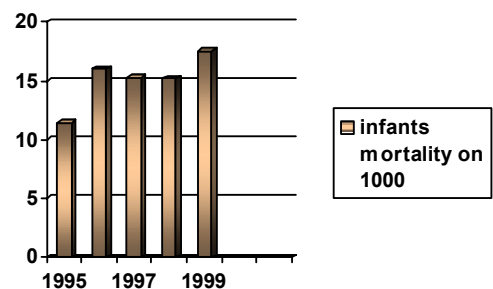


The State Medical Insurance company (established under the bank project), due to the lack of financing and weak management roughly violate the terms and the conditions of payments from one side, from another the funds for particular disease are restricted and do not satisfy all needs⁴³. All of this also creates good ground for corruption.

Despite the privatization and significantly increased tariffs on healthcare service, the salaries for medicinal personal do not increase. In this conditions the personal has been forced to be more involved in shadow economy, prefer to be paid directly that is actually often cheaper than official payments.

As a result of implemented program and reforms nowadays for 30% of population, healthcare service is already inaccessible. Generally, 75% of Georgian families monthly are spending less than 10 GEL (5 USD). Additionally, according to the Ministry of Health poor population spends 20-30% more for healthcare and medicine, than wealthy part. The high risk poor group is the non-economically active population (pensioners, invalids, children) that constitute 40% of population, that is primary focus group for diseases caused by hunger and non-adequate food ration.

The most negative consequence of worsened medical treatment quality is increased rate of mortality of infants and mothers. What is dramatic, is the degree to which public hospitals contribute to overall infant mortality (about 84%). According to the experts opinion the main reasons for this is the appalling state of hospitals, lack of medicinal supplies, other equipment, and poor hygiene and the professional services provided.



⁴² "A Study of Georgian Health Care Financing: Impacts of Alternative Options," prepared by the Actuarial Research Group on October 26, 1998

⁴³ For instance, only about 2 million GEL were allocated for treating oncological diseases in a country where a surgical operation plus the three obligatory cycles of chemotherapy treatment and the four obligatory screenings per year cost 2,500-3,000 GEL per patient. Given these rates, the SMIC can only cover the medical expenses of about 670 patients. Demand is at least three times greater than this. UNDP 2000 annual report, chapter 3, www.undp.org.ge

Chapter VII. Agriculture

The Georgian economy was traditionally based on agriculture. During the Soviet Union times Agricultural policy was artificially reoriented toward the monopoly culture domination. Georgia was identified as a main source of vegetables, tea, wine and citrus for the Former Soviet Union (FSU). These crops were cultivated on state-controlled collective farms using industrial farming techniques and then exported to other areas of the FSU. Prior to its independence in 1991, Georgia enjoyed a comparatively high standard of living due to its favorable geographic location and also through its unique specialization as supplier of agricultural commodities not available elsewhere in the Soviet Union.

Following the independence in 1991, Georgia's market links with other NIS Countries have declined sharply. It has left the country with an agricultural specialization and products that currently has no market. As a result by 1994 production of all major horticultural products had fallen by 60% comparing the 1980s . This is a continuing phenomenon, with the secondary effect that crop-processing factories have also had to close due to lack of identified markets for finished products. As could be expected, this change has negatively affected the income and purchasing ability of much of Georgia's population.

Due to the above mentioned reasons, the share of agriculture in the gross domestic product (GDP) has decreased from 33.6% in 1996 to 21.5% in 2000. However, today agriculture still holds the main share in the country's GDP, followed by the industry (13.3%), trade (11.8%) and transport 11.5%).¹

Private agriculture is now the most important source of livelihood in Georgia. It seems that, with far less resources and land, but rather greater motivation, small private farms have proved that they could be as productive as the former state farms. The small farmers with their broad range of production of different crops in their gardens and fields contribute good quality food supply. Many farmers prefer to be involved in their traditional activities, such as cultivation of land for agricultural production, and livestock breeding.

Traditional agriculture activities which are vital for the rural household livelihood security, such as production of corn, beans, and soya, as well as livestock breeding should be promoted and encouraged. These are the products/activities which are well adapted to the existing climatic conditions, and which have always been important for the well being of local farmers. With the collapse of the former economic system, and with the loss of other household incomes (salaries, pensions, etc), these products became the major source of cash and non-cash income for local population. Moreover, these products grow well with the limited usage of mineral and chemical fertilizers, which positively affects the local environmental security. Despite of the poverty and social problems traditions of farming with proper cultivation practices were not fully lost.

Despite the huge donor assistance, that mainly promotes and supports large producers, mismanagement and corruption in distribution of grants and credits resulted that farmers continue to face many obstacles, and still require assistance to access modern technologies, experiencing difficulty with transportation and delivery of products to market.

State Policy

The State identified and declared following priorities for development of agricultural sector:

- Improvement of provision of market by local agricultural products.

¹ "State Department of Statistics of Georgia. Georgian Agriculture, Statistical Abstract, Tbilisi, 2000"

- Facilitation of reforms in agricultural sector to satisfy market economy requirements.
- Provision of food supplies through the import of cereals and establishment of profitable enterprises in agricultural sector.
- Increase export potential in agrarian sector to ensure export- import balance.

To achieve above mentioned goals the great importance was given to the credits and technical assistance of International Financial Institutions and donor organizations as WB, EBRD, EU, Tacis, KNOW HOW Fund, FAO and USAID that were focused on sector potential research, structural and institutional reforms and creation of favorable investment environment.

In practice, instead of promotion and support of local industry development Governmental structures are giving emphasize to seed import. The most part of subsidies and credits still design import of food and seed products. It should be also underlined that the criteria for seeds selection does not include requirement for safety assessments with respect to human health and local agro biodiversity.

Agriculture Sectoral Policy and Structural Adjustment Programme

With financial support of the International Monetary Fund (IMF), the World Bank, the European Union (EU) and other bilateral donors and creditors, since mid-1994 the Georgian government has been implementing a bold stabilization and structural reform program in order to halt hyperinflation, address the country's large domestic and external imbalances and put the economy back on a sustainable growth path. The policy included on the one hand forced liberalization, and on the other, the conversion of domestic agricultural production for exports.

Program for the period 1997-1999 has been designed in collaboration with the staffs of the IMF and the World Bank. The sectoral policy for agriculture development identified following priorities⁴⁴:

- To complete the privatization program of agricultural land, develop a modern land registration and land cadastre system, and promote the establishment of rural credit union cooperatives.
- To implement the land titling and registration project for Land market development.
- The Government intends to promote the establishment of small credit unions (CUs), with a view to improving the provision of credit to individual farmers.

Land privatization and land ownership

One of the most important steps in the transition from centrally planned to market economy was the establishment of private ownership of land. If during Soviet times land was common public wealth, after gaining the independence following the first phase of the land reform the land was transferred to the natural and legal persons into private ownership.

During the 1992 a large share of land was spontaneously privatized by the allocation of user rights to existing occupiers. However, formal title to the land remained under the state. This partial privatization caused some problems in agricultural sector. Because private land users did not have the formal title to the land they use, they could not offer the land as collateral for loans and this worked as a disincentive to invest in agricultural development.

In 1996 The Law on the Property Rights on Agricultural Land and the Law on Land Registration were approved by the Parliament, liberalizing the land usage regulations. Adoption of the laws has served as the beginning of the second phase of land reform. Agricultural land plots were transferred

⁴⁴ GEORGIA, Enhanced Structural Adjustment Facility Policy Framework Paper, 1997-1999, Prepared by the Georgian authorities in collaboration with the staffs of the International Monetary Fund and the World Bank, February 24, 1997

into ownership not only to the rural population but also to the city dwellers. The land has become the subject of private ownership, leasing, selling, buying, and mortgage, i.e. fundamentals for the land market has been established.

Since that time almost 25.2 per cent of the total resources have been passed on to individuals and households free of charge⁴⁵. However, the plots are mainly too small and the density of rural population is too high.

One of the most important obstacles is the fact that great majority of land users is not able to pay for land title, which is according to the legislation, prerequisite for initial registration of land property right. To solve this problem, the IDA is financing works connected to the land titling and initial registration. In addition, the return of full ownership rights requires through scrutiny of old land records and as a result the process is slow.

The last land cadastral surveying was conducted in 1980s in Georgia. Having right information on land especially after spontaneous privatization is especially important nowadays. Failure to identify existing patterns and rights of ownership leads to delays or even failure in physical planning of the country, since it involves measures that create new subdivisions of the land and new patterns of land use. Land cadastre data is also very important in taxing the land. Today, land cadastral surveying mostly is financed by the international financial institutions⁴⁶.

In general it could be said that land reform in Georgia is moving forward on a piecemeal basis, passing and approving series of laws, decrees, strategies, programs, etc. that cover only certain aspects of land relationships and includes many contradictions. Although the most important shortcoming of the currently existing policy framework regulating land relationships is the fact that relative rules allocating jurisdiction over land issues between national, municipal and local authorities are still not defined. Lack of clarity over this jurisdictional issue lessens tenure security and impedes land market development as well as land resource management when contradictions or uncertainties exist in the legal framework.

Credit Unions

The weakness of the state and private banking systems combined with limited knowledge on the small and medium enterprises' role for economic development and employment creation in general have led to limited emphasis on development of financial services for small and micro enterprises, and farmers. The establishment of credit unions have been designed for development of non-banking financial services targeted at small farmers. A main idea has been creation of trust in the Credit Union (CU) system amongst families who lost their lifetime savings in collapsing banks and through hyperinflation.

The majority of the farmers is interested in obtaining credit and usually put lack of access to finance as the most serious constraint on improving their production. However there are number of obstacles to this, including: lack of collateral, limited knowledge on the credit/loan application process and requirements, low duration of the existing credit lines, and high interest rates.

The existing credit system is not appropriate for the development of agriculture; for instance, banks do not accept private houses and landholdings, as collateral, and the majority of the villagers, who do not possess gold or jewelry, practically cannot obtain credit. Furthermore, one-year term credit with high interest rates (18% the lowest) is unjustified in agriculture. Such situation created favorable

⁴⁵ 433 900 hectares of arable land, 182 300 under perennials and 126 500 meadows and pastures

⁴⁶ Cadastral works and establishment of registration system in Gori district is financed by the UNDP (partially by the Georgian Government); KfW granted the credit for conducting the same activities almost in every district of Georgia; with technical assistance of GTZ cadastral and registration works were conducted in capital city, Tbilisi.

conditions for monopolization in agrarian sector, as the credits are available for already developed and large enterprises.

Equitable access to credit is particularly critical for farmers. It can allow the poor to invest more in education and make their enterprises more viable by allowing them to enlarge their scale of production and avoid shortsighted strategies.

Overall, the formal financial sector needs a major revamping to meet changing needs. This includes training staff, reassessing collateral issues, providing better service and cheaper credits for longer terms. In addition, transparency and accessibility are needed, and trustworthiness is essential for banks to function.

Market Liberalization and WTO

The markets for agricultural outputs and inputs have been fully liberalized in Georgia. Households presently sell less than half of their agricultural products as it is also used to support extended family members and as barter payments for goods and services. Farmers presently sell to traders in the village, in local markets or in urban markets. Due to the low purchasing power, local markets are inconstant. Products sold in more distant urban markets result in low revenues due to the high marketing costs of selling small quantities on an individual basis absorb a high share of sales revenue.

Another problem in agricultural production is the competition with foreign producers, who import products at low prices and thus produce the profit margin of local farmers, whose low productive efficiency puts them in at an initial disadvantage, decreasing the incentives for work. Government has been slow in introducing protective measures, which would give some time for restructuring of the local agricultural production, and makes it more competitive.

Before the Georgia's accession to the WTO the average checked tariff on agricultural products imports was 12 %; with introducing the system of combined tariff it was grown to 16,5%, and after the transition period (5 years after accession to the WTO) will reduce to 15,6%. The increase of the average checked tariff on agricultural products is not so significant, and on some goods, which are actively produced by local farmers and are the main source to earn their living, the tariff is very low. For instance, the combined import tariff on cucumber is 14 %, that is the traditional and widespread product in Georgia. The same could be said regarding crops –12%, and dairy products 5-12%; actually imposing so low tariffs for agrarian products creates stimuli to import in Georgia the cheap, pesticides grown agrarian products from Turkey.

Taxation Issues

According to the PREGF⁴⁷ Program of Georgia, as the necessary step for development of agriculture sector development identified –“The optimization of existed taxation regime, their simplification and the support of encouraged conditions for business maintenance should be held in accordance with obligations taken by Georgia in WTO”⁴⁸. In practice it means - “In order to establish the favorable taxation regime for small enterprises, it is necessary to simplify the registration process of companies and to reduce the registration fees.” There is no talking about reduction of any taxes in agriculture or agro-business sector, which are more discouraging than stimulative for agricultural production.

⁴⁷ Poverty Reduction and Economic Growth Facility

⁴⁸ Under the commitment taken by Georgian government with accession to the WTO the taxation system should be provide to the imported agrarian production not less favorable conditions then to the local production. Additionally subsidizing of agriculture sector is also restricted.

One of the most acute problem for farmers producing agricultural production is high tax (VAT - 20 % of dutiable turnover) which, they are obliged to pay if the total amount of revenue from dutiable operations exceeds 20 000 GEL⁴⁹. 20 % VAT discourages the farmers from getting more land, or leads to another trend – in order not to have an obligation of paying the income tax the whole area is divided between different crops so that the total gain from any single crop does not exceed 20 000 GEL and thus to be free from the extra tax.

The population in rural areas is so poor that they have little purchasing power. They thus do not constitute an important market for domestic industry. This in its turn means that domestic markets are too small to stimulate more economic activity, so production is largely directed toward foreign markets. This creates a high degree of dependence on foreign markets and a lack of structural incentives better living standards for the poor. In short, poverty becomes a vicious circle that is itself an obstacle to development.

Poverty Reduction Strategy Paper and Agriculture

From the March 2000, the Government of Georgia is in elaboration process of PREGF program through support of IMF and World Bank. The Document should set up the foundation for poverty reduction in Georgia, where according to the official data 60% of population is living under the line of poverty. The document positively evaluate the trade liberalization and land reform and state owned enterprises privatization processes and states that the “land reforms have created a real employment possibility for farmers, though there are several problems that must be mentioned, such as: inefficient infrastructure (the lack of refining enterprises in rural areas of Georgia), poor irrigation and drainage systems, scarcely available and unprofitable credits, expensive agro-business means (fuel, chemicals, fertilizers), high transportation costs and more.

The privatization of State owned agro-business enterprises unfortunately still did not contribute to significant growth in production volume. The reason is that the owners of those enterprises do not have the possibility to attract necessary capital to develop modern systems of management and to conquer new markets. The inability to fully use the existing export potential is also related to the above-mentioned problem. Foreign investments are deemed to be the major means for solving these issues.”

According to the Presidential decree⁴, “at the second stage of economic reforms the financial, economic and institutional support of private enterprise initiative gains the vital importance; establishment of healthy competitive environment and carrying measures for demonopolization. Strengthening the partnership between the State and manufacturers in investment sphere; support of effective functioning of privatized enterprises and make the taxation policy more stimulative for enterprise.”

In 1999 with recommendation IMF the Georgia Government has moved amendments in law “on rules of calculation and payment of Value Added Tax”, according to which “individual manufacturers and individual enterprises are obliged to pay VAT (12,28%), if their taxable annual income exceeds 50 multiple amount of living wage” (100 000 Geo Lari - about 48 500 USD). The amendment has been done despite the fact that the Ministry of Food and agriculture was against and claimed that VAT payment will retard development of small agricultural enterprises and will support further monopolization in this sector.

According to the PRGF document “the creation of a favorable environmental climate is a crucial element to improve agriculture. Drought in 2000 brought substantial damage to the countryside. In the regions of Eastern Georgia 57% of agricultural land was damaged. The loss of the agriculture

⁴⁹ According to the law on “rules of Value Added Tax calculation and payment”

⁴ Presidential decree #665 1997, 31 December, “on some measures of State support for development of enterprise and business in Georgia”

came to 400 million GEL. Neighboring countries and several international organizations assisted the country by carrying out aid programs, however relieving the effects of natural calamity, due to its large scope, requires additional financial and material provision.”

However, presented data should be treated with skepticism. Because the production figures are usually entirely inconsistent and many working in the sector consider that the authorities overemphasize bad news to bolster the case for further humanitarian aid.

Due to the global warming process, climate conditions have been obviously changed in Georgia. Consequently some varieties of agricultural crops that for a long time were considered as the most fertile and favorable have lost their advantages. For instance, during Soviet Union’s time Georgia was the main tea producing country, but tea probably does not have a bright future in Georgia, as it is a marginal crop in this climate and therefore needs twice as high power inputs while its quality is not high. Unfortunately, Georgian government do not take into the consideration this fact and usually gives priority to the import of crops and cereals, which often are not adoptable to the Georgia’s climate conditions.

According to the Georgia legislation⁵⁰, dissemination of any imported crops are permitted by the decision of State expertise, which is made based on the three years preliminary testing program. However, in practice this procedure is often ignored, even not talking about assessments on the environmental, health or indirect agricultural impacts of imported varieties of crops. At the same time there is not any legal and financial remedies available to the farmers who incur losses.

Biosafety and Innovative Technologies

In early 1995, because of a shortage of seed potatoes, the Ministry of Agriculture requested the Georgian Agro-biotechnology Institute to prepare a Seed Potato Production Project. In June 1995, the Academy of Agricultural Science and the Minister of Agriculture adopted this project. The project entailed the import to Georgia of 148 tons of Monsanto’s genetically engineered (GE) Newleaf potatoes, in June 1996. There was no consultation with other Ministries, such as the Ministries of Environment or Health.

The project was designed to be financed through a Georgian-US joint venture on a credit of US\$ 2,000,000. It appeared impossible to obtain a description of this joint venture from the Ministry of Agriculture. In April 1996, the Ministry of Agriculture and Agricultural Co-operative Development International (ACDI) signed a letter of guarantee to transfer US\$350,000 to Monsanto. The sum of \$350,000 was given to the Ministry of Agriculture, as credit from the European Union’s program of Technical Assistance to the Commonwealth of Independent States (TACIS) following a request from Minister, "to buy seed Potatoes". TACIS runs a variety of projects in Georgia, but apparently, they were not informed that this particular project with Monsanto would involve genetically engineered seed potatoes.

Georgia’s Parliament became aware of the case and its Parliamentary Committee on Environment and Agriculture recommended in April 1996 a ban on “the import and cultivation of GE products in Georgia, until proper legislation is in place”. However, Monsanto’s Bt potatoes were sown again in 1997 but this was presented as part of a testing program and under the control of the State authorities. In August 1996, the Committee requested that the case be under the joint control of the Georgian State Commission of Testing and Protection of Selectional Achievement and the Ministry of Agriculture. However, Greenpeace’s investigation in July 1998 has revealed that there is still little control and monitoring of the Bt potatoes. Fortunately, the GE potato crop failed, producing just 600 tons of potatoes. It seems that the GE potatoes were not adapted to local conditions and were killed by the fungal disease.

⁵⁰ Law on “permission agricultural crops spreading, high quality seeds and transplants”

The production of Monsanto's "Naturemark" NewLeaf potatoes failed in Georgia leading to commercial losses and debts for the Georgian farmers who entered into this experiment for Monsanto. Those potatoes, which were harvested, are known to be circulating in Georgia, Russia and Azerbaijan. Unfortunately, neither Monsanto nor the Georgian Minister of Agriculture chose to assess the negative ecological or health impacts of this transgenic potato on the Georgian environment.

Clearly, for much less money, local seed producing laboratories could have solved Georgia's potato shortage and produced many different potato varieties, which are highly adapted to local conditions.

Conclusions and Recommendation

Due to the high interest to credits, lack of knowledge and experience, high-level corruption in Georgian Government, the clear long-term priorities for development of Sustainable Agriculture is still not identified. Despite the fact that the small scale private agriculture is now the most important source of livelihood in Georgia, the huge donor assistance mainly promotes and supports large producers; Additionally mismanagement and corruption in distribution of grants and credits resulted that farmers continue to face many obstacles, and still require assistance to access credits and modern technologies, experiencing difficulty with transportation and delivery of products to market.

- The equitable access should be provided to farmers and small and medium enterprises. The formal financial sector needs a major revamping to meet changing needs. This includes training staff, reassessing collateral issues, providing better service and cheaper credits for longer terms. In addition, transparency and accessibility are needed, and trustworthiness is essential for banks to function.
- Traditional agriculture activities which are vital for the rural household livelihood security, such as production of corn, beans, and soya, as well as livestock breeding should be promoted and encouraged.
- Favorable taxation regime should be established to maintenance of farming and small and medium agro-business.
- The effective legal framework for land market development as well as land resource management should be established.

Chapter VIII. Power Sector

Since 1993, Georgia experienced an acute energy crisis that restricted citizens' access to electricity services. It has negativ impact on economical development of the country. The problems become especially hard in wintertime when the population has access to the electricity supply just 4-6 hours per day in the capital city, while the rural regions are without any electricity supply. Access to energy becomes one of the clearest indicators of social vulnerability that has significant impact on poverty, deprivation and economical incentives.

During the Soviet Union times, Georgia was the biggest importer of primary energy resources among the other republics. Approximately 83.6%⁵¹ of consumed energy was imported (oil products – 58.2%, natural gas – 25.4%). Nowadays, domestic energy resource endowments of Georgia are modest. Its hydroelectric potential is estimated at 81⁵² Twh and only about 10% of it has been developed. Its modest oil and coal reserves have been nearly exhausted and local production has shrunk considerably. The power sector of Georgia, along with Armenia and Azerbaijan was a part of the Trans Caucasian Interconnected Power System (500 kV, 330 kV, 220 kV, and 110 kV lines and interconnections to Armenia, Azerbaijan and Russia with a total transfer capacity of 3000 MVA.) - one of the 11 such systems in FSU. Since 1993 when the natural gas supply from Russia was cut off and central heating supply shut down. All demand was allocated on power sector and in 1994, 70% of generation capacity was damaged and the available capacity was limited to 400 MW of thermal power and 400 to 1000 MW of hydropower, depending on water availability.

The rehabilitation of energy sector was one of the main priorities of country assistance strategy of the World Bank. Through the WB, IMF, EBRD and bilateral agencies that contribute financial support and policy advice, about 700 million USD credits have been allocated for rehabilitation of energy sector since 1994. Number of basic studies and rehabilitation projects has been carried out. The Georgian Power Sector Optimal Development Plan for 1998-2020⁵³ is based on development of Least Cost Planning Model for all main scenarios: quick, normal and slow economical development of Georgia. The main goal of the work was to support the Georgian government in proper allocation of foreign direct investments in power generation sector during 2000-2020. According to the Plan, the most cost effective measure for Georgia is renovation of the existing plants and hydrous.

Under the World Bank Structural Adjustment Credit and IMF ESAF was implemented recommendations of the World Bank that include privatization of energy generation and distribution companies, liberalization of tariffs, depolitisation of sector management. The government was obliged to adopt policy that reduce investor's risk through the establishment of independent regulatory bodies, promotion of payment policy. As a pay back the investor was supposed to bring capital technology and management expertise.

However, despite of the huge amount of the credits and human capital spent for rehabilitation of the power sector, the sector still hardly survived and energy security for the Georgian public is very low. The significant amount of the credits was allocated for rehabilitation of generation facilities, however, till now the all generation objects experience lots of technical problems.

Removal of energy price subsidies is an important part of energy sector liberalization for countries in economic transition. Removal of subsidies also creates initiatives for energy efficiency technologies.

⁵¹ Human Development Report, Georgia, 1996, UNDP

⁵² Renewable Resources of Georgia, G. Svanidze, 1987

⁵³ Prepared by Burns and Roe Enterprises, Inc. contract 5826-067, 1998, USAID

Nevertheless, removing energy price subsidies also has serious social repercussions that need to be considered. As practice shows, rapid liberalization, together with rapid increase of poverty, causes the reverse effects and casts doubts on success of energy sector reform.

Quoting of the same World Bank best sums up the situation:

“Given the existing structure of household spending, if the adjustment of prices to economic levels is not to have an adverse impact on the poor, it will be important to design suitable safety net schemes to protect the poor from unaffordable price increases.”⁵⁴

In Georgia the restructuring of energy sector decreases the ability of the population to pay energy bills and stifles initiatives for energy efficiency technologies.

Privatization in Energy sector

The initial stage of privatization in power generation sector was privatization of small hydroes in 1992-1994, that was carried out with full untransparency and most of the hydroes were privatized in prices far below of the ordinary village houses. The first example of huge privatization in Georgia was purchasing of Telasi Energy Distribution Company, units 9 and 10 of Gardabani Power Station and Khrami-1, Khrami-2 hydropower stations by AES Group⁵⁵ in 1998-99. According to the Agreement with the government of Georgia AES purchased 75% shares of the Telasi Energy distribution company⁵⁶ for USD 25.5 million, plus obligation to invest USD 83,8 million in ten years and pay USD 10 million “Telasi” debt. One of the main obligations was to get into order re-metering of electricity consumption, make contracts with consumers and installation of personal electricity meters before the year 2000⁵⁷.

AES bought “Telasi” distribution company only with condition that they in future would also buy generation plants: Gardabani Power Station, two hydros Khrami I and II. Announced tender for generation companies was only fiction. The estimated price for plants (1000 MW of gas station and 223 MW of hydrous) was about 300 million USD, with requirement to repay 80million USD debt of World Bank, KfW and EBRD. Finally AES managed to buy the best units 9 and 10 of Gardabani power plant with capacity 600 MW and two hydroes with capacity 223 MW for 11 million, with condition that it should start IFIs debt repayment in 2007 and finish in 2037.

At the end of 1999 the AES also received exclusive rights for exporting, purchasing the electricity from generation objects ignoring wholesale market law, managing of all financial aspects with Russian and Turkish partners and taxation holidays till 2003. All of those has given possibility to AES to become the largest monopolist at the energy market.

According to the World bank “reform and private sector participation can help the poor in many ways: it can refocus subsidies, reduce their costs and free scarce fiscal resources to fund high priority social spending; mobilizing private funds, decentralizing decisions and improving efficiency, it expands energy access, voice and choice for consumers; [and] by enhancing environmental management, it serves the poor who happen to be the most exposed to pollution”⁵⁸.

⁵⁴ [World Bank; ‘Bulgaria: Poverty During the Transition’; Report No. 18411, June 1999]

⁵⁵ AES Group is US based Company

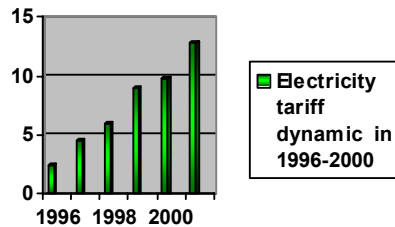
⁵⁶ largest energy distribution company on Georgia with more than 300 000 consumers.

⁵⁷ Despite already invested USD 250 million to year 2002, the aforementioned requirements still are not fulfilled.

⁵⁸ About Markets and Reform - Energy Markets and Reform”, www.worldbank.org/html/fpd/energy/gif.

Investments and Tariffs

The first private investments in the Georgian power sector were made in 1998 simultaneously to sector privatization. Main investor was US based transnational company AES Group through its Dutch daughter company AES Silk Road (operates in Newly Independent Countries). Since 1999 company invested in the sector more than 250 million US\$ for initial working capital and critical investments in consumer re-metering, billing information technology, network components to create a modern, efficient and commercially viable in rehabilitation of electricity distribution network in Tbilisi.



Legally the tariffs setting up is primary obligation of the Georgian National Electricity Regulation Commission, but actually, the World Bank and IMF determine it, as well as through the contract with the AES group that fully prepared under the recommendations of WB⁵⁹. The IMF require from the Georgian Government to increase tariffs on electricity usage in order to service and repay the immense debt of the energy sector of Georgia, that was mainly misused by the government of Georgia due to the high level corruption. This was evaluated negatively by the Georgian society. However, the tariffs have increased significantly since 1996 from 2,5 Georgian tetri (1,25 US cents) to 12,8 Georgian tetri (6,4 US cents) in 2001.

Several programs to mitigate the tariff growth impact for vulnerable groups has taken place. These programs were financed mainly by the US government⁶⁰ (5 million USD), Tbilisi Municipality and WB - Energy Sector Adjustment Credit project. However, several scandals with lists of beneficiaries take place. Additionally, the World Bank admitted that Georgia has met all specific requirements under the first tranche of “Energy Sector Adjustment Credit”⁶¹, except the following one: “to remain current in disbursement of poverty benefits to eligible vulnerable population”⁶². This should be implemented under the second tranche that was successfully approved by Executive Directors of the World Bank in year 2001.

Trend for Further Tariff Increase

There are several reasons for further increase of tariff in Georgia and main of them are discussed below.

1. Privatization of Tbilisi electricity Distribution Company.

The AES has made surplus investment in Georgia. Following the agreement AES was required to invest 83.8 million USD in following ten years and it gets the right to require the tariff growth twice in a year. In year 2000 AES invested 111 million USD; 40 million USD of this amount was loan from IFC and EBRD with 9,5% interest rate with 13 year repayment period and 71 million USD

⁵⁹ Following the agreement AES was required to invest 83.8 million USD in following ten years and it gets right twice in a year require the tariff growth. In year 2000 AES invested 111 million USD; where from 40 million USD was loan from IFC and EBRD with 9,5% interest rate with 13 repayment period and 71 million USD loan from AES Silk Road Holding B.V;Head company with 20% of interest rate.

⁶⁰ USAID pays instead of pensioners electricity cost up to the 300 kwh in month. It should be admitted that program covers only part of the pensioners, needed support.

⁶¹ Georgia – Energy Sector Adjustment Credit of SDR 18.1 million (US\$ 25 million equivalent at the time of – Credit No.3266-GE .

⁶² IDA/R2001-0061 - President Memorandum “Georgia – Energy Sector Adjustment Credit - Credit No.3266-GE – Release of Second Tranche – Waiver of the condition”, April 26, 2001

loan from AES Silk Road Holding B.V. Head company with 20% interest rate.

In the year 2001 AES require the increase of its share in tariff from 3.62 to 17.15 tetri. In this case the consumers tariff would increase to 23.03 tetri (11,5 US cents), from 9,8 tetri (4,9 US cents). Finally the consensus was reached and the tariff increased from 9,8 tetri to 12,8 tetri. The government was quite concerned with reaction of population on new sharp increases of the tariff.

2. *Loan repayment.*

Since the year 2000 the Georgian government has been looking for the sources for restructuring and service of loans of energy sector. The IMF requires that, a component for covering formerly accumulated debts should be envisaged in tariff (EBRD loan to the state owned Enguri hydro power station was already incorporated into the tariff). According to GNEREC official's statement, the electricity market price should be increased 1 -3 tetri/kwh to satisfy the IMF demand.

3. *Planned construction of Tkibuli coal fired thermal power station.*

At the beginning of 2000, the Ministry of Fuel and Energy adopted Electricity Power Sector Crisis Eradication and Development Programme. The programme includes construction of 250 MW coal power station in Tkibuli. The project cost is about USD 350 million. In 2000, the agreement on obligatory purchasing of electricity from Tkibuli Coal Power Station was signed between Tkibuli Power International (TPI)⁶³ and the Georgian Wholesale Electricity Market (WEM)⁶⁴. The agreement contradicts the Georgian legislation including the Law on Antimonopoly and Market, undermines already established system in power sector, rules and regulations of the WEM and the Georgian National Energy Regulatory Commission (GNERC). According to the Georgian National Electricity Regulation Commission, "the energy generated by Coal Power station (about 1700 million kw) and tariff (about 5.6 cents per kw/h) is very big to become competitive from 2004, on local or on regional market. Taking into account macroeconomic issues and significance of the project from energy generation point of view, it is required partially compensate the tariff (about 50%), from state budget in 2004-2018."⁶⁵

⁶³ Tkibuli Power International LTD is created and functions under the legislation of the Islands of Mauritania

⁶⁴ It should be mentioned that at that time, Georgian side was not authorized to sign the contract; authorization... has been delivered on the base of the Presidential Decree that was only issued in 2001).

⁶⁵Notes of Consultation of 5 September, 2000 (Ministry of Energy and Fuel, Ministry of Urbanization and Construction, Wholesale Market, Georgian National Electricity Regulation Commission)

Chapter IX. Environment Protection

Sustainable development is a priority declared by the Georgian Constitution⁶⁶, however, the environmental management is still integrated into the macroeconomic development of the country. The Environmental protection is mostly identified as protection of biodiversity, that of course should be one of the main however not only priority.

Georgia is relatively small in size (approximately 70,000 sq. km), however it is rich in biological diversity due to its highly varied climatic, geologic, topographic, and hydrologic conditions. Historically, Georgia is the center of biodiversity, with lots of unique and endemic species of wild fauna and flora and ecosystems that are highly valuable in terms of biological diversity. Georgia and whole Caucasus region is identified under the World Wide Fund for Nature's Global 200 Ecoregions program, which uses selection criteria of species richness, levels of endemism, taxonomic uniqueness, unusual evolutionary phenomena and global rarity of major habitat types. Recently, Conservation International has identified the region as a global "hotspot"—that is, one of the 25 most biologically rich and most endangered terrestrial ecosystems in the world, based on the number of species present, the number of those species found exclusively in an ecosystem and the degree of threat they face.

Protecting the environment and supporting sustainable resource management is one of four main objectives of the World Bank country assessment strategy. The assistance included support of preparation of Georgia's National Environmental Action Plan (NEAP), Biodiversity Strategy, and the Black Sea Action Plan (BSAP).

The preparation of the National Environmental Action Plan starts at 1996 and was adopted in 2000 by the President of Georgia. Following items are priorities of the NEAP:

- Water resources and pollution sources
- Air quality and pollution sources
- Natural resources use
- Waste and Hazardous substances Management
- Land Resources
- Forests and Forestry
- Protection of the Black Sea from pollution
- Global Environmental problems: Climate Change and Ozone Depletion

The NEAP represent ambiguous plan, were prioritization is a particular concern, it points simultaneously a number of different directions. The document does not adequately define the strategy of environmental protection integration in social-economical plans, the key priorities identified the necessary investments and sources for achievements of the goal step by step. Priority actions identified for inclusion into the NEAP were already intended to be sponsored by the international financial institutions. The plan does not consider funding of any activity from state budget or attraction of private investments. Furthermore, the Georgian legislation does not define the place of the NEAP in the system of country's social-economic development plans, for instance, in developing Indicative Plans.

One of the most significant issues that greatly affected preparation of NEAP, as well as the decision-making in environmental field is the lack and validity of environmental data. Since 1997 the Department of Statistics do not collect the environmental information.

⁶⁶ "3. Everyone has the right to live in a healthy environment and use natural and cultural surroundings. Everyone is obliged to protect natural and cultural surroundings;

4. The State guarantees the protection of nature and its rational use to ensure a healthy environment corresponding to the ecological and economic interests of society, and taking into account the interests of current and future generations; Constitution of Georgia, (article 37), 1995

Economic instruments for environment protection

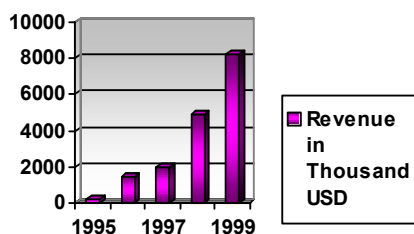
The introduction of economic instruments in environmental policy is recognized as one of the ways for stimulation of pollution prevention, as well as to gain funds for environment protection.⁶⁷ The main aim was “facilitating protection and improvement of the environment through generation of revenues in governmental budget”. Taxes on Environmental Pollution and use of natural resources have been incorporated in new tax Code in 1998.

Today the Economic instruments in Georgia are as follows:

- Taxes on environmental pollution, taxes on the extraction and use of natural resources
- User charges for municipal services
- Production charges on certain environmentally harmful products. ex. gasoline
- Penalties for non-compliance
- Financial incentives as grants and loans

The bulk of the revenue from environmental and nature resources taxes and charges goes to the regional governmental budgets, that could be used for environmental purposes.

The revenues from the environmental taxes have increased strongly over the last couple of years⁶⁸, mainly based on pollution taxes and environmental fuel tax. The tax for fuel has been extended by the Ministry of Finance as one of the important way to increase the state budget. Nowadays, it includes the fossil fuels used by stationary sources, as well as transport fuels. However, due to complexity of tax and charges system itself it is very difficult to collect environmental taxes. The



Revenue from pollution charges and environmental fuel taxes 1995-1999

number of taxable substances exceeds to 350, it is very hard to administer from one hand, and from another almost all laboratories in the country do not work. The weak monitoring system, lack of sufficient human resources and complexity of taxes and charges decrease ability of environmental monitoring.

Another problem is the final destination of collected revenues. The core amount goes to the regional budgets and it is spent usually for various purposes, including social expenditure, but in practice it is rare to be fund the environmental problem solution, as it was declared in the law. The main problem for this is strong position of the IMF against establishment of Environmental Fund until budget balance will not be positive.

Protected Areas system

Since 1990 the Government of Georgia designed major reorganization of the protected areas system, through the intensive work of WWF-International. The traditional models of strict nature reserves were non-adequate, especially in state lands privatization process. The existing 9 strict natural reserves has been transformed in 9 protected areas systems, that in line of 1996 law on Protected areas, set up different managements zone within the protected areas system under the IUCN⁶⁹ categories. According to the plans “traditional” protected areas (nature reserves, national

⁶⁷ Environmental Pollution Taxes were introduced in 1993 (Resolution of Cabinet of Minister N 1010, 1992), Taxes on the Use of Natural Resources in 1994 (Resolution of Cabinet of Minister N 725, 1993).

⁶⁸ Data of Tax Collection

⁶⁹ International Union for Nature Conservation

parks, natural monuments, managed nature reserves) will cover 10 percent of the territory of Georgia, with protection and sustainable development areas (protected landscapes, multiple use protected areas) extending coverage to 20 percent of the country's territory.

In 1997 the president of Georgia dedicated 20% of territory of Georgia to natural protected areas⁷⁰. Three National Parks are under establishment: Borjomi-Karagauli National Park⁷¹, Kolkhety National Park and East Georgia National Parks system (Tusheti and Vashlovani National Parks and Lagodekhi Nature Reserve).

The creation of protected areas system is the step forward for sustainable development. However, without upgrading the environmental planning system, through all stakeholders participation and creation of concrete mechanisms for sustainable use of internal resources of regions, the existing practice and conflict of interests could only devaluated the idea of protected areas.

Increasingly it becomes clear, that the Georgian government do not understand whole importance of Protected Areas system establishment. In different levels of the government it is identified as a main obstacle for traditional infrastructure development of regions. The local population identified establishment of protected areas as a threat for further economic welfare.

- Issue of land-ownership remains one of the most acute issues. Protected areas law recognizes the claims of pre-existing property owners, as a rule, are superior to designations of protected areas and previously within the control of local authorities may be made subject to legal definition by local authorities for certain uses, including privatization. E.g. in the case of Kolkhety Protected Areas system it should be noted that the park lands have never been formally registered with land management authorities⁷². The spontaneous privatization of the state land in early 1990s resulted the privatization of protected areas.
- The various governmental structures have different visions for particular regions developments. While the Government takes international commitments for the main principles of integrated and participatory management of Georgia's Nature, the various official structures actually lobby opposition projects development on same territories⁷³. According to the World Bank "the Government may also need to reassess the way in which it manages its protected areas. It may be difficult for the World Bank and other donors to support the Government's capacity to manage protected areas when the process by which such energy transit projects are approved appears to demonstrate an apparent lack of commitment to protected areas. The World Bank and the Government have recently signed a GEF-financed Protected Areas Development Project that is expected to become effective soon. A review should be conducted to minimize potential planning and land use conflicts as occurred with the Kolkheti National Park in the current situation."
- The conflicts of interests between the protected areas, business and local people will continue, if the approach to the planning of the protected areas will not be changed from the government as well as from the IFIs side.
- Due to the exiting economic crisis into the country, population outside of protected areas have no cash income and heavily rely on natural resources. Of course, the practices are unsustainable. However, just prohibition or limitation of the natural resources use never give required impact, especially in situation when people just try to survive. At the first phase of

⁷⁰ It was done as the result of WWF International Campaign Living Planet "Gift to Nature", and gives some leverage to Georgia as environmentally friendly.

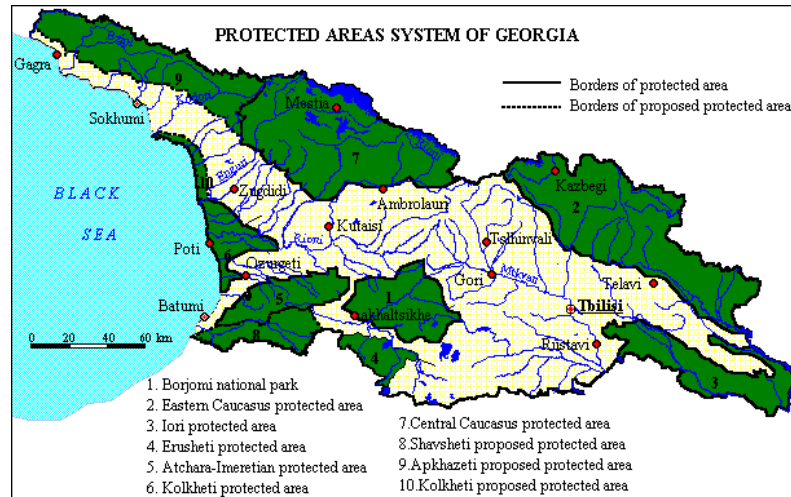
⁷¹ Funded by WWF and KFW (German Development Bank)

⁷² Office Memorandum, World Bank, September 18, 2001 Georgia: Integrated Coastal Management Project and Kulevi Oil Terminal Development - Back-to-Office-Report of Mission,

⁷³ In a case of Kolkhety Protected Areas system, there is several controversial projects such as drainage of Baku-Supsa oil Pipeline (IFC/EBRD), drainage of Kolkhety wetlands (World Bank), Kulevi Oil Terminal construction and oil exploration plans by Anadarko in Kolkhety National Park or the unique wetland sites protected under the Ramsar Convention.

project planning the necessary steps should be undertaken to demonstrate that local social and economic development activities in protected areas that can contribute to poverty reduction and enhance conservation of biological diversity. The participatory approach should be developed on early stages of protected areas planning, rather to implement the expensive public awareness activities that would have more limited effect.

Biodiversity conservation and development plans drafted by outsiders are hard to transfer from paper to reality if the local communities are not consulted in its formulation. Therefore, it is necessary to ensure active participation of local communities in decision-making, implementation, benefit sharing and evaluation of any development and conservation projects for bringing successful results and sustainability to such projects.



Source: State of Environment Georgia, 1996

Natural resources exploitation

In the recent years, one of the most pressing factors on nature of Georgia was increased exploitation of the natural resources. The practices of exploitation of minerals, as well as fauna and flora resources are highly unsustainable.

Forest resources

Due to the energy shortage, many rural families in Georgia deforest and sell wood for heating and cooking purposes. Deforestation leads to depletion of forest resources that the poor themselves depend upon. This exacerbates erosion processes, corroding valuable soil resources and disrupting water circulation regimes. Lots of the experts attribute the severe drought that struck the country in the last few years to the over exploitation of forest resources⁷⁴. While according to the officials, the main problem is cold dwellings and the lack of gas and electricity which has forced people to cut trees for firewood, there is strong suspicion that the majority of timber has simply been exported to Turkey, Armenia and Azerbaijan as the nations cheapest product.

The highest regions of Georgia often experience floods and landslides, which cause a great number of human casualties and economic damage. As a result of these processes, Georgia has ecological refugees in the mountainous part of the Ajarian Autonomous republic. The extensive and unregulated export of timber from this region to Turkey has caused landslides and floods, destroyed

⁷⁴ According to NGOs in last years severely was damaged Georgia's forests and currently only 32% of country's territory is covered by forest.

people's livelihoods and settlements, and forced people to leave their native region. According to the data of the Ministry of Internal Affairs, in 1997 alone the damage cost 176, 2 mln GL (roughly 90 mln USD) as a result of natural cataclysms.

Government statistics vary widely on the amount of timber cut each year. According the information from the Ministry of Environment, 2, 5000 00 cubic meters are cut yearly. But according to the Department of Forestry statistics only 400 000 cubic meters are logged annually, at the same time recognizing the poverty driven illegal cuttings of fuel-wood. However, corruption and illegal exports of timber is one of the main characteristics of Forest sector nowadays.

According to the official data, forests cover 38% of the country, largely in the Greater Caucasus Mountains, the lesser Caucasus and in intervening lowlands and foothills (lowland and riparian relic forests). In the high mountain regions there are tracts of virgin forests and remote areas that are still intact. Moreover, 97.3% of forests are located on mountain inclines and serve as systems of water conservation, soil protection, protection against erosion as well as regulating the climate.

Before Independence in 1991, most of the Georgian Forests were hardly exploited as the main amount of wood products were imported from Russia (around 2 million m³ annually), mostly for construction and pulp production.

Due to relatively high import taxes (12%) on timber imports and almost zero export taxes, now there are growing volumes of wood exported, mainly to Turkey. There are huge discrepancies between the data of the Custom Service and State Forestry Department regarding the volume of exported wood, and even more discrepancies between the data of Armenian and Turkish customs⁷⁵.

Since 1998 the World Bank is preparing the Georgia Forestry Development project. There were lots of concerns regarding the project, the biggest part of them addressed overwhelming corruption in Forestry Sector, as well as with Forestry Code⁷⁶ adopted in 1999, that according to the experts opinion focused more on utilization of forest resources, rather than its sustainable exploitation, has lots of collisions with existing national legislation, as well as with International conventions, among them Convention on Biodiversity.

According to the latest version of the Project appraisal document "There is also a highly visible trade in illegally harvested timber in the form of trucks with unrecorded high-quality beech logs crossing the Turkish border, but it accounts for only 6% of total estimated harvested volume. The most immediate threat to Georgian forests is the harvesting of fuelwood. Declining GDP, rising poverty and the decline in energy subsidies for fossil fuels has led to greatly increased use of fuelwood. At present, nearly 60% of the annual forest harvest (or about 720,000 m³)⁷⁷ is unrecorded fuelwood." However, According to the media reports in 2001 timbers of USD 3 million value were shipped for export⁷⁸, this was going on during the moratorium time.

While recognizing the importance of reduction of logging for fuel-wood, the trend should be towards the eradication of corruption in the Georgian Forestry sector and sustainable use of resources.

⁷⁵ Georgia licenses the export of wood and wood products (as well as scrap, metals, etc.). Evidence shows large discrepancy found between the values of its exports to Turkey in the mirror statistics. For instance, the value of the 1998 exports to Turkey, as reported by Georgia, was US \$ 20.2 million. At the same time, the same year's imports from Georgia, as reported by Turkey, stood at US \$ 91.0 million. Even if we add Armenia's exports to Turkey (US \$ 2.9 million) to Georgia (since they may be recorded in Turkey as of the Georgian origin), the difference will still be 3.9 times. This large a discrepancy cannot be explained by the difference in the valuation of exports and imports. (Polyakov, 2000)

⁷⁶ through technical and financial support of World Bank

⁷⁷ It is still questionable how many timber is cut by local public. According to the recent survey of state Statistic Department (for World Bank "Integrated Coastal Management Project" report No:1731) only the public in Kolkhety National Park are cut annually approximately 119 thousand cubic meter, where from 95,4 cubic meter is for household consumption.

⁷⁸ 14-15 February, 2002, newspaper "Alia"

IMF - Restricting National Sovereignty and Damaging the Environment ?!

Since 1991 there have been several bans on timber exports which were eventually cancelled after some time. However, after an exhaustive public discussion, campaigning and active protest by environmental groups, local population and a large segment of the public in 1997, the law on timber export was introduced in the Georgian Parliament. The Georgian Parliament drafted and adopted a law that offered the possibility of a moratorium on timber exports for a period of seven years. The Georgian president vetoed the law, however, because the IMF was believed to oppose it. Finally, a compromise was reached between Parliament and the President's office to introduce a small tax on the export of timber of about 60 GL per cubic meter. The Georgian Parliament adopted the law, with changes on taxation rates, democratically.

However, a new mission from the IMF required the government to cancel the above-mentioned law, and made the statement that if this was not done, then no additional funds for Georgia would be made available. Following this move, the President of Georgia decided to comply with IMF demands and the Government of Georgia used its right of legislative initiative and passed a new law in Parliament without any moratorium or taxation on the export of timber.

The case clearly illustrates how the IMF ignored the opinion of the Georgian population who was very much aware of the significance of this issue and had expressed their negative opinion about the timber export issue. The IMF not only undermines the principles of sustainable development, but also does not respect the democratic decisions of the Georgian Parliament, even though the transition to democracy is essential for linking Georgia again with the rest of the developed world. The IMF seems to force its policies in a country without real benefit to the people for whom IMF money is apparently intended.

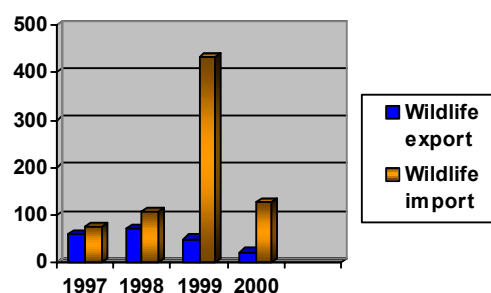
In the mean time, people are beginning to understand that sovereignty and independence for Georgia is still far from reality, they must first protect the national economy and the environment from the blackmailing of the IMF. Especially considering that the timber export from Georgia has already caused not only negative environmental, but social impacts too. These impacts are not just externalities, they are also serious expenses for the Georgian state and in this way the abolishment of the tax is an economically shortsighted demand of the IMF which does not help to increase the country's economic performance.

In July 2001, the Parliament of Georgia adopted a resolution on banning exports of timber and requesting the Government take measures to prevent unlawful and unsustainable logging. The legality of resolution itself was doubtful, gain quite acute reaction from the World Bank "This may have implication on our ability to provide financing under SAC III, as we understand the ban violates prior agreements with the IMF, and their program is a prerequisite for resumption of adjustment lending for Georgia. in addition, it will certainly delay if not jeopardize financing for a forestry project on which the authorities and we have worked so well over many years." (July 31, 2001, Letter to Chairman of the Parliament from Johanness Lynn, Vice president of World Bank).

Wildlife Trade

One of the most acute problem for unique biodiversity protection, that still have not been emphasized by the State is illegal wildlife trade. The wildlife trade has increased after the break down of Soviet Empire and other political changes since 1990. In search of economic alternatives, people are turning to lucrative poaching and trading with natural resources including wildlife. Illegal cutting, export of trees and poaching create the danger for Fauna and Flora in Georgia.

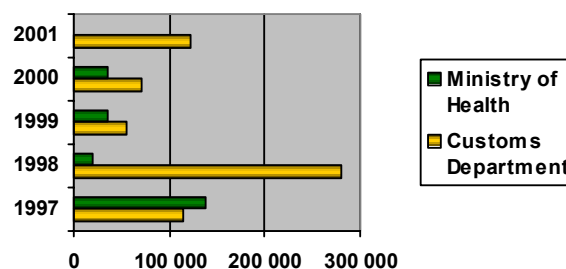
Several facts of illegal international trade with endangered species of wild fauna and flora has been reported in recent years. Despite the lack of the official data and weak control on official level, sets of the data and documents, interviews with scientists, NGOs representatives and local people clearly pointed out an illegal trade with wild plant resources, reptiles and amphibian, as well as international trade with migratory birds. According to the experts` opinion Georgia is one of the ways for illegal wildlife transit and supports for export of native species for trade purposes⁷⁹. Moreover, the official report of CITES Secretariat, 1996, admitted facts of illegal trade with *Galanthus* bulbs from Georgia and Turkey.



Wildlife (plant resources)
export-import in thousands USD

In Georgia, the export-import of wildlife is regulated according to the decree of the Cabinet of Ministry⁸⁰. The Custom is required to control export-import according to the licenses of the Ministry of Economics together with the Ministry of Environment⁸¹, the Forestry Department, the Ministry of Agriculture⁸² and Ministry of Health⁸³. However, the regulations of above mentioned state bodies do not regulate the export-import issues and licensing of the wildlife trade does not exist.

Additionally, according to the decree of the Cabinet of Ministry⁸⁴ customs officials use the common code system for all flora and fauna species and it is impossible to obtain separately information on the exported/imported/re-exported particular species from the customs. Obtaining of required detailed information needs tremendous efforts



through the investigation of each concrete export declaration in central archives of the Customs archives. At the same time, Customs office provided information on the exported-imported wildlife in sum in kilogram's or tones annually. The discrepancies between exported amounts from various sources are huge. e.g. the chart revealed the export of herbs in kilos, since 1997 according to the data of Ministry of Health and Customs Department.

⁷⁹ Species – A call for Action, WWF's Europe/ Middle East Program

⁸⁰ Actually there is two annex 3 (regulated export) of Decree N35 of the Cabinet of Minister 23 January, 1995, that is addressed different items. Both them from legal point of view are enforce.

⁸¹ According the new legislation the export of timber is regulated by State Department of Forestry and Ministry of Economics.

⁸² Phitosanitary service

⁸³ in a case of herbs

⁸⁴ Decree N35 of the Cabinet of Minister 23 January, 1995

According to the data of the Georgian National Management Authority of CITES generally there are facts of the international trade (especially export), mainly for scientific purposes. Only two plant species (*Galanthus woronowii* bulbs and *Cyclamen coum* tubers listed) are exported for commercial purposes every year as decorative plants, under the framework of the Convention. However, according to the data of the Customs Department in 2000 *Galanthus woronowii* bulbs (5 million bulbs) were exported from Georgia as medicinal plant. Since 1997 it was exported about 50 million bulbs officially for commercial purposes by the Georgian National Management Authority of CITES.

Lack of Strategic Planning

The lack of the national development strategy has an impact on physical planning of the country. The framework law, setting the requirements, for the special planning of the country does not exist. In such conditions there were several attempts to limit uncertainty about the future developments and regulate special planning through introducing the elements of land zoning. However, these attempts were not coordinated and sometimes contradictory. The different governmental authorities are elaborating sectoral development strategies, concepts, programmes and plans that are adopted mainly by the Presidential decrees. Sometimes, some authorities use as a guiding document for their activity even conceptual proposals, which even are not considered by other authorities. For instance, speeded up construction of the ports in almost every kilometers of the Black Sea coastal zone is based on the draft concept on Perspective Development of Ports in Georgian Coastal Zone.⁸⁵

Thus returned in enormous number of illegal constructions, including enterprises. In the Capital of Georgia the trend focused on increased number of commercial and service enterprises especially in big cities, embassies of different foreign countries, petrol stations construction in parks, squares and green areas. Since 1998 the Parliament of Georgia issued resolution that bans all kind constructional activities and requires immediate closure undergoing constructions.

As one of the priority anticorruption measure was defined the preparation of the new master plan of capital city, with exact boundaries of the green areas and all new constructions⁸⁶. However, the Ministry of Urbanization has never implemented this measure.⁸⁷

Inexistence of the spatial development plans and previously identified strategies for development of particular areas of the country often results in the situation when the President of the country approves construction of a particular object and the state authorities are exposed to the fact that construction is already approved without any consideration, to say nothing of conducting study for investigation of feasibility of a project from economic, social or environmental points of view. The clear example of such situation is the case of construction of the Kulevi Marine Oil Terminal in western Georgia, on the Black Sea coast, which is discussed in details in Chapter 10. In 1999 the President adopted the decree (see Oil Transit and Environmental protection) according to which he was approving the proposal (!) of the constructing company on construction of the marine oil terminal in Kulevi and state central, regional and local authorities were only required to facilitate to the construction. Similarly, President approved construction of Coal Power Station in Tkibuli, expansion of Poti port. The list of the examples could be continued endless.

⁸⁵ Environmental Planning in Georgia (Land Use Planning and Land Resource Management) Ketevan Gujaraidze, IIIIEE Master's Theses 2001:XX

⁸⁶ "Several first step anticorruption measures" Decree 95, 2000, President of Georgia

⁸⁷ Association of Young Economist and Green Alternative joint press-conference, 2 October, 2001

Oil Transit and Environment Protection

One of the main transit routes through existing pipelines and railways from the Caspian Sea to Europe, is the Georgia, with the highly sensitive ecosystems.

In 1995, the World Bank Group (WBG) started collaborating with Georgia in an effort to mitigate the political risks of the “Early Oil Project”, the first privately financed oil in the Caspian region and a major infrastructure investment. WBG involvement included: policy advice; an oil institution building project; and long-term financing from both the European Bank for Reconstruction and Development (EBRD). as well as the World Bank Group’s private sector lending arm, the International Finance Corporation(IFC). Despite the commitments made by the IFC and EBRD that the project would use Best Available Technologies and Accepted International Environmental Standards, the reality has been completely different. The practice of discharging wastewaters into the sea and using toxic mud during the offshore drilling is a serious environmental threat. Similarly, construction of the Supsa Oil Terminal on the Black Sea Coast, which does not satisfy requirements of the MARPOL Convention (the International Convention for the Prevention of Pollution from Ships), suggests that the World Bank Group is not bringing significant “environmental additionality” to a project that would have been difficult to execute in the absence of Bank Group support.

In an effort to mitigate the political risks posed by the Caspian oil and gas sector to private investors, the Bank Group pushed forward a range of institutional, policy and legal reforms. The Georgia Energy Sector Adjustment Credit (ESAC) in 1999, laid the foundation for policy reforms associated with the transit of oil. In particular, laws were adopted providing for eminent domain procedures (compulsory purchase or easements in the public interest) and for environmental liability in the case of transportation of hazardous substances (including oil). In addition, Georgia ratified a number of important international treaties related to oil spills. The World Bank has tried to pave the way for public support of a massive pipeline and other oil transit projects, which will pump oil from developments funded in the Caspian. The World Bank’s “Georgia-Energy Transit Institution Building project” (March 13, 2001) clearly illustrates that this is the case.

The promotion of oil transit, combined with policy reforms and private sector risk mitigation has given a rise to situation in which the Georgian Government is supporting all oil related projects without calculating the cumulative environmental, economic and social impacts. The Kolkhety Lowland represents a clear example of how policies and strategies, defined by international financial Institutions, are resulting in a Government agenda that is completely unsustainable.

Kolkhety Lowland, located in the coastal zone of Georgia, is one of the unique ecological hot spots of the Black Sea. The Lowland includes Kolkhety National Park, Kolkhety Wetlands, Lake Paliastomi, and Kobuleti Wetlands. The Kolkhety Wetlands (Churia, Nabada, Phichora-Paliastomi, Lake Paliastomi, and surrounding territories and marine waters - 55,5 thousand hectares in all) were included on a list of Wetlands of International Importance, under the Ramsar Convention, by resolution 201 of the Georgian Parliament in 1996. The convention on wetlands of international importance, especially as waterfowl habitat, was signed in Ramsar in 1971. The convention recognizes “fundamental ecological functions of wetlands as regulates of water regimes and as habitats supporting a characteristic flora and fauna, constitute a resource of great economic, cultural, scientific and recreational value, the loss of which would be irreparable”⁸⁸

In April 1999, the first tankers were loaded in the Supsa terminal, which is located on the Black Sea at the end of the Baku-Supsa Export Pipeline that stretches from the Caspian Sea in Azerbaijan across Georgia. Supsa Terminal is located in the mouth of the Supsa river about two kilometers from the Kolkhety Wetland. According to the Baseline Environmental study, “Supsa terminal has the potential to impact on the unique wetland communities and Kolkhety Forests.”

⁸⁸ The Convention on wetlands of International Importance, especially as waterfowl habitat, Ramsar 1971

Additionally, Chevron transports annually about 2,5 million tons of crude oil through the Georgian Railway through this territory. Two rail accidents have already caused large oil spills on the Kolkhety territory, near the National Park. Given the small size of Kolkhety Lowland and the amount of the oil already transported through it, the area should be considered a high-risk area.

The trend has been towards implementing a growing number of new ports and controversial projects within the Kolkhety Lowland, either directly in or nearby the Kolkhety National Park and Ramsar site territories. Several controversial projects (Baku-Supsa Oil Pipeline, Drainage of Kolkhety Wetlands, and Kulevi Oil Terminal) have already begun in the area of Kolkhety Lowland. This occurred parallel with the Integrated Coastal Zone Management Program and Establishment of Kolkhety National Park (already funded by WB, Tacis, and GEF). Infrastructure investments appear set to continue with the expansion and rehabilitation of Batumi and Poti Ports, construction of new Anaklia port in 15 km from Kulevi port, plans of oil exploration on the territory of National park.

As an argument for the development of new ports and harbors, the Government has promoted the idea of mega-projects such as the Baku-Ceyhan pipeline and EU TRACECA . They have said that the potential of the existing ports is insufficient to meet the growing demand for oil and cargo transportation from east to west, while estimation for potential of the turnover of goods through oil silk road still does not exist “While the further traffic along the old silk route is difficult to predict, the trend is encouraging”⁸⁹. On the shore of Georgia, there are three existing ports: Batumi, Poti, and Sokhumi⁹⁰. However, Government officials and state companies are lobbying for the construction of new ports rather than the reconstruction of existing facilities.

The main arguments (without the presentation of economic schemes) of developers in favour of the construction of new ports on the Coast of Georgia are: 1) The potential of existing Georgian ports is insufficient to meet growing demand; 2) further development of Batumi and Poti ports are restricted due to existing cities that surround the ports; 3) The exploitation parameters (depth of navigating channel, maneuvering area inside the port, and state of existing infrastructure) of ports are not satisfactory and create additional problems and environmental risk. [e.g., the depth of Poti Port’s navigation channel and the inside water area restricts Port services to ships with a maximum capacity of 40000 tones. The service of larger ships takes place on the open sea. 4) These ports (including Supsa⁹¹) do not satisfy the MARPOL Convention guidelines⁹².

The development of new ports (especially ones with oil terminals) in this situation does not represent the best solution. Usually, the reconstruction of existing facilities is the most cost effective from a social and environmental point of view. This means lower long-term external costs. This is especially the case when taking into account that environmental and social protection measures have never been prioritized in Georgia⁸. There is no guarantee that the new ports will be equipped in accordance with the MARPOL Convention, and that during the construction the best available technologies will be used.

On existing circumstances, it was not surprising when according to the President decree 1081 (September 8, 1999) Georgian Government supported construction of Kulevi Oil Terminal, the proposed railway link and marine access channel, the de-listing of 90 ha of land from the RAMSAR designated Kolkheti Lowland without proper notification and provision of urgent state interests.

The construction of new terminal in Kulevi in the middle of Ramsar site was started with severe violations of Georgian and international laws, failing to prove the urgent national need and with

⁸⁹ Energy and Transport in the Black and Caspian Sea Regions – barriers and gateways to regional integration.

⁹⁰ now under control of Afkhasian separatists.

⁹¹ Supsa port was developed as a part of the “Early oil pipeline”, with financial involvement of IFC and EBRD

⁹² International Convention for the Prevention of pollution from Ships.

“prior assurance from the authorities to World Bank staff that construction would not go forward”. The prior assessment of construction by the Bank was that “Construction of a new oil terminal in, or adjacent to the Kolkhety National area and a new railway line to serve it would appear to threaten the Kolkhety wetlands”⁹³.

The terminal includes 22 reservoirs with 100 000 tons of storage capacity each. Oil will be transported by rail through the Kolkheti National Park.⁹⁴ According to the project sponsors the initial annual production of oil products will be 6 million tones, gradually increasing to 10 million tones. The whole investment amount is supposed to be USD 120 million, with annual income of USD 78-200 million. Despite the Government’s claim that the project is of “urgent national interest”, the project sponsors even failed to prove economic viability. The project sponsor is still seeking a loan of \$56 million to complete the terminal.

The site chosen for construction of the terminal is territory protected under the Ramsar Convention, in multiple zone of Kolkhety National Park and in the marine protected area. The oil transport is scheduled by the railway construction crossing the Kolkhety National Park.

The high level fact finding mission was set up by the World Bank to “review the facts” and “Assess situation on the ground”. Despite, the fact that the mission report was “forthcoming” the Georgian Government does not hesitate to call the Kulevi Oil Terminal construction “Project of Millennium”, that got support of the World Bank.

According to the World Bank “potential for conflicts of interest between conservation aims for Kolkheti National Park and the business aims of private companies will remain. The entire marine area of the Kolkheti National Park lies within areas licensed out to oil and gas companies and exploration is ongoing. Additional port development projects are also being considered.”⁹⁵ The World Bank failed to resist construction of Kulevi Oil Terminal and railway facilities through the National Park, rather try emphasize the need to resolve existing problems in future through integrated planning.

Oil developments clearly have been prioritized over the protection of the Kolkhety Lowland, the natural heritage of Georgia, with intact wetlands and unique Kolkhety Forests. The latest oil developments in protected areas undermine the efforts of the World Bank to establish a National park and set a precedent for further violation of international agreements and commitments undertaken by Government of Georgia.

⁹³ Letter to NGOs of Judi M.O’Connor , Country Director, July 27,2001

⁹⁴ According to the EIA of the project, the route corresponds to the railway development plan prepared in 1980s where it was envisaged that the railway system might expand on that direction.

⁹⁵ World Bank, *Memorandum: Georgia: Integrated Coastal Management and Kulevi Oil Terminal Development – Back-to-Office-Report of Mission*, September 18, 2001

Chapter X. Recommendations

Georgia entered the new millennium with lots of questions: what was done for last ten years to improve the quality of life of the population, why the poverty rates increased daily, why energy crisis lasted since 1993 has not been overcome, why pensioners and civil servants are waiting their pensions and salaries for ten and more months, why the Georgian Forests, gold, oil and other natural resources that are heavily exported from the country never benefit the country we are living. The simple and core answer “corruption” involves wider aspects of Georgian society life during the transition period.

While fighting with corruption becomes a fashion, when high level officials permanently reporting the successful implementation of anticorruption program, the Donor community allocates huge amounts of money for corruption fighting, there are small hopes that anything will change.

Below, we are trying to present the list of recommendations and actions that need to be executed for improvement of situation. While the recommendations are quite schematic, actually it involves the participation of all relevant stakeholders.

The actions need to be implemented:

- Georgia should develop the National Development Strategy for economic development; clearly identify existing resources; first of all assess public needs; develop mechanisms for poverty reduction, based on sustainable development principals⁹⁶. The Environmental Management should be one of the key macro-economic policy areas.
- The Rule of law is essential tool for successful development of the country. However, the adopted legislation should be based on clear assessments of social-economic consequences, it must have clear financial provisions for its implementation. The rights of President to be involved in concrete cases (through various decrees and resolutions) should be restricted.
- The social impacts of completed and on-going reforms under the IMF/WB auspices should be assessed.
- The clear financial strategy for Public expenditure should be developed; state budget and all special accounts, including reserve and Presidential funds should be transparent. For the all-special accounts should be developed the guidelines and regulations for the funds disbursement. The efficient and strict public control is essential tool for monitoring the public expenditure, assessing viability of foreign debts and planned credits.
- The scopes of projects under development by donors and IFIs need to be carefully revised taking into consideration the affordability of subsequent maintenance and operations. Care needs to be taken to ensure that whatever financing commitments are made do not impose unrealistic claims on limited public and household budgets, crowding out other priority environmental and social goals. Without realistic financing strategies scarce public funds can be drained from other essential infrastructure in the country accelerating deterioration of social services elsewhere.

⁹⁶ Elaboration of PRGF program, is identified by various stakeholders as first attempt for creation of the country economic development plan. However, the latest version of discussion materials failed to answer on questions above. Moreover, despite the claiming that owner of document is the Government of Georgia, we are doubt that adopted version of PRGF will continue the establishment of the World Bank and IMF recommended package of socio-economic activities, which was the one of the core cause poverty, inequity and corruption growth in Georgia.

- Elaboration of new Tax policy, through the assessment of taxation system efficiency. The new tax policy should stimulate small and medium size business development through the setting up clear and realistic tax rates, that will help to reduce the share of informal economy, it would attract direct foreign investments in the Agricultural and Industrial sectors as well.
- Introduction of protectionism measures for development of national industry and agriculture through the legal and financial mechanisms; It is essential to prioritize the creation of micro credit lines that will result the development of agricultural, energy, and industrial sectors, as well as differentiate the approaches for regional development.
- The government should facilitate creation of favorable environment for domestic market growth, including adequately developed infrastructure and human capital; the availability of all these conditions to all companies automatically and by law (without need for a special treatment and discretionary decisions by officials, (with security of property and persons and enforceability of contracts) and/or civil servants).
- For poverty alleviation, it is necessary to identify the priorities between and within sectors, vulnerable groups and most of all measures for limiting factors resulting poverty.
- Effective social safety net should be created for vulnerable groups protection, it should include as the creation of effective insurance mechanisms, redirection of part of social services to local government and so on. The vulnerable and marginal groups identification should be done on the bases of the ground assessments, that will reduce the cases of advantages distribution for wealthy parts of population, that currently take are place. Social assistance should become the protected articles in state budget to avoid the arrears.
- The declared decentralization must gain economical ground, autonomy of local budgets should be based on concrete sources and local estate.
- Prepare mechanisms for a privatization process that will ensure that privatization of public service utilities will not impact negatively vulnerable groups, but will facilitate the improvement of services and benefit equitable economic growth.
- Prioritize, on the policy and institutional levels, creation of micro credit lines in the state budget as well as in donors assistance, rather than creating a favorable atmosphere to attract huge trans-nationals for mega-projects.
- Environment protection should be integrated in economic policies and natural resources management through traditional knowledge recovery, participatory approach development in management of natural resources and protected areas.
- Introduction of Strategic Environmental Assessment could be the one of the best tools for integration of environmental and social concerns into the decision-making process.
- Creation of an effective monitoring system to ensure equitable access to and management of the natural resources of Georgia, through close collaboration with relevant structures. Prevention of resource depletion and environmental pollution should lay foundation in decision-making process in social and economic fields.
- Identify and integrate all stakeholders interest in economic, social and environmental fields to ensure the sustainability of the country's economic growth.