Environmental Overview for Care Long-Range Strategic Planning Mid-Term Review.

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December 2007

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Executive Summary

The purpose of this report is to present an unbiased portrayal of the Georgian economy, state of governance and socio-political climate in advance of CARE's 2008 Long Range Strategic Planning Mid-Term Review. The report does this by trying to identify 'indicators' of development from a range of places. It serves two purposes. First, it offers a background for those involved in the meeting who do not have a comprehensive understanding of the current situation in Georgia. Second, it should help to facilitate discussions about where CARE goes from here.

Secondary materials rather than primary research are the most efficient way of gathering information for a report of this kind that favors breadth of coverage over detail on any particular issue. This report uses official Government statistics as well as reports and analysis from news, research and development organizations. This was supplemented with expert interviews but these were minimal. This approach has its limitations. Government data is notoriously unreliable and, on some issues, subject to political influence. In addition, changes to systems of reporting since the Rose Revolution make comparison over time difficult. These limitations are unavoidable but the report tries to minimize their impact by looking for multiple indicators on important variables like poverty and unemployment.

The report tries to focus on information pertinent for development and divides into categories on economics, governance and politics. The main findings are summarized below. As one can see, the project has chosen to focus on economics and governance over politics (either domestic or international). This is not based on the belief that politics is unimportant, but rather that the variables involved in political decision making, particularly in the charismatic politics of Georgia, are extremely volatile and analysis does not necessarily lend insight.

The Economy

GDP has grown at around 10% in 2005 and 2006 and was predicted to grow at 12.5% in 2007. The procedure for starting and running a business has been dramatically simplified. Taxes have generally been reduced and import taxes abolished on many goods while the amount of taxes collected has increased about 400% since 2003. Also, there have been significant improvements in physical infrastructure with almost continuous electricity supply restored throughout the country, improvements in roads, irrigation and rail.

However, there has been little or no improvement in levels of poverty or unemployment. Around 34% of the population live in poverty and 30-40% of the population are unemployment (if one looks at self-classification rather than Government statistics). Most Georgians do not seem to feel that their economic situation has improved since the Rose Revolution.

The failure to generally increase the situation for the bulk of the population results from the Governments failure to improve agribusiness, which provides about half the country's employment, or find anything else to replace it as a major employer. Rural productivity remains dire and there continues to be little investment in secondary food processing (with a few notable exceptions). As a result since 2003 agricultural production has seen a drop of 7% in real terms and the role of agriculture in GDP has dropped from 19%-11%.

For this reason, agricultural development has seen some of the most sustained efforts by development organizations. These IOs have worked on infrastructure (roads and irrigation), diversification and marketisation of production, provision of credit and encouragement of cooperation between farmers on buying and selling. Most of the international efforts have focused on import substituting agriculture which still seems to hold the greatest potential market in the short to medium term.

Governance

The reorganisation of the Government following the Rose Revolution aimed to remove corruption and down-size the administration of a bloated bureaucracy. This has been surprisingly successful in reducing day-to-day experience of corruption but concern still persists amongst Georgians that corruption continues in the higher levels of Government. In addition, while the reduction in Government size was essential, the continued regular change of ministers (on average one change of minister in each ministry per year since 2004) and the regular restructuring is potentially destabilising, particularly since the Ministers often change large proportions of the ministerial personnel with them.

The Government has incredibly successful in raising taxes, increasing its revenues from GEL 1.3 billion in 2003 to over GEL 5 billion in 2007. Expenditure has also increased accordingly but the priorities have shifted over the three years. In the first two years there were dramatic increases in expenditure on social services but over the last 12 months the priorities have made a decisive shift towards military expenditure. The recently announced 2008 budget suggests that this will be reversed.

Government power has appeared highly centralised, largely the result of the massive parliamentary majority held by the National Movement. Amendments to the constitution have further enhanced Presidential power and there have been no real efforts to strengthen regional Government. If anything localised power, particularly in the form of tax and spending capacity has reduced.

Politics

The political situation is obviously currently very difficult to judge. Certainly, the Government had shown little interest in inclusive politics, and Georgian politics generally continued to be characterized by mutual abuse on the part of all political groups more than reasoned argument. The run up to the local government elections in 2006 were troubling in two respects; first they seemed to suggest that the Government was more interested in securing absolute and unqualified victory than subscribing to meaningful democratic standards. Second, they showed, once again, that the opposition was utterly incapable of finding a common platform.

Of course, any assessment of the democratic or undemocratic inclinations of the Government seems to have been eclipsed by recent events. The decision to use strong-arm tactics to break up peaceful demonstrations in Tbilisi were horrifying and incomprehensible in equal part, particularly to the international community who had put so much faith in this government. Saakashvili seemed to realize that he had critically misjudged the mood of the international community when he quickly cancelled the 'state of emergency' and called early elections but whether this acts as the antidote to national and international disappointment is impossible to know. Finished in advance of the 5 January election, the report does not contain discussion of the election or the campaign that led up to it.

The very fact that the protests, and the reaction they generated were sufficiently serious to trigger a new election date is obviously significant. The Government's failure to improve the economic situation of average Georgians is often cited as a contributory cause for the current problems and Saakashvili's administration seems to accept this. The significantly modified budget for 2008 that re-orients priorities from the military to social spending should help. But without real improvements in industries that employ people (for the time being agriculture) Georgia is unlikely to stabilize anytime soon.

Background

The Rose Revolution of 2003 offered a massive mandate for change and the new Government, ratifying the revolution with elections in 2004, took the opportunity to force through a range of changes to the institutions of government, legal framework and orientation of the country. The vitality and grass-roots democracy of the revolution, combined with the enthusiasm for reform of the new Government and their Western orientation have encouraged huge levels of foreign interest, from foreign governments and international organizations. These have impacted on economics, governance and politics.

It was not long after the revolution that CARE developed its LRSP for 2005-2009. This plan was based on an understanding of the situation at the time and realistic hopes for the direction the new Government would take. The optimistic interpretation of possible development is manifested in their vision of the (hoped for) Georgia in 2015, entitled, *Return of David the Builder – Economic Growth, with a Benevolent Autocrat.* This predicted stable growth and development under an autocratic President who was able to negotiate the diplomatic difficulties of the region and the social tensions of the country to develop the economy, resolve the frozen conflicts and maintain good relations with Russia.

Some of there predictions proved to be accurate. The Government has succeeded in attracting considerable FDI under a highly centralized Government structure. The legal and regulatory environment for businesses has improved and become more transparent. Considerable improvements in infrastructure have been made and future improvements seem likely.

However, territorial integrity has not been restored. Far from achieving political détente with Russia, relations are truly disastrous with almost no practical contact between the countries. Perhaps worst of all, the failure of the government to secure significant improvements in the situation of average Georgians has fuelled dissatisfaction and can, at least partially, explain the recent protests. The rest of the report will consider these developments in more detail.

Economics

GDP and Income Distribution

GDP per capita has seen steady improvement over the last five years. Growth for 2005 was 9.6%, for 2006 was 9.4% and in 2007 is currently projected to be 12.5%. Average nominal wage has increased even more dramatically from 116 GEL per month in 2004 to a projected 225 GEL in 2007.[1]

Data on income distribution is limited. Official statistics show little change in the Gini coefficient[2] but day-to-day experience and simple deduction from other evidence suggests inequality has increased. Similarly, while average income has certainly gone up, suggestions of how most normal households have faired since the Rose Revolution are harder to find. One indication that the situation for the average household has not improved is the International Republican Institute (IRI) polling. Out of the six polls IRI have conducted since 2004 only once did more people say their financial situation had improved rather than worsened in the preceding 3 months. In their September poll only 8% said their financial position had improved while 46% said it had worsened.[3]

Poverty

According to the latest official statistics, at the beginning of 2006 33.6% of the population live below the absolute poverty line, defined by the Georgian Government as a subsistence income of between GEL 189 and 207 (USD 115 to 125) per month per average family.[4] In 2006 the average poor family lived 16% below this poverty line.[5] The overall percentage is slightly up on the first quarter of 2004 (32.8%). The latest World

[1] This is the increase in wages for those in Georgia with steady employment who, as we will see later, constitute a relatively small proportion of the economy. Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends: October 2007*, http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english-november%202007.pdf , p10
[2] The latest published figures show the Gini coefficient at a consistent 0.38 in gross cash income and 0.53 in consumption. In 2005 they were virtually identical. There has been no published Government figure on this since then. Statistics Department (2007) Quarterly Bulletin I p. 73 http://statistics.ge/publication.php?pform=-999999&plang=2
[3] International Republican Institute et al, *Georgian National Voter Survey*, (Tbilisi, Sept 10 2007), p10 http://www.iri.org.ge/eng/engmain.htm
[4] Department of Statistics estimates, http://statistics.ge/main.php?pform=49&plang=1
[5] Statistics Department, www.statistics.ge website accessed on 10/10/07.

Bank figures suggest that absolute poverty (measured at the $2 per day level) in Georgia was 25.3% in 2005.[6]

Official statistics show a sharp increase in rural poverty in 2005-2006. In the first quarter the poverty rates in urban and rural areas were almost the same at around 33% but in the by the end of 2005 urban poverty dropped had dropped very slightly, while rural poverty jumped to 39.3%.

There are, however, reasons to be suspicious of Government figures on poverty. For a start, relative poverty figures differ significantly depending on whether one is looking at the Georgian or the English language versions of the Department of Statistics web-site.[7] Equally, historic Government documents show different figures for the same years.[8]

A better alternative for measuring poverty is to look at the number of individuals who have registered at the database of socially vulnerable families.[9] As of September 2007, 496,000 households (or 1.4 million people) were registered at the database. This is 42% of total number of households or 34% of population.[10]

Using the same statistics we can see that the poorest continue to be those in rural areas and the elderly. 17% of people aged 70 and more receive subsistence allowance, as compared to 3.6% of age group 20-29 and 4.2% of age group 30-39. Recent Social Subsidies Agency data also suggests that this trend is worsening, since 61,287 rural inhabitants receive subsistence allowance as compared to 38,117 urban residents.

The limited progress in poverty reduction, in the face of high economic growth, results from the fact that the benefits of growth have mainly gone to those in full-time employment. Lower income groups, who are either unemployed or involved in subsistence agriculture, do not benefit from this growth in wages. Furthermore, income redistribution is weak and under-funded. Only 21% of the households registered at the

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[6] World Bank (2007) http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/GEORGIAEXTN/0,,contentMDK:20169119~menuPK:301771~pagePK:1497618~piPK:217854~theSitePK:301746,00.html (accessed December 2007)

[7] On the Georgian language site the level of relative poverty is 23.3% (see http://statistics.ge/main.php?pform=80&plang=2). On the English language site it is 34.1% (see http://statistics.ge/main.php?pform=49&plang=1)

[8] For example, Government of Georgia, *Economic Development and Poverty Reduction Program: Progress Report*, shows poverty in 2004 at 52%, while the current Department of Statistics website (above) shows it at 33% for the same year.

[9] The approach is strong because it should include the majority of people who self-identify as 'poor' without the need for statistical extrapolation, or problematic calculations of what level we should set poverty. At the same time, feelings of poverty may not reflect real income or consumption levels so may not be entirely valid against any objective standard.

[10] Social Subsidies Agency (2007) Report on the Recipients of Social Assistance (Prepared for the Ministry of Labor, Health and Social affairs and provided by a former civil servant, Sept 2007). The main reason for the disparity between households and population percentages is that individuals living alone (particularly the elderly) are the most likely group to be living in poverty.

database of socially vulnerable families are entitled to a means-tested benefit,[11] and this benefit is far below the subsistence minimum.[12] In addition, the cut-off point for this means-tested benefit does not seem to be growing with inflation.[13]

Unemployment

Officially, unemployment has increased from 12.6% in 2004 to 14.9% (projected) for 2007. In contrast when people are asked somewhere between 30 and 40% classify themselves 'unemployed'.[14] The reason for this, as a 2006 TI report suggested, is that

> the Department of Statistics does not include in this figure individuals living in villages on even minimal plots of land as they are considered self-employed. That is, individuals who are effectively unemployed and rely on subsistence farming to survive are included among the employed. Thus, while it is difficult to obtain credible information about the unemployment rate in Georgia, public concern about the issue is widespread.[15]

Therefore, more important than simple employment figures is the composition of employment and the percentage of the population available for employment. Again, according to official statistics, in 2006, out of 1.7 million employed approximately two thirds or 1.1 million are self-employed and 84% of these are in the agriculture sector. Overall employment rates, at 53% and also show a decline from 56.8% in 2003.[16]

Because of the inclusion of subsistence agriculture in official statistics, urban areas routinely show higher unemployment than the countryside, however, if one did not include subsistence agriculture as 'employed' the situation would probably reverse.[17]

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[11] Social Subsidies Agency (2007) Report on the Recipients of Social Assistance (Prepared for the Ministry of Labor, Health and Social affairs and provided by a former civil servant, Sept 2007)

[12] The value of the means-tested benefit is 30 GEL for the first person and 12 GEL for each additional family member Statistics Department (http://statistics.ge/main.php?pform=80&plang=2)

[13] January 2007 to October 2007 it has increased only by 4.5% from 99.6 GEL to 104.5 GEL a month. This would assume an average inflation rate of 5.4% per annum for that time, significantly below the rate of inflation, even as formally recorded.

[14] IRI's poll gave an average unemployment estimation of 31%. See International Republican Institute et al, *Georgian National Voter Survey*, (Tbilisi, Sept 2007), p7 http://www.iri.org.ge/eng/engmain.htm. The CARE baseline survey of Samtskhe-Javakheti and Kvemo Kartli suggested an unemployment rate of 36.3% across these regions. Institute for Social Researchers, *Baseline Survey with Communities along the BTC/SCP Pipelines*, Report for CARE International in the Caucasus (2007), p12, International Republican Institute et al, *Georgian National Voter Survey*, (Tbilisi, Sept 10 2007), p7 http://www.iri.org.ge/eng/engmain.htm

[15] Transparency International, *Fighting Unemployment in Georgia*,

[16] Statistics Department, *Quarterly Bulletin I 2007*. pp. 85-86 available at www.statistics.ge

[17] Tbilisi, has continually rated 20% unemployment compared to around 10% in the regions. In 2004, for example, Samtskhe-Javakheti officially only had 6% unemployment and Kvemo Kartli had 12% while Tbilisi had 20%. Kocks Consult GmbH, *Samtskhe-Javakheti Rehabilitation Project: Socio-Economic Impact Study Report*, prepared for the Millennium Challenge Georgia Fund, Tbilisi, Georgia (November 2007), p17

The fact that employment continues to be focused in agriculture also explains the growth of unemployment in the face of apparent economic growth. Since 2003 agricultural production has seen a drop of 7% in real terms. As the economy has expanded this has meant that the role of agriculture in GDP has dropped from 19%-11% over the same period.[18] The areas of the economy that have seen clear expansion in terms of employment are ill-suited to labor transfer from agriculture. While there may be some manual labor available in construction,[19] the growth areas of finance and telecoms are clearly more suited to newly trained university graduates.

In fact, the great worry is that the boom in some sectors of employment at the moment is creating the equivalent of a 'Dutch Disease' whereby large foreign inflows can distort the economy away from long-term sustainable development. Well educated Georgians often find that they can earn more in the NGO sector than in commercial work.[20] They also have wide ranging opportunities for foreign funded Masters degrees.[21] For those with the right combination of language and/or technical skills incomes are clearly soaring, particularly in finance, telecoms and IT. One result of this is that in areas requiring modern technical skill sets there is labor shortage. One director of a large IT consultancy firm in Tbilisi explained that it is cheaper for him to fly technicians in from India than to hire them locally.[22]

Similarly, the boom in property prices and the high-end incomes of some of Tbilisi's upper-middle class is both encouraged by, and encourages, entrepreneurs in Georgia to focus their attention on property, hotel and restaurant development. As Richard Hurelbrink, the Director of AgVantage, said 'Georgians just don't want to invest in agriculture. Some of these opportunities are good solid businesses but they are considered too risky by entrepreneurs looking for quick returns'.[23]

In addition, little of the foreign investment of NGO money has successfully produced sustainable improvements in employment. For example, in spite of its enormous size, MCG estimates it will only employ around 400-500 people directly during the two-year building project that will hopefully start in the spring.[24] In comparison the closure of the Russian military base that employed 1,500-2,000 people will continue to have a

[18] Calculations based on figures at: Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends: October 2007*, *http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english-november%202007.pdf* (viewed December 2007), p11

[19] One senior construction manager that was interviewed for this project suggested that about half of the construction workers in Georgia are foreign, mainly Turkish.

[20] This may not be true for those with good degrees in technical/professional skills like computing, engineering or finance.

[21] It is not uncommon in the current environment for individuals offered positions on the US Muskie Program (a US Government funded program that places and pays for Masters Degrees in the US), to turn down the positions offered to them because the prospective student does not consider the institution prestigious enough.

[22] Interview with Senior Director of IT consultancy firm. Interview conducted by George Welton for another research project (October 2006)

[23] Interview with Richard Hurelbrink (for another project), Director, AgVantage, (August 2007).

[24] Kocks Consult GmbH, *Samtskhe-Javakheti Rehabilitation Project: Socio-Economic Impact Study Report*, prepared for the Millennium Challenge Georgia Fund, Tbilisi, Georgia (November 2007), p17

significant impact on the Akhalkaki region (estimated at USD 300-600, 000 per month) for the foreseeable future.[25]

Rampant unemployment has commonly been acknowledged to be one of the biggest problems of Georgian society, not only creating poverty, but fuelling social tensions and encouraging migration.[26] The Governments inability to tackle both poverty and unemployment is routinely cited in opinion polls as their greatest failure[27] and as such is often considered the main reasons for the anti-Government feeling that facilitated the recent political troubles.

The Government continues to claim (particularly as part of its election campaign) that reducing poverty and increasing unemployment are its top priorities, and Saakashvili has made extremely ambitious claims about the degree to which he would tackle unemployment in his second term. He has offered few specifics on *how* he would do this. Up until now, however, government has adopted a three-fold approach for combating unemployment. First, they have attempted to stimulate labor demand by establishing favorable conditions for employers by adopting a very liberal labor code and cutting profit and social taxes (again, to be discussed later).[28]

Second, in September through to December 2006, the Government initiated a trial on-the-job training program. Through this program they provided 150 GEL per month to up to 50,000 beneficiaries and helped to place them in working businesses. The aim of the program was to provide on-the-job training to the unemployed and make use of a lot of free labor. However, assessments of this program have not generally been positive. Transparency International, for example, suggests that positions were generally ill-suited to offer training and little or no long-term employment resulted.[29] For this reason the program was not continued, though immediately after the January election was called, the Government reinstated and expanded the program for 2008.

Third, the Government have attempted to stimulate employment by offering incentives to businesses that employ a lot of people. Most obviously, the principle target of the agricultural *100 New Businesses* project is employment. I will discuss this in more detail below.

Inflation

25 Hedvig Lohm, *Javakheti after the Rose Revolution: Progress and Regress in the Pursuit of National Unity in Georgia*, ECMI Working Paper No 38 (April 2007) p10.

26 International Crisis Group, *Georgia's Armenian and Azeri Minorities* (Tbilisi, Nov 2006), p4.

27 International Republican Institute et al, *Georgian National Voter Survey*, (Tbilisi, Sept 2007), p14 http://www.iri.org.ge/eng/engmain.htm

28 From 2008 social and income taxes (the former being 20% paid by the employers and the latter paid by employees at a flat rate of 12%) will be merged into a single income tax with a flat rate of 25%. The payment of the will be privately decided between the employer and employees.

29 Transparency International, *Fighting Unemployment in Georgia*, (April, 2007). Because of its apparent ineffectiveness this program was planned to be scrapped, but in November (and after the crisis) Saakashvili announced that it would be reinstated, even expanding its remit to cover 100,000 people.

Inflation was officially 9.2% for 2006 and has consistently stayed close to 10% since 2004. However, there is a strong sense amongst Georgians that the cost of necessities has increased much more quickly than this figure would suggest. In order to gain some indication of how prices have changed on essential goods we interviewed four Tbilisi residents and asked them their recollection of prices three years ago compared to today.

Average cost of basic necessities.

Item	2004 (GEL)	2007 (GEL)	Overall increase (%)	Equivalent Annual increase
Gas (1 cubic meter)	0.27	0.51	88%	23%
Bread (1 loaf)	0.45	0.625	38%	11%
Cheese (1kg)	4.25	8.125	91%	24%
Meat (1kg)	4.37	8.125	85%	22%
Tomatoes (1kg)	0.55	1.06	92%	24%
Potatoes (1kg)	0.45	0.925	105%	27%
Electricity (kilowatts)	0.082	0.16	95%	24%
Water (per unit)	0.95	2.10	121%	30%

Reference: The figures are the average of interview with four Tbilisi residents (who more or less agreed on the prices).

Obviously it would be unwise to place too much credence in figures that are based upon the recollections of so few people. However, it is worth noting that if the price of many basic goods has increased by 100% in 3 years, this might effectively wipe-out the benefits of, for example, increases in average wages, or increases in pensions.

Market Liberalisation/Market Orientation

As already mentioned, one of the main strands of the Governments reforms (and particularly economic development) agenda, has been to liberalise the economy, reduce taxes and regulations and make it easier to conduct an officially registered and legally taxed business. The international assessments of these efforts have been positive. Most often cited is the World Bank which ranked Georgia 18th on its *Ease of Doing Business Report*.[30] The areas in which the World Bank formulates their assessment include, starting a business (now ranked 10 in the world), dealing with licenses (ranked 11), employing workers (ranked 4), registering property (ranked 11), etc.[31]

Alterations to the tax and customs system are also generally considered to have made life easier for businesses (particularly medium and large businesses). After 2003 the Georgian Government undertook three kinds of reforms in the area of taxation. First, they

[30] According the same report Georgia improved faster in 2005 than any other country and in 2006 improved in more areas than any other top performer The World Bank, *Ease of Doing Business Report: 2006* and the same report for 2007 http://www.doingbusiness.org/ExploreEconomies/?economyid=74

[31] Note that not all sources agree on this assessment. The World Economic Forum 2007-8 *Competitiveness Report* ranks Georgia as 90th out of 131 countries. But parts of this report seem out of date.

reorganised the institutions of collections and control,[32] second, they changed the procedures for tax declaration and third they changed the values of tariffs charged. The overall tax-burden for businesses is now estimated by the World Bank to be 38%.[33]

Customs has seen even more drastic change in taxation rates with a move to zero rating on most non-agricultural goods. This is part of a general liberalising strategy, but is also part of Georgia's attempt to try and make itself a transportation hub between Central Asia and Europe. The most recent development in this trend was the enactment, on July 3rd, of a law that would allow for free economic zones within Georgia. Companies within these zones would be exempt from profit, property tax and VAT. This paves the way for the development of Export Processing Zones in the vicinity of Batumi and Poti ports and Batumi and Tbilisi airports.

Agricultural goods are an exception to this trend and are likely to remain so for political reasons. Most agricultural goods produced in Georgia, including meat, potatoes, tomatoes, onions, cucumbers, carrots and cabbage have the highest import tariff rate of 12%, and only cheese has the intermediate rate of 5%.[34]

Social Impact

Of course, while all of these reforms are to be welcomed, their impact on the most socially vulnerable is less clear. The World Bank 'Ease of Doing Business' indicators, take the employers rather than the employees perspective. Scoring high on ease of 'employing workers', for example, means that employers can hire and fire who they choose and for whatever reason.

Similarly, while the increase in Government tax receipts has been vital for the Government to function, increased effectiveness has brought with it costs that are particularly hard on the poorest sections of society. Prior to the Rose Revolution many street vendors, seasonal traders and small agricultural producers were operating without licenses, or registered businesses, and paying little or no taxes either for themselves or their employees. While they were susceptible to occasional police extortions, this way of life provided support for many of Georgia's most vulnerable.

In addition to requiring traders to pay taxes there have been continual moves to reduce street trading particularly in Tbilisi. No figures exist to show how many businesses have been closed by the process of economic 'normalisation' since the Rose Revolution. However, the simple disappearance of most street trading in agricultural products from Tbilisi streets, the cost incurred in buying cash registers and keeping proper accounts and

[32] The Departments responsible for taxation have seen almost continual overhaul since the RR. Following significant reorganisation of both the customs and tax departments of the Ministry of Finance, in April 2007, the functions of the Tax Department and the Customs Department and Financial Police were combined into a new State Revenue Service under the Ministry of Finance. This was intended to streamline the administrative operations of the two departments and to ensure better information sharing.
[33] See http://www.doingbusiness.org/ExploreTopics/PayingTaxes/Details.aspx?economyid=74
34 Interview for another project with Teimuraz Kopaleishvili, Head of Staff of the Parliamentary Budget and Finance Committee (August 2007).

the 'new taxes' that formerly grey businesses are now paying, is clearly a source of dissatisfaction for many and will have pushed some people, surviving under the old system, back into poverty.[35]

Composition of the Economy

There have been significant changes to the economy since 2004 in terms of composition of production and consumption. Between 2003 and 2006 industry (manufacturing, energy production and mining) reduced its role in GDP from 17.7% to 14.9%, agriculture reduced from 19.3% to 11.3% and construction went from 6.4% to 6.9%.[36] These (mainly) reductions have been made up for by increases in transport and communications and in trade, hotels and restaurants. One estimate suggests that the value of tourism services for July to October 2006 amounted to 95.8 million dollars.[37]

Agriculture

As the single largest employer it is worth taking a moment to consider the situation for agribusiness in Georgia. As already mentioned, the output of the agricultural business has decreased marginally in real terms and significantly as a proportion of GDP. Its share of GDP decreased from 19.3% in 2003 to 11.3% in 2006.[38] The agricultural sector also shows practically the lowest productivity of any sector of the economy.[39]

The difficulties of agriculture in Georgia are well documented. The collapse of the Soviet collective farming system, and the process the Government chose for distributing land, left Georgian farmers with small land-plots and no immediate land-market or incentives for consolidation. As a result, even now, of the (approximately) 656,000 farms in Georgia, the vast majority have land-plots of less than 1 hectare, and less than 16,000 farms have plots of more than 4 hectares.[40] In income terms, Georgia produces roughly

[35] Many of these changes, particularly on the need to legalise street markets and the need for electronic cash-registered have been either reversed explicitly or ignored by the authorities on the run up to the Georgian Presidential elections. Whether this marks a serious attempt by the Government to correct past failures, or whether it is simply an attempt to appear more reasonable before the January 5th Ballot is unclear at this time.

[36] Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends: October 2007*, *http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english-november%202007.pdf* (viewed December 2007), p13

[37] Government of Georgia, Department of Statistics, *Shuttle Trade in Georgia: Report of the Survey of Shuttle Trade and International Tourist Services* (Tbilisi, 2006), p8

[38] Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends: October 2007*, *http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english-november%202007.pdf* (viewed December 2007), p13

[39] Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends: October 2007*, *http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english-november%202007.pdf* (viewed December 2007), p13

40 Interview (for another project) with Richard Hurelbrink, Director of AgVantage (20th August 2007)

50% of its income from plants and 50% from animal husbandry and this has remained consistent for the last 6 years.[41]

A range of problems are generally considered at the heart of Georgia's agricultural woes. Ironically, the collectivist system seems to have left farmers with no idea how to organise collectively. A state apparatus that required cooperation was not replaced with a commercial understanding of the benefits of specific collective efforts, so coordination in maintenance of infrastructure, buying of inputs, pooling of production or selling functions has not emerged naturally. Without this, machinery, infrastructure and collective capacity collapsed.

A range of efforts are being made to correct the major infrastructure problems facing farming. Transport infrastructure is being rebuilt (discussed below) which should allow farmers to get their products to market.

The second biggest infrastructure priority for farming across the country is repair of the irrigation system. Irrigation is important because better irrigated fields are more productive, but perhaps more importantly, irrigation is a protection against drought. Droughts occur every three or four years in Georgia and without protection from drought it is extremely hard to persuade farmers to invest in more productive methods, seeds or machinery, since a drought will effectively destroy an investment that might require return over many years.[42]

As a result of this, irrigation has also been the focal point of international efforts. The World Bank has been the largest investor, though many organisations have put money into irrigation. The World Bank effort was originally planned to spend $27 million and finish at the end of 2007, but following flooding last year another $13 million dollars was added and the project was extended until the middle of 2008. This will pay to physically reconstruct the irrigation for 30,000 hectares and will support 'amelioration associations' to better manage existing networks on another 80,000 hectares.[43]

Agriculture also suffers from poor financing, inputs and out of date equipment. All of these problems are being tackled by a range of institutions. At the same time there seems to be a growing sense in the development community that these inputs and finances are unlikely to be utilized well without considerable improvement in the financial expertise and management skills on the part of farmers. As a result, along with the provision of inputs it has been increasingly common-place to provide business development and consultancy support.

[41] Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends: October 2007*, *http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english-november%202007.pdf* , p17

42 This is particularly clear for potato production since good seeds need a return over 3-5 years. In this situation, a drought is not just destroying earnings for one year, but is destroying the basis for earnings over several years. In this risky situation, it makes more sense to buy cheap, less productive seed.

[43] It is important to be clear on this. While the World Bank and the Ministry of Agriculture routinely cite the 110,000 hectare figure, according to the manager of the World Bank project only 30,000 hectares are being physically reconstructed by this program. Interview with Constantine Mgeladze, Manager, Irrigation Department, Municipal Development Fund of Georgia, (Tbilsi, December 2007).

With growth in productivity and reduction in price it is hoped that the agricultural industry should be able to provide a large local demand that is currently being serviced by imports. CARE's own market survey identifies a market for seed potatoes which are consumed locally at a level of 80,000 MT while only 600-700 MT are produced locally of any reasonable quality.[44] In potatoes for consumption there was an increase in imports from 4,600MT to 23,508MT between 2005 and 2006, carrot imports went from 102 MT to 1,186MT, tomatoes from 1,100MT to 4,135MT (all of these increases were partially the result of a poor 2005 harvest in Georgia).[45] Processed food products seem to offer even more opportunity for import substitution.[46]

As a result, while many of the international organizations argue that they are trying to promote exports, the usual focus of agricultural production, in the first instance, is import substitution. As Richard Hurelbrink from AgVantage points out, 'we started out aiming at export markets but then we realised that even the goods that you export are 85% consumed at home. You can't do export without doing the domestic market'.[47]

Another reason to focus on local markets is that developing agricultural products for export is far more difficult. The Turkish and the European markets are still fairly protected. Russia's market, except for small amounts of goods still making their way through the Ukraine and goods illegally transiting through Abkhazia or South Ossetia, is closed.

However, even without these hurdles, in the short-medium term Hurelbrink continues,

> Georgia farmers do not engage in the kind of commercial planning and contracted relationships necessary to supply export markets. Even in Moscow [a less Westernized market space] there are only 5 or 6 major retailers, and they want suppliers who can provide reliable products year round. Georgia is just not able to provide them the quality and consistency of product they demand.[48]

The effort to see secondary producers develop alongside agricultural production has also produced one of the Governments key agricultural development projects. Called *100 new businesses*, the Government will sell off 40,000 hectares of agricultural land (in 400 hectare plots) at 20 percent of its market price with the requirement that the investor sets up a

[44] Association of Business Consulting Organizations of Georgia, *Market Study for Potato, Vegetable, Milk and Cheese in Georgia* (Tbilsi, 2007), p5

[45] Association of Business Consulting Organizations of Georgia, *Market Study for Potato, Vegetable, Milk and Cheese in Georgia* (Tbilsi, 2007)

[46] In private discussion with one informed investor, it was suggested that their research put imported volumes at food retail outlets between 75-80% and the possibility of import substitution of these goods anywhere between 30-90%.

47 Interview (for another project) with, Richard Hurelbrink, Director of AgVantage (August 2007).

48 Interview (for another project) with, Richard Hurelbrink, General Director of AgVantage (August 2007).

processing plant on the land within a year. The principle objective of the investment is project is job creation.[49]

Changes to Physical Infrastructure

Changes to infrastructure since the Rose Revolution have been considerable. The government have particularly focused on hard infrastructure with the largest expenditure going on roads, irrigation, rail and energy provision. Developments in irrigation were dealt with in the section on agriculture. We will now consider road, rail and energy.

Transport Infrastructure

There are roughly 20,250 km of operational motorways in Georgia and 1,550 km of railways. Annually, roughly 24.5 million tonnes of freight are transported over roads, compared to 16.3 million tons by rail. Unsurprisingly, passenger travel also heavily favours the roads, with 257 million person trips on the roadways compared to 2.2 million on the railways.[50]

Both road and rail travel are rebounding from the collapse following the economic downturn of the early 1990s. Traffic and freight levels are climbing back to pre-collapse levels, but the road and rail networks are ill-suited to manage the increasing load. In response to this, and in line with the Governments plans to develop Georgia into a major transportation hub, major road repairs are currently underway, mainly financed from the central government budget and the Millennium Challenge Georgia account.

The main road through the country has undergone some repair and a small section of it, heading West out of Tbilisi, has been transformed into a two-lane dual carriageway. Considerable central Government funds have been allocated for this work with (as has already been mentioned) the Government projected to spend a projected GEL 440 million in 2007 (USD 267 million) on communications and infrastructure and a large proportion of that is expected to be spent on the central road.

On top of this the region of Samtskhe-Javakheti has already seen remarkable improvements in the quality of their road connections. The vast majority of the 310km from Tbilisi to Ninotsminda, much of which was impassable 3 years ago, is now good quality new road. This has already improved the connection time and ease of transportation to the main market in Tbilisi and should help to make agricultural businesses in the region more viable.

The connection of this ethnically concentrated region will further improve when USD 102 million allocated by the Millennium Challenge Georgia Account is dispersed. In particular, this will involve the construction of a 167km road that connects the ethnically

[49] Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends: October 2007*, *http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english-november%202007.pdf* (viewed December 2007), p10

50 *Assistance in Assessing the SJRR Project, Draft Final Report*, The Louis Berger Group (April 2005)

Armenian town of Ninotsminda to Tbilisi directly. This should further help integrate this previously isolated region, reducing travel times from 6hrs (on the more indirect road) to 3 or 4hrs. At the same time, with a USD 200 million loan from the Azerbaijani Government, the Georgians will be constructing their section of the Baku-Tbilisi-Kars railway project.

Clearly all of these developments have enhanced the physical integration of the country and make agricultural businesses more viable as they give agricultural businesses access to new markets. In addition, they increase the viability of Georgia as a new transit hub and therefore create potential revenue from transportation.

Energy Supply

Dependence on external sources of gas and oil continue, although Georgia responded to the 2007 Russian gas price increase by re-sourcing much of its gas needs from Azerbaijan. In the first ten months of 2007 Georgia has imported 830 million cubic meters from Russia, but for the same period of 2006 had imported 1.4 billion cubic meters.[51]

Electricity provision has improved dramatically since the Rose Revolution. According to USAID the regions of Georgia, for the first time in 15 years, can expect 24 hr electricity provision under normal circumstances.[52]

This has partially resulted from significant investments in infrastructure designed for electricity provision. Under management of the USAID partner PA consulting consumer bill collection rates across the country have risen from a 17% in 2003 to almost 100% in 2006.[53] In cash terms this has increased collection rates from USD 19 million in 2003 to USD 119 million in 2006.

This success has helped to facilitate the deal, finalised in the last quarter, that secured the purchase of six hydro plants and two electricity distribution companies by the Czech *Energy Pro*, giving Energy Pro 60% of the market for electricity provision in Georgia, valued at USD 132 million. As part of this deal Energy Pro committed to 'spend USD 85 million on the rehabilitation of the hydro plants and USD 15 million on the energy networks'.[54] Of course this does not mean that all households have 24 hr electricity, since some houses are off-grid. But there has certainly been significant improvement.

Telecommunications and Computing

[51] Civil Georgia, *Georgia Imported 830 mln m3 of Gas from Russia* (24th November 2007)
[52] USAID web-site, accessed December 2006 (http://georgia.usaid.gov/index.php?m=17)
[53] USAID web-site, accessed December 2006 (http://georgia.usaid.gov/index.php?m=17)
[54] Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends: October 2007*, *http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english-november%202007.pdf* (viewed December 2007), p9

While the landline network in Georgia is out-of-date and needs considerable investment the country enjoys almost complete coverage with its mobile-telephone network. According to one large recent poll, almost as many households now have a mobile phone as own a color TV.[55] In addition, the market remains competitive with new entrants Beeline applying pricing pressure to the existing Duopoly of Magti and Geocell.

Computer and internet use, however, remains low and internet connections both geographically restricted, expensive and slow. Computer ownership in Tbilisi is 24% though in the country it is more likely to be 1-2%.[56] Computers and internet connections are almost non-existent in schools.

This may change soon. Georgian telecommunications provider, Caucasus Online and the US-based Tyco Telecommunications, are set to build a 1100-kilometer fibre-optic link which will connect Georgia's Black Sea port of Poti with the Bulgarian city of Varna, giving Georgia direct connection to the European network for the first time.[57] The Government has also been discussing the terms of its own virtual private network (VPN) with providers and this could provide the backbone fibre-link to connect far more of the country.

Foreign Direct Investment

One of the reasons for the efforts to westernize and liberalise Georgia's economy has been the belief that this will attract foreign investment to the country which will, in turn, produce jobs and growth. Earlier this year Saakashvili set ambitious goals for attracting USD 2 billion of FDI to Georgia in 2008.

FDI for 2006 was USD 1.1 billion, up from USD 330 million in 2003 and projected to increase significantly again in 2007. The composition of this investment is extremely variable. Kazakhstan has, in recent years, been the most consistent large investor, but in the last published quarter, with its investment in energy supply, the Czech Republic has surpassed them.

Amongst the main investments over the last couple of years (excluding BP) has been Kazakh investment in Batumi and investment in the ports as well as the construction of new Airports for both Batumi and Tbilisi. These investments have often been tied to the sale of state assets. Where state assets are concerned the official Government strategy has been to prioritize long-term investments plan over price. For example, the electricity distribution sale to *Energy Pro* already outlined, was structured to ensure long-term development of the electricity provision infrastructure.

While this approach to the sale of assets makes good sense in the long-term, its efficacy entirely depends on the Governments ability to ensure that companies conform to the terms

[55] According to this survey 50% or rural households have a mobile phone, 64% of urban households and 74% in the capital. Hans Gutbrod, *Georgia on the Eve of the Elections: Insights from the Data Initiative 2007*, Caucasus Research Resource Centre, Tbilisi, (December 2007), p6

[56] Hans Gutbrod, *Georgia on the Eve of the Elections: Insights from the Data Initiative 2007,* Caucasus Research Resource Centre, Tbilisi, (December 2007), p6

[57] Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends: October 2007*, *http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english-november%202007.pdf*, p11

of their contract and make the investments they have promised to make. Some observers suggest that the Government has performed badly in this area. As Giorgi Chekheidze, the President of GYLA, points out,

> There are frequent cases when people who have purchased state property to not fulfill their accepted responsibilities and the Ministry of Economic Development, as the second party in the contract, do not take action to enforce the contracts.[58]

The generally impressive range of FDI has been encouraged by and helped to facilitate improvements in Georgia's official investment ranking. Its credit rating, according to international organizations has been generally improving. In July 2007 Fitch, a global credit rating organization improved its ranking of Georgia to a 'BB-' rating with a 'stable outlook'. This resulted from, 'a declining public debt burden, rapid GDP growth, an impressive record of structural reform, an increase in foreign FDI and strong international financial support.'[59] However, there have been some reversals. Standard and Poor, having significantly upgraded their rating in 2005, downgraded it slightly in 2006 from 'positive outlook' to 'stable' because of tensions with Russia.[60]

In addition, it is clear that this level of investment over such a short time has created a number of side effects. It has certainly fuelled inflation and allowed the GEL to maintain an exchange position which the fundamentals of the economy cannot currently justify. In particular it has helped to finance a massive trade deficit since the strong GEL has kept the price of imports relatively low and made exports expensive. The trade deficit of USD 1.8 billion (for 2006 and currently increasing) is clearly unsustainable.

Governance

The Rose Revolution of November 2003 represented an unprecedented mandate for change in the Government of Georgia. However, the Government structures the new Government inherited reflected an organization that not only depended upon corruption and nepotism but lacked the basic administrative requirements for a modern civil service. In reaction to this, the Saakashvili administration has attempted to reorganize the structure of government and, with the help of the international community, provide a new legislative environment within which internal reform can be coordinated.

The Government started by radically reorganizing the basic structure of the executive. Amongst the major changes that have been implemented are that 28 old ministries were consolidated into 13 new ones, 18 state departments were abolished and large numbers of personnel at all levels were either replaced or required to re-apply for their old positions in the new ministerial structure. The OECD report on this process commented in 2006,

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[58] Interview with Giorgi Chkheidze, Chairman of GYLA, December 2007

[59] Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends: October 2007*, http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english-november%202007.pdf , p10

[60] Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends: October 2007*, http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english-november%202007.pdf p10

> The new Government introduced active reforms in the area of public administration since it gained power in late 2003. The reforms dealt with difficult institutional issues of central government restructuring and massive re-staffing, as well as streamlining administrative management practices in operation.[61]

The initial reform of the Government structure was aimed at slimming an inflated bureaucracy and tackling corruption. These efforts have been generally considered a success. However since then the process in Governance reform has stalled. As one public administration expert explained to us, 'we have made good progress in legislative and bureaucratic reforms, reducing red-tape, corruption, etc. But after these initial reforms we did not move forward and there is no political will for significant further reforms'.[62]

As a result of this Governments Departments have remained unstable. Reforms are still regular with the Ministers changing, on average, once a year in all of the Government Ministries since the Rose Revolution. The Ministry of Economic Development, for example, has had six Ministers since the Rose Revolution and the Ministry of Defence has had four.

This is particularly debilitating to Ministerial effectiveness because, in the highly centralised, clientilistic and politicised bureaucracy of the Ministries it is common place for significant numbers of the staff to be moved with the Ministers. Even though it is not technically legal under the existing *Law on Public Service* Ministers will routinely ask all of the subordinates to resign the day they start in office, and then selectively rehire those they want to keep.

This problem is made worse by the culture of continual reorganisation that pervades central Government. Ministers often seem to feel that it is important to reorganise their departments both to stamp their own character on their new terrain and demonstrate effectiveness. Ministers are fiercely protective of their autonomy, but particularly under the guidance of State Minister for Reforms Coordination, Kakha Bendukidze it has become stated policy that this form of decentralized leadership is the best way of getting things done. As Vakhtang Lejava, the Deputy State Minister for Reforms Coordination explains, 'imagine if 10 years ago you had fixed Government [so that now they would have to be part of the present Government]. You would have 10% of the staff knowing computers and languages'.[63]

Assessing the effectiveness, efficiency and responsiveness of the Government in Georgia is extremely difficult because the Government itself does not have a clearly enough stated strategy to provide indicators for comparison. For example, while the *Medium Term Expenditure Framework*, has been officially adopted by the Government to increase transparency and efficiency in Ministries and in Government financial planning generally, as Transparency International points out, the Ministries have been falling behind in utilizing

[61] *Istanbul anti-corruption action plan for Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, the Russian Federation, Tajikistan and Ukraine: Georgia Draft Monitoring Report (Revision 1)*, Anti-Corruption Division Directorate for Financial and Fiscal Affairs, OECD, (June 2006), p19
[62] Interview with public administration expert and senior member of the civil service, (Oct 2007)
[63] Interview with Vakhtang Lejava, First Deputy State Minister on Reforms Coordination (Oct 2007).

this instrument since 'to date the ministries have been having difficulties in providing quality information about needs assessment, anticipated results, and assessment criteria'.[64]

All of this means that there are very few centralized systems of management and control to assess and the workings of individual ministries differ considerably, depending on who is the Minister at any one time. Needless to say this means that Government coordination across Departments, let alone Ministries, is extremely inefficient.

Income and spending priorities

Probably the clearest indication of Government success in eliminating the grey economy and normalising business is that while the level of taxes has gone down, overall tax receipts have increased dramatically. Government income was GEL 1.3 billion (USD 788 million) in 2003 and has risen to GEL 4.2 billion (USD 2.55 billion) in 2006 and GEL 5.1 billion (USD 3.1 billion) in 2007. Put another way, Government income has increased 4 times in 4 years.[65]

While Government has tried to develop strategic planning faculties, plans rarely remain constant for long. In 2006 the Government prepared the *Basic Data and Directions* document that provides an explanation of Government priorities and projected spending break-downs for next three years. However, this does not provide a good basis for assessing Government priorities since it is drastically out of date almost as soon as it is written. Defence spending, for example, in 2007 is already more than 50% higher than its projected 2011 level.[66]

The easiest way of assessing changes in Governmental spending priorities is to look at the changes in the government budget over the last three years. The biggest recent shift in spending has been a move to prioritise defence, public order and security. As a combined line-item this was already worth 24% of Government expenditure in 2006, but for the first two quarters of 2007 it increased to 34% of Government expenditure. The majority of these increases have gone into defence. With further increases in September the current projected defence budget for 2007 is GEL 1.27 billion (USD 770 million) or around 30% of the state budget.[67] This is a dramatic increase on the level of 10% that the Government projected for 2007 last year and it is hard to know what has changed in 12 months that could justify such dramatic increases.[68]

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[64] Transparency International, *Expenditure Dynamics Since the Rose Revolution*, (Tbilisi, April 2007)

[65] Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends: October 2007*, *http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english-november%202007.pdf* (viewed December 2007), p21

[66] Government of Georgia, *Basic Data and Directions*, (Tbilisi, 2007), p27

[67] Ministry of Defence Website, http://www.mod.gov.ge/?l=E&m=6%20(English).

[68] Transparency International, *Expenditure Dynamics Since the Rose Revolution*, (Tbilisi, April 2007), p2 Note that this shift may be a little misrepresentative since until the middle of 2006 other, non-budgetary instruments existed for financing the Ministries and police. Up until the middle of 2006 two funds existed outside of the conventional budgetary system called, *the Georgian Army Development Fund* and the *Law Enforcement Development Fund.* These collected 'donations' from patriotic businessmen. These funds were legal entities in Public Law and so not the responsibility of the Ministries directly and since the bodies that reviewed them only had National Movement Members, they effectively avoided oversight.

This could be about to change. In the run-up to the Presidential election the announcement of the 2008 budget has shown a drastic shift from military back to social service spending. Social services that include pensions, means tested benefits, families assistance, utilities subsidies, support to IDPs and child-care were together the largest item on the Government budget until 2007. They had dramatically increased after the Rose Revolution, moving from GEL 107 million (7% of the budget) in 2003 to GEL 643 million (or 16% of the budget) in 2006.[69] This dropped to 11% for the first two quarters of 2007.

Spending on education also seems to have increased from 4% of Government expenditure to 9% of Government expenditure in 2006. However, it is hard to know how significant this jump really is, since 2006 was the year when central Government took full responsibility for school funding. Up until that time some school funding had been provided locally. This was projected to increase to 10% in 2007 but with the recent reallocations may fall (as a proportion of Government expenditure) to 7%. Spending on health remains at 4% of Government expenditure for 2006 and the first two quarters of 2007.

While still a relatively small proportion of the overall budget communication and infrastructure expenditure have seen the most drastic increases in percentage terms. Particularly representative of spending on road construction, this constituted only 1% of government expenditure in 2003, had risen to 5% by 2006 and was projected to rise to 11% in 2007.[70]

Decentralisation

While it is difficult to make assessment of the efficiency and effectiveness of Government departments, it is possible to make an assessment of some of the general trends in the structure of responsibility between different branches of the Government. One immediate question is whether the current Government has been more or less centralised than those that Georgia has seen previously. For a start it is necessary to address the issue of decentralisation within the executive. Since it has already been suggested that Ministers enjoy considerable autonomy over their departments, this might suggest that the executive is decentralised. This is not the case. In spite of the considerable autonomy that Ministers enjoy within their Ministries, the directives for the Ministries often come from the President directly and are, therefore, prone to somewhat erratic change. Similarly, as long as Ministerial reorganisation is as common as it has been over the last three years, there will remain a feeling inside the ministries that their number one priority is to respond to the rapidly shifting priorities of the President.

Similarly, while Parliament is supposed to offer some oversight to the executive, the overwhelming majority of the National Movement in Parliament has effectively

[69] Transparency International, *Expenditure Dynamics Since the Rose Revolution*, (Tbilisi, April 2007), p2
[70] Transparency International, *Expenditure Dynamics Since the Rose Revolution*, (Tbilisi, April 2007), p3

weakened this capacity. Constitutional amendments have further enhanced the power of the Presidency.

Finally, changes to the relationship between local and central government have failed to give major significant powers to the regions. There were considerable changes to the local government structure in 2004, but these did not confer significant power to either regional or municipal authorities to raise or spend more taxes.[71] In addition Governors, who are appointed by the central executive have seen their remit expand, so that with the recently passed Law on Governors they have control over state transfers to the regions. Similarly, according to Giorgi Chkeidze, the Chairman of GYLA, while the current Minister of Interior Affairs, Van Meribishvili had been in favour of locally elected Sheriffs, all that has materialised so far is one pilot scheme in Mtskheta.

Judicial reform

There has been wide-ranging reform of the judiciary, the structure of the court, the disciplinary system for judges, remuneration for judges and court staff and improvement of the courts and buildings. This has seen a corresponding increase in funding of the court system with a budget that rose form GEL 13 million to GEL 33 million between 2005 and 2006. As with many of the reforms, the first priority has been the removal of corruption and the main mechanism of achieving this has been the operation of the disciplinary system. This system resulted in the dismissal of 19 judges in 2004 and 2005.[72]

The Government claims that one of its main priorities has been to increase the power and independence of the judiciary, 'to reform the High Council of Justice through increasing the number of judges and, in general, by strengthening the 'voices' of judges'.[73] However, according to the head of Giorgi Cheklidze, the Head of GYLA, 'financial corruption has been replaced with political corruption' as the courts operate under strong political pressure. For this reason, in a 2007 IRI poll, with only 22% of the population giving them a positive response, the courts remain one of the least trusted institutions in the Georgian Government.[74]

Corruption

Corruption was clearly a massive problem in the Georgian Government and the country as a whole before the Rose Revolution. One of the core objectives of the post-Revolution

[71] The only locally raised taxes are gambling tax and property tax so local authorities are largely dependent on state transfers.
[72] Government of Georgia, *Main Directions of Court Reform*, provided by Tamuna Karosanidze from Transparency International, p5
[73] Government of Georgia, *Main Directions of Court Reform*, provided by Tamuna Karosanidze from Transparency International, p4
[74] Only trade unions and the mafia are less well trusted. International Republican Institute et al, *Georgian National Voter Survey*, (Tbilisi, Sept 10 2007) http://www.iri.org.ge/eng/engmain.htm p67

Government has been the fight against corruption.[75] And by the accounts of most international observers, the battle has been extremely successful. The World Bank hails Georgia as the top anticorruption performer in its 2006 *Anticorruption in Transition-3 (ACT3)* report.[76] The World Bank and European Bank for Reconstruction and Development (EBRD) reports that the percentage of firms that identified corruption as a significant obstacle fell from 60% to 39% from 2002 to 2005, and the percentage of firms that paid bribes during tax collection fell from 44% to 11% from 2002 to 2005.[77]

In addition, Transparency International's 2007 corruption perception index has shown significant improvement. The index ranks the perception of corruption in a country out of a 10 point system (with zero being lowest and ten highest). Georgia now ranks an average score of 3.4 which is a 'significant improvement' on the 2006 score and an even greater improvement on the 2003 baseline of 1.8. Having achieved a score over 3 (and now ranking 79th out of 180 countries) means, according to TI, that Georgia moves out of the category of 'rampant corruption' but still suggests that corruption is a significant problem.[78]

This is still a surprisingly high score, given that according to many other sources the instances of day-to-day corruption seem to have reduced dramatically in Georgian society. Only 1% of Georgians surveyed said they had paid a bribe to receive a public service in the last 3 months according to a September 2007 International Republican Institute poll.[79] Similarly, as already mentioned, the consensus amongst students, teachers and observers seems to be that the Government has, in two years, more or less completely decapitated corruption in the higher education system. However, a common perception seems to remain amongst Georgians that, while small level corruption has now diminished, high level corruption persists. The ease with which charges of corruption between politicians are believed (even in the absence of any evidence) certainly seems to suggest that even if corruption has diminished trust in the political process has not increased.

Social Services Reform

Education

75 In 2005, the National Security Council of Georgia developed and approved the National Anti-corruption Strategy of Georgia. The strategy is targeted at developing an effective government system, activating legal and civil measures to fight against corruption and preventing corrupt practices in governance.

76 The World Bank, *Anti-Corruption in Transition-3:Who is Succeeding and Why?* (2006), http://siteresources.worldbank.org/INTECA/Resources/ACT3.pdf

77 The World Bank, *Anti-Corruption in Transition-3:Who is Succeeding and Why?* (2006), http://siteresources.worldbank.org/INTECA/Resources/ACT3.pdf, p46

78 Transparency International Press Release, *Transparency International Releases the Corruption Perception Index for 2007* (Tbilisi, September 2007). http://www.transparency.ge/files/210_342_141428_CPI%202007%20Press%20Release.pdf

79 International Republican Institute et al, *Georgian National Voter Survey*, (Tbilisi, Sept 10 2007) http://www.iri.org.ge/eng/engmain.htm p68

Reform of the educational system has been extremely fast-paced since the Rose Revolution. The financing of schools and universities has attempted to move to a 'money follows the student' principle, with schools becoming legal entities that have greater autonomy, operating under 'Education Resource Centres' (which replace local government education departments) and Universities gaining fixed fees per student, either from the Government or the student themselves. National exams have been administered by the National Assessment and Examination Centre and have effectively removed corruption in higher educational institutions.

There has been an effort to ensure that teachers are more effectively trained and/or retrained, that courses are properly accredited or use accredited materials, that more vocational training is made available and that access is increased for students from ethnic minorities. In addition to all this, under the 'Deer Leap' project, ambitious targets have been set for improvements in information technology training in schools (with a recent government statement that they intend to computerize 400 schools across the country) and money from the Presidential National Program that will spend GEL 390 million on school renovation over the next 4 years.

The groundwork for many of these reforms was set by the work that had been done under the 2001 USD 26 million World Bank *Education System Realignment and Strengthening Program* but a range of other agencies have also been involved, including USAID who have a USD 9.3 million *General Education Decentralization and Accreditation Project,* and GTZ and the EU who have helped support vocational training and university reform. The Ministry of Education and Science has also been extremely proactive in approaching bilateral donors.[80]

Many of these reforms have been widely applauded with the national examination system, in particular, routinely cited as one of the Governments great successes. However, overall expenditure remains low and is currently less than 3% of GDP, having fallen in the first two quarters of 2007.[81] As a result, after extremely favorable assessment of institutional reforms, a recent World Bank report produced for the Ministry of Education stated,

> the proportion of GDP devoted to public expenditure on education in Georgia may be underestimated, but it is undoubtedly among the lowest in the region and the country's schools certainly suffer from budget deprivation. Schools lack not only libraries, computer classes and internet connections but, in many cases, basic utility facilities.[82]

Also, in terms of its enrollment figures

> Its primary and basic education enrollment rates are probably well below 100 per cent and intake into the final primary grade is estimated at only 86 per cent, which leads the World Bank to put it into a category of only three countries (along with Tajikistan and Moldova) that are 'unlikely' to achieve MDG2, universal primary

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[80] World Bank, *Georgia Education Policy Note*, (Tbilisi, Feburary 2007), p10

[81] Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends: October 2007*, *http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english-november%202007.pdf* (viewed December 2007), p24

[82] World Bank, *Georgia Education Policy Note*, (Tbilisi, Feburary 2007), p7

> education. At upper secondary level, the gross enrollment rate is one of the lowest in the region, with enrollment in vocational education having fallen as a proportion of the total.[83]

Therefore, while there is clear evidence that the Georgian Government has been trying to legislatively and organizationally improve the situation within education one can still argue that in the absence of fundamental changes to budgetary priorities there are very strong limits on what these changes can accomplish.

Health Care

Georgian health care system has been undergoing reforms for more than a decade. Major measures include increasing the share of private sector in health care provision, investing in infrastructure and human resources, strengthening of primary health care with a focus on family medicine, improving regulation, improving health sector management and financing.

Nevertheless the progress towards the aim so far is very limited. Public expenditure on health care remains very low between 1% and 2% of GDP.[84] Organized forms of risk pooling (like health insurance) are underdeveloped. As a result out-of-pocket expenditures constitute 76% of total health expenditure.[85] Overall the health system is inefficient and inequitable and in many cases people face the risk of incurring catastrophic costs when requiring essential health services which in its turn leads to medical poverty trap.

Major health indicators are far worse than European average. Again, the official data is contestable, but even this data shows poor performance of the health system. Infant mortality rate is 18.1 as compared to 8.6 EU average, maternal mortality 23.4 as compared to 6.7 EU average.[86] Life expectancy is 69.4 for men and 76.7 for women, and average healthy life expectancy is 60.2. Both incidence and prevalence of non-communicable and infectious diseases are increasingly prevalent.[87]

One medical professional from the international community even told us, Georgia's health system is lagging behind developed health systems by 20-30 years'[88]

The major recent positive development has been the launch of Medical Assistance Program for Population below the Poverty line in July 2006, which provides

[83] World Bank, *Georgia Education Policy Note*, (Tbilisi, Feburary 2007), p2
[84] Ministry of Labor, Health and Social Affairs, National Health Account, (2006)
[85] Statistics Department (2007) Household Survey on Health Service Utilization and Expenditure, www.statistics.ge
[86] Ministry of Labor, Health and Social Affairs, *National Health Report* (2007) pp. 70, 74
[87] Ministry of Labor, Health and Social Affairs National Health Report (2007) pp. 70, 74
[88] Interview with International Health Expert, Tbilisi, Georgia (December 2007)

supplemental benefit package for 650,000 people who are registered at the database as the poorest. Earlier this year, the government laid out a plan, entitled *100 New Hospitals* which aims to increase private investment in the building of new hospitals and healthcare clinics throughout Georgia.[89] However there has been considerable concern amongst observers that (contrary to initial pronouncements) the Government is prioritizing quantity of beds over quality of healthcare in these changes.[90]

Shift from institutional care

Apart from the means tested income support already suggested, social services in Georgia has historically been restricted to institutional care. Georgia has 5200 children placed in 46 large long-term care institutions.[91] The state also operates three long-term care institutions – two for elderly and one for the disabled. The total number of people in these three institutions do not exceed few hundred and total budget allocated for them is GEL 960, 000.[92]

A shift to non-institutional care which started to emerge in social services during the recent stage of the child welfare reform was strongly encouraged by the EU under the TACIS project. This reform has tried to develop alternative services for children, such as adoption, foster care, day care services, small group homes, respite services, etc. At present there are 19 day care centers providing services for 1189 children, and 13 small group homes for 292 children.[93] Furthermore, 700 children are receiving different types of family and child support services, including cash benefits for reintegration and foster care.[94]

Total spending on child services is GEL 10.1 million out of which GEL 2.2 million are allocated for de-institutionalization.[95] 52% of child services are funded and managed by the Ministry of Education and Sciences which employs 79 social workers.[96] The rest are funded and managed by NGOS, local governments, the Georgian Orthodox Church and the Ministry of Labor, Health and Social Affairs. Overall, the scope of alternative services is still quite limited and it will take several years before their presence is felt.

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[89] 6th September Statement by Saakashvili, Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends: October 2007*, *http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english-november%202007.pdf* (viewed December 2007), p11

[90] Transparency International, '*100 Hundred New Hospitals for Georgia': How Long will they last?,* (Tbilisi, May 2007)

[91] Child Welfare Support Project (2007) Report for the Ministry of Labor, Health and Social Affairs

[92] Government of Georgia (2007) Law on State Budget 2007, p.137 http://www.mof.ge/DinamicPage.aspx?cmd=page&rootid=317&pageid=240

[93] Child Welfare Support Project (2007) Report for the Ministry of Labor, Health and Social Affairs

[94] Child Welfare Support Project (2007) Report for the Ministry of Labor, Health and Social Affairs

[95] Government of Georgia (2007) Law on State Budget 2007, pp.100-101 http://www.mof.ge/DinamicPage.aspx?cmd=page&rootid=317&pageid=240

[96] Child Welfare Support Project (2007) Report for the Ministry of Labor, Health and Social Affairs

Pensions

Since the Rose Revolution the pension provision has substantially improved. First, the government cleared all the arrears and started paying pensions on time. Second, minimal pensions have been increased significantly from 14 GEL a month to 38 GEL a month, whereas the special merit pensions have been capped. Furthermore, requirement of minimum years in service in order to be eligible for old-age pension has been abolished and all citizens above the pension age (65 for men and 60 for women) can receive minimal pension.[97] However, concerns persist that even though these increases are to be welcomed, the high levels of inflation (outlined earlier) on basic goods may cancel out many of the pension increases that have been offered so far. In response to this, Saakashvili has recently announced plans that will result (assuming his reelection) in the 2008 government doubling the level of minimum pensions to 76 GEL.

In addition to state pensions elderly people are entitled to Family Assistance, a cash benefit paid at a rate of 22 GEL for single pensioner and 35 GEL for pensioner couple. Also, WWII veterans and their survivors are entitled to Utilities Subsidy, another cash benefit paid at the rate of 44 GEL for the veterans.

Politics

Political Opposition

Putting to one side the current political situation, conventional political opposition in Georgia has been extremely weak since the Rose Revolution. The actions of spring and summer 2006, when the opposition declared a boycott of parliament were instructive if only because they demonstrated how unimportant the opposition was. Similarly, the local election that took place at the end of the year demonstrated the opposition's inability to mobilise. In particular, in spite of initial suggestions that the opposition would coordinate around a single candidate for the Tbilisi Mayoral elections, they failed to agree on one in time.

At the same time, the Governments preparedness to play fast and loose with the rules governing the electoral process at the time have only served to underscore some of its less democratic inclinations. Failing to announce the election in good time or resolve concerns about the make-up of the election commission, failing to ensure that the electoral roll was in good order, utilising the power and finances of the executive to garner support and expelling Russian spies only days before the ballot, all together left the international community unable to properly monitor the elections and concerned about their process.

Of course, all of this seems like ancient history. With an election looming in which nine of the opposition parties seem to have coordinated behind the candidacy of Levan

[97] Government of Georgia (2005) Law on State Pensions

Gachechiladze and when mass demonstrations have forced the President to offer an early election it seems strange to talk about opposition weakness.

However, while the chain of events that lead to the early election might have given the opposition the opportunity to unseat the President, it is important to stress that structural problems remain. While portions of the opposition have unified behind of moving to a constitutional monarchy, little else unites them ideologically. The political spectrum of Georgia continues to be dominated by personalities rather than consistent positions or well thought out programs and slanderous unsubstantiated (but often believed) accusations characterises the interchange between groups. As long as this continues to be case the country will be susceptible to violent and unpredictable mood-swings. As one long-time observer commented to this researcher a couple of years ago, ‘the thing with change in Georgia is that when it happens it will happen remarkably quickly and no-one will have predicted it’. Recent events seem to bear this view out.

Civil Society

In the immediate aftermath of the Rose Revolution, in which many civil society organizations played a clear partisan (pro-Revolution) part, the role of Civil Society and Civil Society Organizations (CSOs) in Georgia was unclear. As a 2005 report on Civil Society in Georgia states,

> The government believed that it had already absorbed a large part of the best human resources available in the Third Sector. Thus, listening to the remaining CSO activists was seen as less important, especially as the government did not lack public support. Within the donor community the opinion prevailed that the funding flows should be diverted to the new government, since this would be the shortest and most effective way of achieving the country’s goal of democratic development. The media paid less attention to CSO-organised events, as it no longer considered this community an important actor in public life.[98]

However, as they continue, ‘From today’s perspective, a general assessment can be made that the changes in the status and activities of CSOs have proved to be less profound than expected in the months immediately following the revolution’.[99]

Georgian CSOs consistently display two main weaknesses. First, they tend to display the twin characteristics of low participation and international dependency. One of the great ironies of Georgian political life is that while Georgians clearly believe in political protest as a means for facilitating change, they are not consistently active in social pressure groups or self-organisation. As Ghia Nodia says, ‘Taking into account that the development of civil society in Georgia has been strongly supported by foreign

[98] Ghia Nodia, *An Assessment of Civil Society in Georgia*, Centre for Training and Consultancy, Tbilisi 2005, p20
[99] Ghia Nodia, *An Assessment of Civil Society in Georgia*, Centre for Training and Consultancy, Tbilisi 2005, p20

assistance, it did not come as a surprise that *citizen participation is low*, while inter-relations among civil society actors are good and their resources sufficient'.[100]

The second problem, connected to the first, is that while CSOs are effective at providing oversight of Government policy it is a lot harder to see examples of their affecting change or interacting effectively with the Government. As Nodia again argues,

> Georgian civil society seems to have a rather strong role in attempts to hold the state accountable, respond to social interests and empower citizens. At the same time, the country's civil society is less effective when influencing public policy and trying to meet societal needs directly. The latter corresponds to the lack of focus on poverty eradication, while the failure to influence public policy may be linked to the political context, which does not allow for any substantive policy engagement…[101]

Even before the recent political upheavals this observation still stands. The Governments centralizing impulse, clearly demonstrated by the Constitutional amendments of February 2004, their strong arm tactics for dealing with opponents and their refusal to engage with any critical voice have ironically and simultaneously demonstrated the continued need for the third sector while making it difficult to involve them in shaping the reforms.

That said, many international organizations partner highly effectively with local NGOs and many development organizations have considered these partnerships to be vital for the sustainability of any developmental benefits in the long-term. Marine Koreli, from Save the Children, Georgia, argues that since the early 1990s the non-governmental sector has developed remarkably and is scurrently 'far ahead of other countries in the region' so that now 'Local NGOs compete with well-established international organizations for funding on equal terms'.[102]

The International Environment

Relations with Russian

It is easy to forget that the Saakashvili Administration's relations with Russia began well. For example, the re-incorporation of semi-autonomous region of Adjara into Georgia proper, early on in the new administration, was partially helped by Moscow support. Things have soured since then and the current relationship is defined by perpetual crisis. In December 2005 the Russian Government imposed 'temporary restrictions' on the import of some Georgian agricultural products. In March and May 2006 this was followed by a ban on Georgian wines and brandies first and then mineral water. This was particularly significant because at the end of 2005 Russia accounted for 88% of Georgia's

[100] Ghia Nodia, *An Assessment of Civil Society in Georgia*, Centre for Training and Consultancy, Tbilisi 2005, p6. In their analysis they argue that social breadth of participation is particularly low.
[101] Ghia Nodia, *An Assessment of Civil Society in Georgia*, Centre for Training and Consultancy, Tbilisi 2005, p7
[102] Interview with Marine Koreli from Save the Children Georgia, Tbilisi, Georgia (December 2007).

wine export market and was, overall, Georgia's biggest export market.[103] All air, sea, rail and postal links have been severed since 3 October 2006. Russia has also dramatically increased its charge for gas over this period, doubling it at the beginning of 2007 to the level of $235 per 1,000 cubic metres.

Even with economic connections cut, the two sides have been able to keep increasing the tension. When a missile landed in field close to the conflict zone of South Ossetia in August, but failed to explode, there were strong indications that it had originated in Russia.[104] Georgia for its part, has responded to this range of intimidation by regularly demanding debate at the UN, a reorganisation of peace-keeping operations in Abkhazia and South Ossetia, and by continually blocking Russia attempts to join the World Trade Organization. At the same time there is a continued suspicion in Georgian politics and wider society that Russian machinations are behind every political drama that unfolds in the country. Relations show no sign of improving in the near future.

Continuing Western Orientation

In foreign policy terms, the Georgian Government clearly sees its Western orientation as key to its development if not its very survival as a viable state. This orientation has a range of dimensions that work through the government, economy and the military.

The Government still considers NATO membership to be its number one foreign policy goal. It currently has an Individual Partnership Action Plan (IPAP) and is waiting to see if it will advance to the next level of membership consideration, the Membership Action Plan (MAP).[105] The second form of institutional alignment is with European structures. This will be primarily organised through the European Neighbourhood Policy (ENP).[106]

Both NATO and the European Union cooperate with Georgia on a wide range of issues. For example, the ENP action plan for Georgia for 2006 and 2007 has eight priority areas; the judiciary, development of business climate, economic development and poverty reduction, enhanced cooperation on cross-border issues, regional cooperation, security cooperation, conflict resolution and transport and energy. Similarly, the IPAP commitments, while heavily focused on security and defence issues, also include discussion of issues on corruption and governmental development.

Finally, organisations like the World Bank, the IMF and the WTO offer advice and assistance on the development of principally economic structures, though these are more accurately described as internationalising or 'marketising' than Westernizing. Georgia's

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[103] Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends,* (Tbilisi, December 2005), p54

[104] Investigations were carried out by the OSCE, two independent experts and by Russia. The independent experts suggested that the missile had been delivered by a plane originating in Russia but failed to make any more specific accusations, Economist Intelligence Unit, *Georgia: Country Report* (2007), p14

[105] Government of Georgia, *Georgia's Commitments Under the Individual Partnership Action Plan (IPAP) with NATO 2004-2006* (2006)

[106] Government of Georgia, *EU/Georgia Action Plan for the European Union* (2006/7)

incorporation into international financial structures owes as much to Central Asian investment and transit of goods from the East as it does to Western market orientation.