May 2006
IMF Country Report No. 06/175

Georgia: 2006 Article IV Consultation, Third Review Under the Poverty Reduction and Growth Facility, and Request for Waiver of Performance Criteria—Staff Report; Staff Statement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Georgia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2006 Article IV consultation with Georgia, the third review under the Poverty Reduction and Growth Facility, and request for a waiver of performance criteria, the following documents have been released and are included in this package:

- the staff report for the combined 2006 Article IV consultation, Third Review Under the Poverty Reduction and Growth Facility, and Request for Waiver of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on February 15, 2006, with the officials of Georgia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 17, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of March 31, 2006 updating information on recent economic developments.
- a Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its March 31, 2006 discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- a statement by the Executive Director for Georgia.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Georgia*
Memorandum of Economic and Financial Policies by the authorities of Georgia*
Selected Issues Paper
Statistical Appendix
*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

GEORGIA

Staff Report for the 2006 Article IV Consultation, Third Review Under the Poverty Reduction and Growth Facility, and Request for Waiver of Performance Criteria

Prepared by Middle East and Central Asia Department
(In consultation with other departments)

Approved by Julian Berengaut and Adnan Mazarei

March 17, 2006

- Georgia's three-year PRGF arrangement in the amount equivalent to SDR 98 million (65 percent of quota) was approved on June 4, 2004. The first review was completed on December 20, 2004. The second review was completed July 20, 2005 (Country Report No. 05/314).
- The last Article IV consultation was discussed by the Board on October 17, 2003. Discussions for the 2006 Article IV and the third review under the PRGF arrangement were held in Tbilisi during October 19–November 2, 2005 and February 8–15, 2006. Staff met with the prime minister; speaker of parliament; ministers of finance, economic development, and energy; president of the National Bank of Georgia; other senior government officials; civil society organizations; and members of parliament. The staff team was headed by Mr. Berengaut during the first mission and by Mr. Wakeman-Linn during the second mission. The team comprised Ms. George, and Messrs. Ding and Billmeier (all MCD), Ms. Yackovlev (FAD), and Mr. Zeuner (PDR). Mr. Christiansen, resident representative, assisted both missions.
- The attached Letter of Intent and Memorandum of Economic and Financial Policies (Attachments I and II) set out the authorities' economic program for 2006. The authorities have requested completion of the third review and waivers for nonobservance of two end-September 2005 performance criteria.
- The authorities submitted a Poverty Reduction Strategy Paper (PRSP) progress report to the Executive Boards of the Fund and the World Bank in March 2005. The report (Country Report No. 05/113) and the related Joint Staff Advisory Note (Country Report No. 05/210) have been posted on the Fund's external website.
- The companion Selected Issues Paper (SIP) comprises five chapters: I. Financing economic development in Georgia; II. Recent surveys on the business environment; III. Measuring the shadow economy: the impact of the Georgian anti-corruption drive; IV. Legal entities of public law in Georgia: accountability and reform; and V. Is Georgia competitive?

Contents Page

Appendices

Attachments

EXECUTIVE SUMMARY

Georgia's economy has performed well over the last two years. Prudent macroeconomic policies and structural reforms have resulted in robust growth rates, inflation in single digits, and a significantly improved revenue performance that has allowed for many fiscal initiatives to be undertaken while maintaining fiscal stability.

Performance under the program has been good. All but one quantitative performance criteria were met. The target on arrears clearance was missed due to concerns about inflation, but the authorities are committed to clear the entire stock by end-2006. The structural performance criterion on the submission of a new customs code was delayed, mainly to give more time for discussions with the business community. The authorities have requested completion of the third review under the arrangement, and waivers for the missed performance criteria.

Economic prospects over the medium term are favorable, with robust economic growth likely to continue. Policy discussions on the medium-term focused on measures to remove obstacles to growth, including a public investment program that addresses infrastructure needs (such as roads and power supply) to sustain growth, a financial sector development strategy that would increase the sector's contribution to growth, and ways to improve institutional quality and reduce rent seeking opportunities affecting private sector investment.

Program discussions focused on the macroeconomic framework and policy objectives for 2006. While maintaining the fiscal deficit broadly unchanged, social expenditures are projected to increase, reflecting higher minimum pensions and a targeted poverty benefit program scheduled for implementation in mid-2006. The monetary program targets reserve money growth of 25 percent for the year, consistent with the authorities' inflation objective of 5 percent by end-2006, and a further reserve accumulation to 2.3 months of import coverage. In this regard, efforts are underway to strengthen the National Bank of Georgia's (NBG) ability to conduct monetary operations and control inflation, and to improve the coordination of policies between the NBG and ministry of finance. Consistent with the objective of increasing fiscal control and transparency, the authorities are in the process of developing guidelines for monitoring and reporting the activities of all central government Legal Entities of Public Law. A Banking System Development Strategy for 2006–09 is under preparation.

The main risks to the medium-term outlook stem from election pressures, with significant elections scheduled for each of the next three years, political tensions regarding the status of the breakaway territories of Abkhazia and South Ossetia, and energy sector vulnerabilities. Finally, it will be important to implement further measures to improve governance, building on the progress in this area in recent years.

Georgia has made substantial progress in creating a sound policy framework, and the authorities' strong record of accomplishment bodes well for continued successful implementation of the program.

I. DEVELOPMENTS SINCE THE ROSE REVOLUTION

1. The breakup of the Soviet Union brought a steep fall in real GDP in Georgia—almost 75 percent, by most estimates the worst for any transition country. Over the following decade, the government had some success in stabilizing prices (following early hyperinflation), as well as in price liberalization, privatization of state-owned enterprises, and a first phase of legal, fiscal and financial reforms.[1]

2. From 2000 to 2003, real GDP growth averaged 5.8 percent, while CPI inflation averaged 4.8 percent. Mismanagement and poor tax administration, however, undermined the implementation of policies, leading to low tax collections and rapidly rising domestic arrears. Tax revenues were low—averaging 13.2 percent of GDP—and the cash fiscal deficit, constrained by financing, was 1.8 percent. Domestic arrears totaled 3.4 percent of GDP by end-2003. The Rose Revolution brought in a new government in January 2004.

3. The new authorities embarked on an ambitious agenda of reforms:

- To reduce graft in tax and customs administration, high-ranking officials were fired or prosecuted, with many making large reparations payments; the state tax department was reorganized; and a financial police was created.
- To create a business-friendly environment, a simplified and streamlined tax system—eliminating nuisance taxes and reducing burdensome regulations—was initiated.
- To improve governance in the public sector, measures to restructure the civil service, strengthen management in state-owned enterprises, and reinvigorate privatization were initiated.

4. The restructuring of the public sector led to significant improvements in governmental functions, particularly revenue collection. Tax revenues grew by 3.7 percent of GDP in 2004, and a further 1.6 percent in 2005. With this improved performance, many fiscal initiatives—increasing pensions, upgrading defense capacity, and clearing arrears—could be undertaken while maintaining fiscal stability.

5. The Saakashvili administration continues to attach priority to the reintegration of the breakaway regions of South Ossetia and Abkhazia. Relations with Russia—Georgia's largest trading partner—are tense, related in part to Russia's relations with Abkhazia and South Ossetia and in part to Georgia's dependence on Russia for gas and electricity.

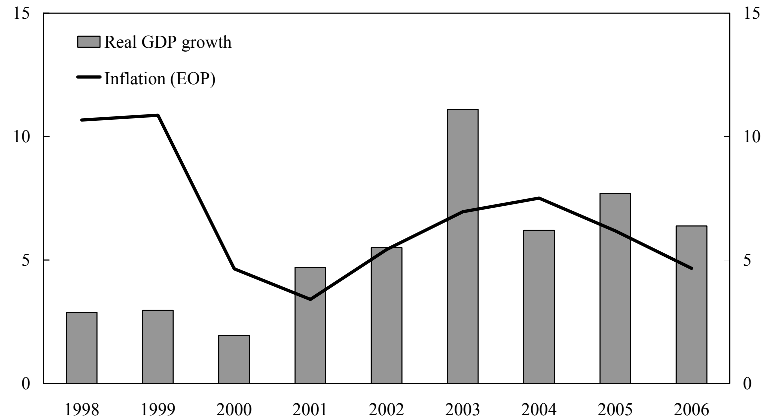
---

[1] IMF Country Report 03/346 presents a detailed discussion of these policies.

II. Recent Developments

6. **Economic activity accelerated and inflation pressures abated in 2005 (Table 1, Figure 1).** Real GDP growth is estimated to have been 7.7 percent, supported by a rebound in agricultural production, more stable electricity supply, and continued buoyancy in manufacturing (especially food processing) and communication. Twelve-month CPI inflation hovered around 10 percent in the first half of the year, largely due to expansionary monetary policy, but declined to 6.2 percent by the end of the year, as a much smaller-than-planned fiscal deficit contributed to a slowdown in the growth rate of money. Poverty remained high in 2004 (the latest information available)—with 52 percent of the population living under the official subsistence level and 17 percent in extreme poverty (Table 2). [2]

Figure 1. Georgia: Inflation and Real GDP Growth, 1998-2005
(In percent)



Sources: Georgian authorities; and Fund staff estimates.

7. **The general government deficit was 2.4 percent of GDP in 2005, far below the budgeted 4.8 percent (Table 3).** Tax revenues rose to 19.8 percent of GDP. Total expenditure and net lending increased from 18.6 percent of GDP in 2004 to 24.9 percent in 2005, led by an increase in current expenditures of 4.5 percent of GDP, in particular in transfers and subsidies to Legal Entities of Public Law (LEPLs) to buy defense goods. While social spending increased from 7.1 percent of GDP in 2004 to 8.1 percent in 2005 (on a cash basis),[3] defense spending more than doubled from an estimated 1.6 percent to 3.5 percent of GDP.[4] Privatization receipts (3.6 percent of GDP) financed the deficit, modest net foreign repayments, and an increase in government deposits with the National Bank of Georgia (NBG).

8. **The introduction of a reserve money target strengthened the monetary policy framework and helped maintain price stability (Table 4).** Although capital inflows were substantially lower than in 2004—due in part to lower than forecast privatization proceeds

---

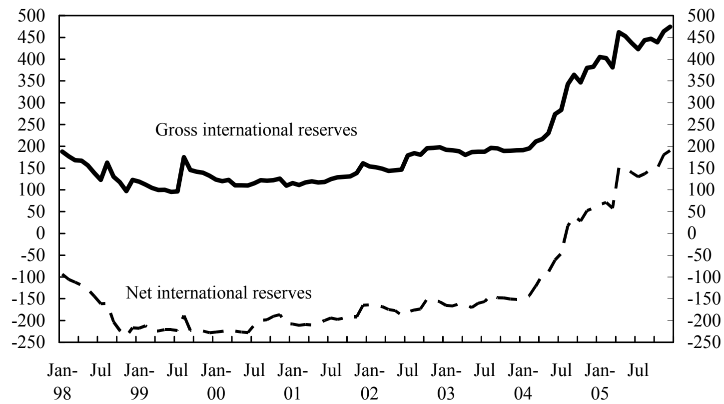
[2] The authorities are currently working with World Bank staff to determine 2005 poverty figures.

[3] The outturn was slightly less than programmed as some social programs were phased out and the targeted poverty benefit meant to replace them was delayed to mid-2006.

[4] These figures exclude defense-related expenditures by LEPLs, for which no data are available. As discussed below, all such expenditures have ceased since January 2006.

and a winding down of pipeline investments—NBG gross international reserves increased by US$91 million (Figure 2). The lari appreciated about 2 percent both nominally against the U.S. dollar and in real effective terms (Figure 3), with limited central bank discretionary intervention (Figure 4). Remonetization of the economy continued (Table 5). Cooperation between the NBG and the treasury in forecasting liquidity conditions improved, but unexpected government spending occasionally still results in swings in reserve money.

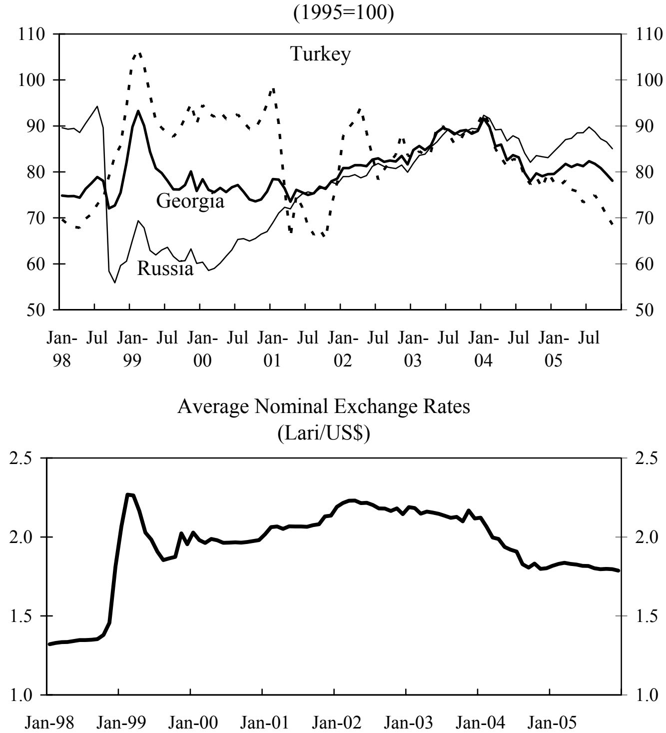
Figure 2. Georgia: International Reserves, 1998 - 2005
(In US$ million)



Sources: Georgian authorities; and Fund staff estimates.

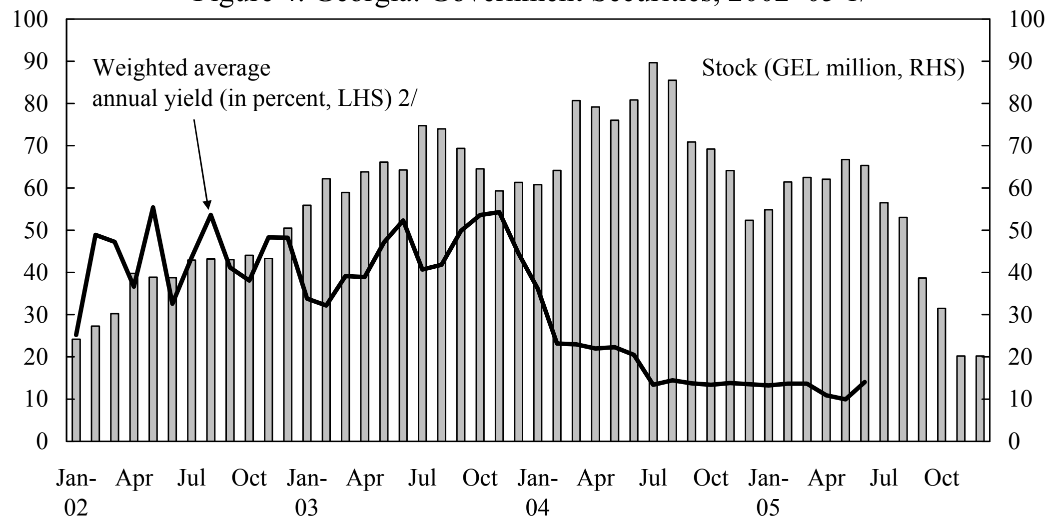
Figure 3. Georgia: Exchange Rate Developments, 1998–2005

Real Bilateral and Effective Exchange Rates 1/
(1995=100)



Sources: Georgian authorities; and Fund staff estimates.
1/ Based on INS exchange rates and CPI. An increase in the rate indicates a depreciation of the lari.

Figure 4. Georgia: Government Securities, 2002–05 1/



Sources: Georgian authorities; and Fund staff estimates.
1/ End-period stock of T-bills at settlement prices.
2/ There was no primary treasury bill issuance after June 2005.

9. **The banking sector has performed well.** Returns to assets and equity rose in 2005, while credit to the private sector grew 83 percent, albeit from a low base. Although lending continued to be primarily in foreign currency, lari-denominated loans tripled, reducing loan dollarization by about 10 percentage points to 77 percent of total loans. Most of the credit boom was financed through higher deposits, which grew 31 percent, with the rest financed by net borrowing abroad. The share of non-performing loans has fallen from 6.2 percent at end-2004 to 3.8 percent at end-2005 (Table 6). Mirroring developments on the asset side, deposit dollarization declined to 72 percent. Consolidation in the banking sector continued in 2005, with 3 banks merged or closed.

10. **Banking supervision has become more proactive.** The authorities took decisive steps to resolve an insolvent bank in February 2006, once the situation was uncovered in an on-site inspection. Temporary administration was put in place, an offer was made to Georgian banks rated CAMEL one or two, and contingent plans were prepared in case viable offers were not received. When these actions were publicly announced, net withdrawals from the bank were insignificant, indicating no loss of depositor confidence. The sale of this bank brings the number of banks to 18.

11. **A fiscal stance that was less expansionary by more than 2 percent of GDP compared with the budget helped prevent the projected widening of the current account deficit in 2005 (Table 7).** In addition, lower-than-projected official disbursements (mainly reflecting slower than targeted project implementation) and foreign direct investment in the new pipelines slowed import growth. Preliminary data suggest export growth (net of a one-time adjustment for unregistered trade in 2004) also slowed. The strengthening of the

lari since the beginning of 2005 may have contributed to this (Box 1). International reserves remained at about 2 months of non-pipeline imports.

Box 1. Is Georgia Competitive?

Evidence on the level and trend of Georgia's competitiveness is mixed (SIP, Chapter V). Georgia's real exchange rate (RER) has appreciated during the past 24 months because of both strong real GDP growth and foreign exchange inflows related to foreign direct investment and a repatriation of savings. A continued positive external outlook and domestic spending pressures suggest that RER appreciation is likely to persist.

External competitiveness has started to suffer as a result. The share of Georgian exports in the country's main trading partners' import markets started to decline in early 2005. Furthermore, Georgia's cost of doing business indicators continue to rank poorly, even compared to its neighbors. Notwithstanding these facts, U.S. dollar wages are the lowest in the region, and the RER is most likely still undervalued. Furthermore, two recent competitiveness studies indicate that the productivity of Georgia's economy has improved markedly in 2004–05.

12. **Georgia has reached debt rescheduling agreements with most bilateral creditors** on terms comparable to those offered by the Paris Club in July 2004 (MEFP, paragraph 12). The authorities have asked the Paris Club to extend the deadline for concluding the remaining discussions to end-February 2006.

13. **Structural reforms moved forward in many areas:**

- **Fiscal:** A comprehensive ***tax reform*** took effect in 2005 entailing a significant simplification of the tax code: (i) the number of taxes was reduced from 21 to 7; (ii) personal income tax rates ranging from 12 to 20 percent were unified under a single rate of 12 percent; (iii) the VAT rate was reduced from 20 to 18 percent; (iv) the payroll tax rate was reduced from 33 to 20 percent; and (v) exemptions and special regimes were significantly curtailed. In parallel, the authorities have continued to improve revenue administration. ***Treasury reforms*** continued throughout 2005. In early 2006, the Single Treasury Account (STA) became fully operational. LEPLs, however, operate outside the STA. Progress continues toward the goal of compliance with the recommendations of the Government Finance Statistics Manual 2001 (***GFSM 2001)*** by early 2007. While the authorities produced their first **Medium-Term Expenditure Framework** (***MTEF)*** in 2005, they recognize further work is needed to make this an effective policy tool. A new ***customs code***, which will further modernize customs administration in Georgia, was submitted to parliament in October 2005.

- **Banking:** The NBG has started to develop a strategy to guide development of the financial sector over the medium term, and has proposed eliminating restrictions limiting nonbank shareholders to 25 percent of the equity capital in Georgian banks.

Also, the major banks have created a credit information bureau, enabling them to better gauge the creditworthiness of potential borrowers.

- **Energy:** The technical and financial viability of the energy sector improved somewhat during the year, with quasi-fiscal losses declining from 4.5 percent of GDP in 2004 to an estimated 4 percent in 2005, owing mainly to the significant increase in collections due to the use of communal metering and reinforcement of payment discipline.

- **Business environment:** A law was passed in June 2005, reducing the number of businesses for which a license is required from 900 to 150, and reducing the time for applying and processing applications using a "one-window" approval and the "silence is consent" principle.

III. Performance Under the Program

14. **The program is broadly on track, with only one missed quantitative performance criterion** (Table 8). Fiscal performance was stronger than programmed, with tax revenues well above program levels more than offsetting expenditures slightly above program levels. After slightly exceeding the June indicative reserve money target, the NBG stepped up efforts to contain reserve money growth, observing the end-September quantitative performance criterion and end-December indicative targets on reserve money by wide margins. NIR targets were met comfortably. The one area where performance was poorer than programmed was arrears clearance, as the authorities missed the September performance criterion for clearance of domestic expenditure arrears, and the indicative target for the year. Citing inflationary concerns, the authorities only cleared arrears of GEL 104 million (0.9 percent of GDP) in 2005, compared to the programmed level of GEL 149 million (1.3 percent of GDP).

15. **One end-September structural performance criterion was met, while the other—the submission of the Customs Code to parliament—was implemented with a short delay** (Table 9). Two of three end-September structural benchmarks were also met. The missed structural benchmark (on the submission of the trade liberalization strategy) was delayed to give the business community time to comment, and the authorities time to consider a more radical liberalization. The resulting strategy calls for a reduction of the top tariff rate from 30 to 12 percent in 2006, 5 percent in 2007, and the elimination of import tariffs by 2008. The authorities met the end-December performance criterion for completing the transition to the single treasury account, the benchmarks for proposing upgraded "Fit and Proper" criteria for bank owners, and the preparation of a pension strategy, but missed two of five end-2005 benchmarks.[5] The introduction of targeted poverty benefits, which was delayed by inflation concerns and the complexities of proper targeting, is proposed as a

[5] These criteria and benchmarks apply to the fourth review of this PRGF arrangement.

performance criterion for end-June 2006. The other missed benchmark—to complete registering taxpayers—is underway.

IV. Report on the Discussions

16. **Against the backdrop of reasonably low inflation and good growth performance, underpinned by strong and consistent reforms, the Article IV discussions focused on medium-term policies necessary to maintain growth and reduce poverty.** Discussions centered on measures to deal with obstacles to growth—including crumbling infrastructure that needs to be addressed by the public investment program, financial sector underdevelopment, and poor institutional quality affecting private sector investment—while maintaining macroeconomic stability.

A. Medium-Term Economic Prospects and Challenges

17. **The authorities assess economic prospects in the medium term as strong (Table 10).** Their focus on maintaining macroeconomic stability, liberalizing the economy and removing remaining obstacles to businesses, and developing complementary public infrastructure required for private sector activity, should create an environment for steady growth and improvement of living standards in the coming years.

18. **The primary focus of the public investment program over the medium term is on improving roads and power supply, which the authorities consider to be key to maintaining growth.** The authorities recognize the importance of strengthening their medium-term fiscal planning, and in that context are seeking to improve the Basic Data and Directions (BDD) document, their equivalent of an MTEF. Nonetheless, they view the four supplementary budgets in 2005 as a positive reflection of their strong revenue and privatization performance. Discussions focused on ways to increasingly tie expenditure policy to a well prioritized medium-term strategy that could provide a coherent policy framework in which to prepare supplementary budgets.

19. **The NBG and government are preparing a financial sector development strategy for 2006–09.** The strategy will focus on (i) streamlining some of the more cumbersome regulations and harmonizing them with Basle principles, (ii) consolidating NBG's functions and independence; (iii) refining the payments system; (iv) introducing measures to develop capital markets, including for government securities; and (v) easing the entrance of foreign banks into Georgia.

20. **Despite substantial progress on reducing corruption and improving governance, the authorities realize that further reforms, particularly in the judicial area, are needed (SIP, Chapter III).** The authorities see Georgia becoming a liberal and deregulated market economy, with few opportunities for rent-seeking. In addition, the new trade liberalization strategy, which will eliminate all tariffs by 2008, is seen by the authorities as a key step to integrate Georgia into the global economy.

21. **The main challenge facing the authorities is to maintain macroeconomic stability in the face of a significant inflow of resources, election pressures, and regional tensions.** With privatization proceeds, remittances, and official assistance—including grants soon to begin from the Millennium Challenge Account (MCA)—financing rural infrastructure and the rehabilitation of the energy sector, the burden of controlling inflation will be on monetary policy. In addition to maintaining the quality of spending given capacity constraints, the fiscal and monetary policy mix may need to be reexamined going forward. In this regard, the authorities recognize that the NBG's ability to conduct monetary operations needs to be strengthened, and the coordination of policies between the NBG and ministry of finance improved. Finally, regional tensions and political uncertainties represent a risk to sustainable medium-term growth.

B. Near-Term Economic Policies

22. **As a foundation for program discussions, the authorities updated the macroeconomic framework for 2006 to reflect the recent robust performance of the economy, keeping in line with underlying PRSP objectives.** Real GDP growth is projected to be 6.4 percent in 2006, assuming a slowdown of agricultural growth to a more sustainable level and high oil and gas prices. The fiscal stance is projected to remain roughly unchanged, with a programmed deficit of 2.6 percent of GDP on a cash basis, as all remaining domestic arrears are cleared. While the budget projects the fiscal deficit on a commitment basis to increase to 2.2 percent of GDP, staff projects the deficit to decline to 1.1 percent of GDP (from 1.5 percent in 2005). The monetary program targets a further reserve accumulation of about US$146 million in 2006, which would increase non-pipeline import coverage to 2.3 months, whereas growth of reserve money would be limited to 25 percent, consistent with a targeted decrease of CPI inflation to 4.7 percent by end-December 2006 (MEFP Table 2).

2006 budget

23. **The 2006 budget incorporates the following key features:**

- A fiscal framework in line with the PRSP and MTEF;
- Financing from privatization proceeds and concessional resources;
- Tax revenues that are projected conservatively against the backdrop of large improvements in tax administration in 2004, and the major tax reform in 2005; and
- A focus on the quality and sustainability of increased expenditures on infrastructure, energy, and defense, and the replacement of untargeted social programs with well-targeted extreme poverty benefits.

24. **The 2006 budget envisages a roughly unchanged fiscal stance,** with a deficit of 2.2 percent of GDP on a commitment basis. Clearance of arrears is budgeted to be

0.4 percent of GDP, reflecting arrears claims that have already been verified, leading to a deficit of 2.6 percent of GDP on a cash basis.

25. **The budget contemplates an increase in current expenditures (0.6 percent of GDP) and a decrease in capital expenditure (0.5 percent of GDP).** The wage bill is expected to remain roughly unchanged as a share of GDP, and defense spending to decline slightly, while social spending is projected to increase to about 9 percent of GDP, reflecting anticipated increases in minimum pensions as well as the targeted poverty benefit program now scheduled for mid-2006.[6,7] The budget also includes GEL 35 million in temporary energy subsidies to cushion private gas consumers from the 70 percent increase in gas tariffs, prior to the introduction of the new poverty benefit.

26. **The 2006 budget includes a conservative 19.3 percent of GDP revenue projection, as the budget was prepared before the 2005 outturns were known.** Actual 2005 tax revenues amounted to 19.8 percent of GDP, reflecting continued gains in tax collections and further improvements in revenue administration. The authorities agree that this strong revenue effort is likely to be sustained, with 2006 tax revenues expected to be about 1 percent of GDP higher than budgeted. They intend to use excess revenues first to finance the clearance of any additional verified arrears, as the government seeks to resolve all arrears claims outstanding as of end-2005 by end-2006 (MEFP, paragraph 16 and Table 1; a planned structural performance criterion for end-December 2006). Notwithstanding the reductions in customs duties, import taxes are expected to be unchanged as a percentage of GDP, as lower rates (including excises on cigarettes) are expected to reduce smuggling.

27. **Grants are expected to increase in 2006, partially offsetting declining privatization receipts.** The 2006 MCA disbursements comprise the majority of the projected 1.3 percent of GDP in grants. Privatization receipts are projected to be 2.6 percent of GDP.

Monetary and exchange rate policies

28. **The monetary program for 2006 targets reserve money growth at 25 percent, consistent with the authorities' single-digit inflation objective (Box 2, MEFP paragraph 32).** The program does not foresee direct borrowing from the central bank, and the authorities intend to introduce legislation prohibiting any such borrowing in the future (an end-March performance criterion).

---

[6] Progress toward the implementation of this targeted poverty benefit has been substantial, with a significant share of Georgian families already having applied for the benefit.

[7] Goods and services are expected to increase by 2 percent of GDP. This increase is largely presentational, and mostly offset by lower local government expenditures, as schools were converted to LEPLs, and transfers to LEPLs are recorded as purchases of goods and services.

29. **The NBG emphasized that it stood ready to use its indirect monetary policy instruments more actively to affect the monetary base, including sterilizing its foreign exchange interventions.** To increase its stock of such instruments, the ministry of finance and the NBG are nearing agreement on securitizing some of the non-tradable government debt held by the central bank (MEFP, paragraph 33).[8] In the event of unexpected capital inflows, the NBG will conduct sales of treasury bills and central bank CDs to contain the monetary expansion from any foreign exchange purchases. In light of mounting confidence in the banking system that should allow further dedollarization, the NBG also plans to streamline its reserve requirements by equalizing the requirements for domestic and foreign-currency deposits.[9]

Box 2. Preparing for Inflation Targeting

Most CIS countries, including Georgia, manage the exchange rate, but are exposed to frequent and sometimes large external shocks. An (implicit) exchange rate peg may not be sustainable, since both reserves and sterilization instruments are limited. Recognizing the importance of low and stable inflation, most countries also monitor monetary aggregates. This strategy, however, can prove difficult in light of money demand instability.

As an alternative monetary policy framework, a growing number of countries have chosen to target inflation directly. Some of the prerequisites of *inflation targeting* include (i) price stability as the overriding objective of monetary policy; (ii) an independent central bank that has instruments to reach its (assigned and agreed) inflation target; (iii) a strong accountability framework; (iv) a strong and well-understood transmission mechanism from the NBG's operating target to inflation; and (v) a sufficiently good econometric model to successfully forecast inflation.

While the NBG believes it will not be ready to switch to this paradigm soon, fulfilling these prerequisites would contribute to improving the conduct of monetary policy. Although the NBG is in principle autonomous, it is subject to political pressures to influence the exchange rate and interest rate. A public declaration that price stability is the NBG's overriding goal (together with a commitment to a more flexible exchange rate) would help reduce these pressures. While the NBG's legal mandate currently includes price stability, it also includes maintaining the purchasing power of the lari, which could conflict with price stability. The NBG has announced an "estimate" (as opposed to "target") for the one-year-ahead CPI inflation rate, continues to develop a macroeconomic model, and is aiming to publish a financial stability report. Finally, the NBG recognizes that it should embark on a public campaign to explain its monetary policy actions and report to the public at a higher frequency.

30. **Maintaining external competitiveness remains a key policy challenge.** The CPI-based real exchange rate and low labor costs suggest the lari may be undervalued. Thus,

[8] Discussions on this agreement are currently focused on the government's desire to see a reduction in NBG administrative costs. Failure to reach agreement would make implementation of the agreed monetary program more difficult, but would not fundamentally undermine the authorities' economic program.

[9] Reserve requirements are currently 2 percent for lari deposits and 13 percent for foreign currency deposits.

further upward pressure on the exchange rate stemming from strong international financial support and FDI expected for Georgia over the medium term could well be accommodated. At the same time, surveys of the costs of doing business in Georgia suggest that external competitiveness may be weaker than the real exchange rate comparisons suggest.

31. **The authorities reiterated their commitment to a floating exchange rate regime and their general intention to refrain from intervention other than to smooth market fluctuations.** However, while recognizing the importance of the inflation target, the authorities voiced concerns about the negative impact of a lari appreciation on exports in the event of larger-than-anticipated foreign exchange inflows. In their view, large U.S. dollar-denominated household assets and income flows would require a more managed approach to appreciation if pressures were to arise.

C. Structural Reforms

32. **There have been improvements in fiscal transparency since 2004.** However, concerns remained about the persistence of quasi-fiscal funds operating outside the budget with limited accountability and transparency. Two such funds—the Armed Forces Fund and the Law Enforcement Fund—had been widely discussed in Georgia. The authorities explained that these funds had been formed in early 2004 to address specific problems, but noted that there was no longer any need for them. These funds are now closed, and are being liquidated (MEFP, paragraph 30). A third fund, the Reform and Development Fund, which previously financed budget expenses, has been transformed into an NGO.

33. **More generally, the authorities are undertaking a program of reforms of LEPLs, which have become the cornerstone of their decentralization strategy.** The authorities are committed to decentralizing the provision of government services, and are delegating control and accountability of major government functions to these LEPLs. While having no disagreement with these principles, staff argued that a monitoring and reporting framework needed to be put in place urgently. The authorities agreed it was important to ensure the LEPL reform did not undermine gains in fiscal transparency and accountability (Box 3), and are committed to a number of steps designed to ensure effective monitoring of their activities (MEFP, paragraph 29). It was agreed that progress in this area would be reviewed in the context of the fourth review of Georgia's PRGF arrangement.

Box 3. Reforming Legal Entities of Public Law (LEPLs)

The authorities view the conversion of fiscal entities into LEPLs as an opportunity to improve government service delivery (SIP, Chapter IV). The conversion of budgetary organizations to LEPL status is designed to provide them greater autonomy, and thus allow them to implement reforms quickly while bypassing bureaucratic red tape. However, insufficient consideration may have been given to ensuring the new LEPLs were accountable for results, or to monitoring their activities. While the exact number of LEPLs is not known, between 1999 and 2003 an estimated 700 budgetary organizations were converted to LEPLs at the local and central government level. In December 2005, the authorities converted about 2,700 individual schools into LEPLs, bringing the estimated number to more than 3,400.

The main fiscal risks associated with the LEPL reform include the following:

- The LEPL reform in its present state weakens the monitoring and reporting of the fiscal accounts of the general government, with implications for budget transparency and control;
- The delegation of authority will create problems controlling the quality of spending, particularly as LEPLs have less developed Public Expenditure Management systems; and
- There is a significant risk that LEPLs may incur debt and arrears.

34. **The authorities emphasized the importance of upgrading the Budget Systems Law (BSL) to organic status,** but noted that certain technical amendments to the BSL were needed first; after these were passed, they would renew their efforts to get the law upgraded. They reiterated their intention to be GFS 2001 compliant by 2007.

35. **Building on the comprehensive tax reforms that took place in 2005,** the ministry of finance plans to improve tax administration by focusing on three key priorities: (i) self-assessment, (ii) risk management, and (iii) taxpayer segmentation. An FAD regional tax administration advisor will assist the authorities in these efforts. While acknowledging that the customs code that was recently submitted to parliament represents a significant improvement, staff urged the authorities to strengthen the penalty provisions in this code; the authorities agreed to consider this recommendation.

36. **The NBG plans further financial sector reforms (Box 4),** including strengthening supervision (MEFP paragraphs 34–39). Consideration is being given to introduction of a deposit insurance system, but the authorities recognize that appropriate conditions are necessary before its introduction. The authorities believe further sector consolidation, by merging or closing weak banks, will be an important step toward creating appropriate conditions for deposit insurance. Finally, an FSAP update is currently underway. The authorities plan to implement recommendations coming from this exercise, which will be reflected in an FSSA to be presented to the Board along with the fourth review.

Box 4. Developing the Financial Sector in Georgia

Financial sector development in Georgia has lagged behind many other transition countries (SIP, Chapter I). Monetization was low after independence, trailing the levels in Central and Eastern European economies and the Baltics (see table). Financial intermediation is shallow, and commercial banks have targeted their activities to a small group of companies and consumers, resulting in lower private sector credit than in the comparable countries.

Over the past year, increased confidence in the Georgian banking system, higher consumer spending, and emerging business opportunities have triggered a credit boom. Since end-2004, commercial banks' lending to the private sector has increased by more than 80 percent—albeit from very low levels. Some of the additional loans are consumption-related or mortgages, fuelling property prices in Tbilisi.

While economic growth has been high in recent years despite the limited financial market development, a stronger financial sector will be essential to sustain this economic development. Greater financial intermediation, in particular benefiting small- and medium-sized enterprises, should spur investment and job creation. As firms' financing needs go beyond retained earnings, and equity financing is not viable given shallow equity markets, the banking sector will play a crucial role. For the financial sector in Georgia to catch-up with the advanced transition economies, financial sector reforms such as greater consolidation and foreign entry, and enhanced creditors' rights, need to gain momentum.

Table 1. Selected Transition Economies: Financial Sector Development, 1996–2005

(In percent of GDP)

	1996	1998	2000	2002	2004	2005 Est.
Banking system credit to economy						
Georgia	3.3	4.7	7.3	8.3	9.5	15.0
Selected CEE 1/	36.5	35.4	35.8	31.3	35.5	39.0
Baltics 2/	11.8	16.1	17.5	22.4	37.6	54.1
Monetization 3/						
Georgia	6.7	7.3	10.3	11.6	15.2	16.5
Selected CEE 1/	49.7	48.0	51.1	53.6	53.3	55.4
Baltics 2/	21.6	23.6	28.9	33.6	38.7	47.6

Sources: International Monetary Fund, *IFS*, *WEO*, and MCD centralized databases.

1/ Includes Poland, Czech Republic, Hungary; simple average.
2/ Includes Estonia, Latvia, Lithuania; simple average.
3/ M3 where available, M2 otherwise.

37. **The authorities are increasingly focused on strengthening the energy sector through modernization, privatization and diversification of energy sources.** They noted the need to install individual meters for households and adjust electricity tariffs to cost-recovery levels, upon the completion of the tariff review sponsored by the World Bank (Box 5). The authorities plan to privatize six hydropower plants and three distribution companies in 2006. In addition, a draft law has been prepared establishing a debt restructuring committee charged with resolving the long-standing problems in the sector.

Box 5. The World Bank Work Program in Georgia

The World Bank Country Partnership Strategy (CPS) for FY06–09 builds on the government Economic Development and Poverty Reduction Program (EDPRP), as well as emerging government strategic thinking on the development framework. It targets several goals: i) generating growth and job creation by removing barriers to private sector development and improving infrastructure, finance and markets; ii) enhancing human development and social protection through improved education, health, social protection, and community services; and iii) strengthening public sector management and budgetary processes to enable Georgia to better plan and meet its own development goals.

A key component of the CPS is a series of Poverty Reduction Support Operations (PRSO). The PRSO has four pillars:

- Strengthening public sector accountability, efficiency, and transparency.
- Improving electricity and gas sector services.
- Improving environment for private sector development.
- Improving social protection, education, and health care services.

38. **A key goal for the authorities is to create a favorable business climate by liberalizing the economy, and restructuring and privatizing the remaining state-owned enterprises.** The EBRD transition indicators show significant accomplishments in these areas, especially in comparison to other CIS countries (Box 6). In addition to a better business environment, several surveys have also reflected improvements in governance, although important challenges remain.

Box 6. Latest Surveys on the Business Environment and Governance

The Georgian authorities have clearly established momentum in reforming the business environment. A series of surveys that came out in 2005 reflect improvements resulting from the policy changes undertaken by the current administration. Most informal views are that the next round of these surveys will reflect even larger gains.

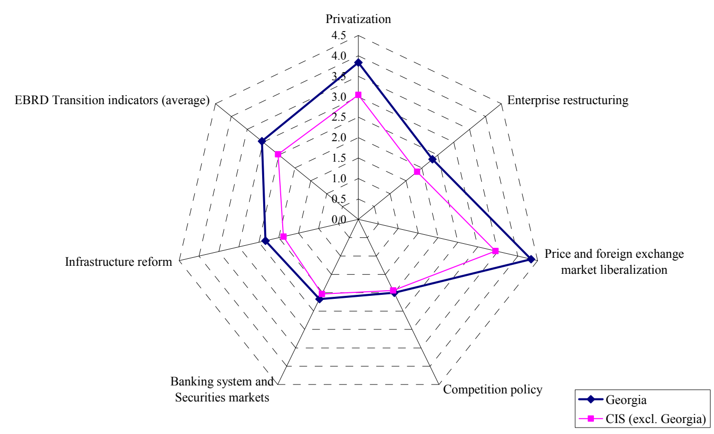
In the World Bank's Doing Business 2005, Georgia showed the second largest improvement and ranked 100 out of 155 countries. Georgia performed better than other countries in the region in starting a business, rigidity of employment, registering property, and closing a business.

In the World Economic Forum's Global Competitiveness Index of 2005, Georgia was ranked 86th out of 117 countries, up 8 spots, the seventh largest upward move. The two main areas of improvement were macroeconomic stability and the quality of public institutions.

Heritage Foundation's Index of Economic Freedom had Georgia jumping from 100th place in 2005 to 68th place in 2006, with its score improving from "mostly unfree" last year to "mostly free" this year. Areas of improvement were concentrated in monetary policy, the financial sector, and foreign investment, while property rights, regulation, and the informal market scores remained poor.

Transparency International's Corruption Perceptions Index 2005 showed modest improvement from 2 to 2.3.

Figure 5. EBRD Transition Indicators, 2005



Technical assistance and data issues

39. **The authorities expressed satisfaction with the technical assistance provided by the Fund during the last two years (Appendix I).** While the assistance has been broadly effective, there have been delays in the implementation of some recommendations. These shortcomings can be attributed to capacity constraints and, in certain areas, changing priorities. Future needs involve government finance and balance of payments statistics

methodology, as well as implementation of recommendations from the FSAP update currently underway.

40. **The quality and timeliness of economic and social statistics have improved over the past few years,** although real sector, fiscal, and balance of payments data require further enhancements (Appendix IV). Georgia plans to subscribe to the General Data Dissemination Standard, and the data provided to the Fund are generally adequate for surveillance and program monitoring.

D. Medium-Term Risks and Capacity to Repay

41. **The medium-term debt sustainability analysis (Appendix V), shows that Georgia faces a moderate risk of debt distress,** as evidenced by the decline in the medium term of all indicators of external indebtedness below the relevant debt-burden thresholds of the NPV of debt (150 percent of exports, 40 percent of GDP, and 250 percent of fiscal revenue).[10] Stress tests indicate that Georgia would be vulnerable to adverse external and domestic shocks, or bad policy choices. For example, export value growth less than historical averages—2 percent growth for 2 years—would result in the NPV of debt-to-exports ratio becoming unsustainable at 150 percent, even if the gap were financed at better than commercial terms (30 percent grant element). With official reserves low (at about 2 months of non-pipeline imports), this could erode hard gained exchange rate stability. Overall, Georgia's capacity to repay the Fund seems strong (Tables 11 and 12).

42. A significant risk this year is the authorities' commitment to maintain ***macroeconomic restraint in the face of election pressures*** while sustaining commitment to pro-poor spending. In addition, relations with Russia are tense, as ***political tensions*** remain high regarding the status of the breakaway territories of Abkhazia and South Ossetia. The recent explosions, which interrupted gas and electricity imports from Russia, show that the ***energy sector*** continues to be a major source of vulnerability. Energy sector reforms, including privatizations that are transparent and internationally tendered, as well as a further diversification of energy sources, would contribute to the sector's medium-term viability. Finally, continued progress in ***structural reforms*** will be necessary for sustainable medium-term growth.

V. Staff Appraisal

43. **The transition, following the Rose Revolution, to better quality fiscal policies underpinned by a determined undertaking of a broad range of reforms, including in tax**

---

[10] These thresholds are policy-dependent and Georgia is considered a medium policy performer, as measured by the World Bank's CPIA. The main macroeconomic assumptions of the baseline scenario include real GDP growth of about 5 percent in 2006–11 and 3½ percent in 2016–25, inflation of less than 5 percent after 2006, and an external current account deficit excluding interest payments of less than 5 percent of GDP in 2006–11, falling to less than 2 ½ percent thereafter.

policy and administration and the business environment, has provided a key foundation for placing the Georgian economy on a strong growth path. The authorities are to be commended for their performance over this period. The challenge ahead is to reinforce the reforms with adequate implementation, while proactively addressing the remaining vulnerabilities.

44. **The staff welcomes the effective implementation of the economic program in 2005.** All but one of the quantitative performance criteria for end-September 2005 were met. Although the authorities cited inflation as the reason for not clearing the programmed level of arrears, staff believes that clearing back wages and salaries would have had minimal impact on inflation. The staff thus welcomes the authorities' commitment to clear all remaining arrears by end-2006.

45. **Owing largely to the strong revenue performance and restraint on capital expenditures, the deficit was half the budgeted level.** Given this positive fiscal position, staff regrets the delay in clearing arrears and introducing a targeted poverty benefit. Moreover, staff believes there is an urgent need to strengthen fiscal planning, and to put it in the context of a meaningful MTEF. The pace of increase in some categories of spending is also cause for concern, such as the increase in current expenditures by more than 4 percent of GDP and the more than doubling of defense spending.

46. **The projections underlying the 2006 budget appear conservative.** The main risk to the agreed framework is the danger of supplemental budgets to increase spending in an election year. The staff urges the authorities to exercise spending restraint, and to ensure all expenditures are in line with the PRSP and MTEF.

47. **The newly created LEPLs have to be monitored carefully to ensure adequate financial control.** While acknowledging the authorities' objective of creating more flexible functions of government, staff is concerned with the rapid movement in this direction without adequate monitoring and reporting procedures. The staff urges the authorities to urgently develop and implement such procedures.

48. **The current stance of monetary policy, aimed at lowering inflation to about 5 percent, is appropriate.** To attain this target, it will be important to allow the exchange rate to appreciate, especially in the event of higher capital inflows. Foreign exchange intervention should be limited to smoothing exchange rate fluctuations. The level of the exchange rate is possibly somewhat undervalued at the present time; the nominal exchange rate should be allowed to appreciate over the medium term while safeguarding competitiveness through structural reform-induced productivity improvements.

49. **While staff welcomes the improved coordination between the ministry of finance and NBG, there is need for further improvement** in this coordination to avoid swings in monetary aggregates. Moreover, the authorities should be prepared to actively use the newly created instruments of monetary policy to achieve their inflation targets.

50. **The financial sector's growth in the last year, albeit from a very low base, has been impressive.** To ensure the sector remains healthy amid such vigorous expansion, it will be critical to ensure strong and effective banking supervision. In addition, increasing minimum capital requirements, allowing foreign banks to enter and further consolidate the sector, and implementing fit and proper ownership requirements will be important. The adoption of forthcoming FSAP recommendations should further strengthen the financial sector.

51. **Notwithstanding the tremendous gains made in the last two years, the structural reform agenda needs to be ambitious to increase competitiveness, sustain growth and reduce poverty.** The authorities' priorities to overhaul and transform transport infrastructure, and the energy and water sectors, to deepen the financial sector, and to improve customs in conjunction with radical trade liberalization that envisages a complete abolition of import tariffs in two years, appropriately target removing the key obstacles to growth. If effectively implemented in the context of macroeconomic stability and a favorable business environment, they will provide reasonable assurance of sustained growth over the medium-term. Notwithstanding the impressive recent improvements, to ensure a favorable business environment, it will be important for the authorities to continue to aggressively work to improve governance and property rights.

52. **Staff remains concerned that safety nets are not in place at this critical juncture.** While increasing pensions and defraying higher energy costs for households will help the poor, the authorities need to move ahead with clearing wage and pension arrears and introducing the targeted extreme poverty benefit. Going forward, poverty and inequality reduction is essential to keep broad support for the market-based reforms that will deliver higher living standards for all in Georgia.

53. Given Georgia's good overall performance under the program, and commitments outlined in the MEFP, staff supports the authorities' request for waivers for the nonobservance of performance criteria and recommends the completion of the third review of the PRGF arrangement. It is proposed that the next Article IV consultations be held in the 24-month cycle.

Table 1. Georgia: Selected Macroeconomic Indicators, 2004–06

	2004	2005		2006
		CR/05/314	Prel. Est.	Proj.
(Annual percentage change, unless otherwise indicated)				
National accounts				
Nominal GDP (millions of lari)	9,970	11,660	11,600	13,080
Nominal GDP (US$ million)	5,193	6,303	6,409	7,522
Real GDP	6.2	6.4	7.7	6.4
Population 1/	4.3	4.3	4.3	4.3
Consumer price index, period average	5.7	9.4	8.3	5.3
Consumer price index, end-of-period	7.5	7.0	6.2	4.7
GDP/capita (US$)	1,203	1,461	1,485	1,743
Poverty rate (in percent)	52.7	...	...	...
Unemployment rate	12.6	...	...	...
(In percent of GDP, unless otherwise indicated)				
Investment and saving				
Investment	26.6	28.9	26.4	26.6
Public	2.4	5.5	4.2	3.8
Private	24.2	23.4	22.1	22.8
Gross domestic saving	18.3	17.1	19.0	19.4
Public	5.5	2.0	2.7	1.6
Private	12.8	15.1	16.3	17.9
Saving-Investment balance	-8.3	-11.8	-7.4	-7.1
Budgetary operations				
Total revenue and grants 2/	21.7	21.7	23.4	22.9
Of which: Tax revenue	18.2	18.1	19.8	19.3
Total expenditure and net lending	18.6	25.2	24.9	25.0
Of which: Current expenditure	16.2	19.7	20.7	21.3
Primary balance	4.3	-2.4	-0.5	-1.3
Fiscal balance, commitment basis	3.1	-3.5	-1.5	-2.2
Net change in expenditure arrears	-2.6	-1.3	-0.9	-0.4
Statistical discrepancy	-0.8	0.0	0.0	0.0
Fiscal balance, cash basis	-0.2	-4.8	-2.4	-2.6
Financing	0.2	4.8	2.4	2.6
Privatization	0.9	3.4	3.6	2.6
External 3/	0.2	0.8	-0.3	-0.2
Domestic	-0.9	0.6	-0.9	0.3
Public debt	46.4	37.8	36.2	30.5
Of which: External debt (P&PG)	35.8	29.4	27.1	22.9
(Annual percentage change, unless otherwise indicated)				
Monetary sector				
Reserve money	44.3	26.0	19.7	25.0
Broad money (including foreign exch. deposits)	42.6	31.8	26.4	29.0
Velocity of broad money, level (M3 annual average)	7.8	…	6.8	6.0
(In millions of U.S. dollars, unless otherwise indicated)				
External Sector				
Exports of goods and services (percent of GDP)	55.0	34.2	34.1	31.2
Annual percentage change	48.7	9.6	11.0	7.5
Imports of goods and services (percent of GDP)	51.4	52.4	47.3	44.3
Annual percentage change	46.9	23.7	13.7	9.7
Net imports of oil	233	304	326	389
Current account balance	-429	-742	-472	-537
In percent of GDP	-8.3	-11.8	-7.4	-7.1
Gross international reserves	383	493	474	620
In months of imports of goods and services (excl. pipeline imports)	2.0	2.0	2.1	2.3
Foreign direct investment	503	731	415	390
Average exchange rate (lari per dollar)	1.9	…	1.8	...

Sources: Georgian authorities; and Fund staff estimates.

1/ Excludes Abkhazia residents.

2/ Revenue projections for 2006 are as budgeted.

3/ External financing for 2004-06 includes debt relief from the Paris Club.

Table 2. Georgia: Millennium Development Goals, 1990–2003
(In percent, unless otherwise specified)

	1990	1995	2000	2003
1 Eradicate extreme poverty and hunger	2015 target = halve 1990 $1 a day poverty and malnutrition rates			
Population below US$1 a day	...	...	...	...
Poverty gap at US$1 a day	...	...	...	...
Share of income or consumption held by poorest 20 percent	...	...	6.4	...
Prevalence of child malnutrition (percent of children under 5)	...	...	3.1	...
Share of population below minimum level of dietary energy consumption	...	39	...	27
2 Achieve universal primary education	2015 target = net enrollment to 100			
Net primary enrollment ratio (percent of relevant age group)	97.1	...	95.2	88.7
Primary completion rate (percent of relevant age group)	...	81.0	93.0	82.0
Percentage of cohort reaching grade 5	...	...	...	...
Youth literacy rate (ages 15-24)	...	...	...	...
3 Promote gender equality	2005 target = education ratio to 100			
Ratio of girls to boys in primary and secondary education	98.2	99.4	100.9	99.7
Ratio of young literate females to males (ages 15-24)	...	...	...	...
Share of women employed in the nonagricultural sector	44.5	45.0	41.2	46.5
Proportion of seats held by women in national parliament	...	6	7	7
4 Reduce child mortality	2015 target = reduce 1990 under 5 mortality by two-thirds			
Under 5 mortality rate (per 1,000)	47	...	45	45
Infant mortality rate (per 1,000 live births)	43	41	41	41
Immunization, measles (percent of children under 12 months)	...	63	73	73
5 Improve maternal health	2015 target = reduce 1990 maternal mortality by three-fourths			
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	22	32	...
Births attended by skilled health staff (percent of total)	...	...	96.4	...
6 Combat HIV/AIDS, malaria and other diseases	2015 target = halt, and begin to reverse, AIDS, etc.			
Prevalence of HIV, total (ages 15-49)	...	...	0.1	0.1
Contraceptive prevalence rate (of women ages 15-49)	...	...	40.5	...
Number of children orphaned by HIV/AIDS	...	...	...	...
Incidence of tuberculosis (per 100,000 people)	38.2	47.2	82.2	82.8
Tuberculosis cases detected under DOTS 1/	...	15	31	51.9
7 Ensure environmental sustainability	2015 target = various (see notes)			
Forest area (% of total land area)	43.0	...	43.0	...
Nationally protected areas (percent of total land area)	...	2.7	...	2.3
GDP per unit of energy use (PPP $ per kg oil equivalent)	1.2	1.6	3.4	4.4
CO2 emissions (metric tons per capita)	2.8	1.1	1.2	...
Access to an improved water source (percent of population)	...	...	...	76
Access to improved sanitation (percent of population)	...	...	...	83
Access to secure tenure (percent of population)	...	...	...	...
8 Develop a Global Partnership for Development	2015 target = various (see notes)			
Youth unemployment rate (percent of total labor force ages 15-24)	...	...	21.1	...
Fixed line and mobile telephones (per 1,000 people)	98.9	102.3	140.2	239.7
Personal computers (per 1,000 people)	...	...	22.3	31.6
General indicators				
Population (in millions)	5.4	5.1	4.5	4.4
Gross domestic product (US$ billion)	5.1	2.1	3.0	4.0
GDP per capita (US$)	940	410	686	917
Adult literacy rate (percent of people ages 15 and over)	...	...	...	...
Total fertility rate (births per woman)	2.2	1.4	1.1	1.1
Life expectancy at birth (years)	72.3	72.5	...	73.5
Public and publicly guaranteed external debt (percent of GDP)	...	64.1	51.3	46.4
Investment (percent of GDP)	29.1	23.9	21.6	24.4
Trade (percent of GDP) 2/	85.6	67.9	81.2	78.8

Sources: World Development Indicators database, April 2005; Georgian State Department of Statistics; and Fund staff estimates.

Note: In some cases the data are for earlier or later years than those stated. The goal targets are the following: Goal 1: Halve, between 1990 and 2015, th proportion of people whose income is less than US$1 a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger; Goal 2: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling; Goal 3: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015; Goal 4: Reduce by two-thirds, betwee 1990 and 2015, the under-five mortality rate; Goal 5 target: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio; Goal 6: Hav halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases; Goal 7: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water; Goal 8: Develop further an open, rule-based, predictable, nor discriminatory trading and financial system. Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth. In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries. In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.

1/ Directly observed treatment, short-course case detection and treatment strategy (World Health Organization).

2/ Trade is calculated as the sum of imports and exports of goods and non-factor services relative to GDP.

Table 3. Georgia: Operations of the General Government, 2004–06
(In millions of lari)

	2004	2005						2006					
		Quarterly Profile				Prel.	Prog.	Quarterly Profile				Budget	Proj.
		Q1	Q2	Q3	Q4		CR/05/314	Q1	Q2	Q3	Q4		IMF
Total revenue and grants	2166	559	595	746	816	2715	2532	637	707	875	771	2990	3129
Total revenue	2042	548	578	726	759	2611	2395	618	690	808	703	2819	2954
Tax revenue 1/	1811	449	537	636	678	2300	2107	513	624	731	658	2527	2647
Taxes on income	269	66	67	72	85	291	263	74	74	80	64	293	323
Taxes on profits	162	43	58	63	46	210	221	55	73	80	58	266	266
Social tax 1/	...	51	60	97	106	315	228	48	56	90	99	293	293
VAT	628	195	231	257	305	987	875	230	280	316	278	1105	1195
Customs duties	123	24	28	35	37	123	135	27	32	40	43	143	143
Excises	181	53	75	81	76	286	319	63	89	97	89	339	339
Other taxes	111	13	15	28	20	76	66	15	20	27	27	89	89
Nontax revenue 1/	231	99	41	90	81	312	289	104	66	77	44	292	307
Of which: NBG profit transfers	12	40	0	0	0	40	40	40	0	0	0	40	40
Extrabudgetary revenue	337	...	...	...	...	...	...	...	...	...	...	...	...
Grants	124	11	17	19	57	104	137	19	17	67	68	171	174
Total expenditure and net lending	1853	531	652	791	918	2892	2939	667	723	923	964	3276	3276
Current expenditure	1618	466	554	644	736	2400	2292	589	637	766	790	2782	2782
Wages and salaries	312	100	114	115	123	452	447	117	117	117	117	469	469
Goods and services	264	77	105	93	143	420	602	169	176	207	214	766	766
Transfers and subsidies	237	183	201	226	259	869	598	206	226	270	276	978	978
Interest payments	120	32	29	27	32	120	122	32	30	32	29	123	123
Domestic	71	21	20	21	19	82	78	18	17	18	17	70	70
External	49	11	9	6	13	39	44	13	13	14	13	53	53
Extrabudgetary expenditures 2/	304	...	...	...	...	...	...	...	...	...	...	...	...
Local government expenditures	380	73	105	183	178	539	524	65	87	140	153	446	446
Capital expenditure 3/	208	62	93	143	162	459	584	69	78	148	165	461	461
Of which: Foreign financed	107	27	50	55	46	178	192	24	27	45	64	160	160
Net lending	27	4	5	4	20	33	63	9	9	9	9	34	34
Of which: Foreign financed	56	4	5	4	20	33	78	13	13	13	13	52	52
Overall balance (commitments)	313	28	-57	-46	-102	-177	-407	-30	-16	-48	-193	-287	-148
Adjustment to cash basis	-337	2	-31	-38	-34	-102	-149	-5	-15	-25	-15	-59	-146
Net change in expenditure arrears (-, reduction)	-259	-32	-37	-8	-27	-104	-149	-5	-15	-25	-15	-59	-146
Of which: Domestic expenditure arrears	-259	-32	-37	-8	-27	-104	-149	-5	-15	-25	-15	-59	-146
Statistical discrepancy	-78	34	5	-30	-7	2	0	0	0	0	0	0	0
Overall balance (cash)	-24	30	-89	-84	-137	-279	-556	-35	-31	-73	-207	-346	-294
Total financing	24	-30	89	84	137	279	556	35	31	73	207	346	294
Privatization	87	37	226	38	119	419	393	25	49	126	137	338	338
Domestic	-86	-53	-96	31	14	-104	67	0	-18	-33	88	37	-14
Net NBG credit	-61	-56	-82	51	11	-76	47	0	-18	-33	88	37	-14
Of which: Government deposits	0	-56	-82	56	15	-67	47	0	-18	-33	88	37	-14
Of which: Treasury bills	0	0	0	-6	-3	-9	0	0	0	0	0	0	0
Of which: NBG recapitalization	0	0	0	0	0	0	0	0	0	0	0	0	0
Net commercial bank credit	-12	3	-13	-22	2	-30	20	0	0	0	0	0	0
Nonbank	-14	-1	0	2	1	2	0	0	0	0	0	0	0
External	23	-14	-42	15	4	-36	97	10	-1	-21	-17	-29	-29
Disbursements	173	17	18	30	60	125	270	39	39	73	29	180	183
Amortization	-150	-31	-60	-14	-56	-161	-174	-29	-40	-94	-46	-209	-212
Memorandum items:													
Overall balance excluding grants (commitments)	105	17	-74	-65	-159	-281	-544	-49	-33	-115	-261	-458	-322
Defense spending 4/	161	...	...	...	...	389	391	...	...	...	...	427	427
Social spending (commitments) 5/	624	...	...	...	...	881	919	...	...	...	...	1,124	1,124
Social spending (cash)	708	...	...	...	...	941	964	...	...	...	...	1,183	1,261
Nominal GDP (millions of lari)	9,970	2,477	2,839	2,982	3,300	11,600	11,660	2,811	3,251	3,378	3,640	13,080	13,080

Sources: Georgian authorities; and Fund staff estimates.

1/ 2005 tax revenue, social tax, and nontax revenue include some back tax payments from corporations privatized that year.
2/ 2004 extrabudgetary expenditure have been adjusted to exclude GEL 84 million in payment of pension arrears.
3/ Starting in 2005 capital spending includes expenditure previously undertaken by the Road Fund and recorded as current spending.
4/ Based on Ministry of Defense budget; excludes defense spending from the President's Fund.
5/ Social spending has been updated to more accurately reflect the authoirities measures in this area.

Table 3. Georgia: Operations of the General Government, 2004–06 (concluded)
(In percent of GDP)

	2004	2005						2006					
		Quarterly Profile				Prel.	Prog.	Quarterly Profile				Budget	Proj.
		Q1	Q2	Q3	Q4		CR/05/314	Q1	Q2	Q3	Q4		IMF
Total revenue and grants	21.7	22.6	20.9	25.0	24.7	23.4	21.7	22.6	21.8	25.9	21.2	22.9	23.9
Total revenue	20.5	22.1	20.3	24.4	23.0	22.5	20.5	22.0	21.2	23.9	19.3	21.6	22.6
Tax revenue 1/	18.2	18.1	18.9	21.3	20.5	19.8	18.1	18.3	19.2	21.6	18.1	19.3	20.2
Taxes on income	2.7	2.7	2.4	2.4	2.6	2.5	2.3	2.6	2.3	2.4	1.8	2.2	2.5
Taxes on profits	1.6	1.8	2.0	2.1	1.4	1.8	1.9	2.0	2.3	2.4	1.6	2.0	2.0
Social tax 1/	...	2.1	2.1	3.2	3.2	2.7	2.0	1.7	1.7	2.7	2.7	2.2	2.2
VAT	6.3	7.9	8.1	8.6	9.2	8.5	7.5	8.2	8.6	9.4	7.6	8.4	9.1
Customs duties	1.2	1.0	1.0	1.2	1.1	1.1	1.2	1.0	1.0	1.2	1.2	1.1	1.1
Excises	1.8	2.2	2.7	2.7	2.3	2.5	2.7	2.3	2.7	2.9	2.5	2.6	2.6
Other taxes	1.1	0.5	0.5	0.9	0.6	0.7	0.6	0.5	0.6	0.8	0.7	0.7	0.7
Nontax revenue 1/	2.3	4.0	1.4	3.0	2.5	2.7	2.5	3.7	2.0	2.3	1.2	2.2	2.3
Of which: NBG profit transfers	0.1	1.6	0.0	0.0	0.0	0.3	0.3	1.4	0.0	0.0	0.0	0.3	0.3
Extrabudgetary revenue	3.4	...	...	...	...	...	...	...	...	...	...	...	...
Grants	1.2	0.4	0.6	0.6	1.7	0.9	1.2	0.7	0.5	2.0	1.9	1.3	1.3
Total expenditure and net lending	18.6	21.4	23.0	26.5	27.8	24.9	25.2	23.7	22.3	27.3	26.5	25.0	25.0
Current expenditure	16.2	18.8	19.5	21.6	22.3	20.7	19.7	21.0	19.6	22.7	21.7	21.3	21.3
Wages and salaries	3.1	4.0	4.0	3.9	3.7	3.9	3.8	4.2	3.6	3.5	3.2	3.6	3.6
Goods and services	2.6	3.1	3.7	3.1	4.3	3.6	5.2	6.0	5.4	6.1	5.9	5.9	5.9
Transfers and subsidies	2.4	7.4	7.1	7.6	7.8	7.5	5.1	7.3	6.9	8.0	7.6	7.5	7.5
Interest payments	1.2	1.3	1.0	0.9	1.0	1.0	1.0	1.1	0.9	0.9	0.8	0.9	0.9
Domestic	0.7	0.9	0.7	0.7	0.6	0.7	0.7	0.6	0.5	0.5	0.5	0.5	0.5
External	0.5	0.5	0.3	0.2	0.4	0.3	0.4	0.5	0.4	0.4	0.4	0.4	0.4
Extrabudgetary expenditures 2/	3.1	...	...	...	...	...	...	...	...	...	...	...	...
Local government expenditures	3.8	3.0	3.7	6.1	5.4	4.6	4.5	2.3	2.7	4.2	4.2	3.4	3.4
Capital expenditure 3/	2.1	2.5	3.3	4.8	4.9	4.0	5.0	2.5	2.4	4.4	4.5	3.5	3.5
Of which: Foreign financed	1.1	1.1	1.8	1.8	1.4	1.5	1.6	0.9	0.8	1.3	1.8	1.2	1.2
Net lending	0.3	0.1	0.2	0.2	0.6	0.3	0.5	0.3	0.3	0.3	0.2	0.3	0.3
Of which: Foreign financed	0.6	0.1	0.2	0.2	0.6	0.3	0.7	0.5	0.4	0.4	0.4	0.4	0.4
Overall balance (commitments)	3.1	1.1	-2.0	-1.5	-3.1	-1.5	-3.5	-1.1	-0.5	-1.4	-5.3	-2.2	-1.1
Adjustment to cash basis	-3.4	0.1	-1.1	-1.3	-1.0	-0.9	-1.3	-0.2	-0.5	-0.7	-0.4	-0.4	-1.1
Net change in expenditure arrears (-, reduction)	-2.6	-1.3	-1.3	-0.3	-0.8	-0.9	-1.3	-0.2	-0.5	-0.7	-0.4	-0.4	-1.1
Of which: Domestic expenditure arrears	-2.6	-1.3	-1.3	-0.3	-0.8	-0.9	-1.3	-0.2	-0.5	-0.7	-0.4	-0.4	-1.1
Statistical discrepancy	-0.8	1.4	0.2	-1.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (cash)	-0.2	1.2	-3.1	-2.8	-4.1	-2.4	-4.8	-1.2	-0.9	-2.2	-5.7	-2.6	-2.2
Total financing	0.2	-1.2	3.1	2.8	4.1	2.4	4.8	1.2	0.9	2.2	5.7	2.6	2.2
Privatization	0.9	1.5	8.0	1.3	3.6	3.6	3.4	0.9	1.5	3.7	3.8	2.6	2.6
Domestic	-0.9	-2.2	-3.4	1.0	0.4	-0.9	0.6	0.0	-0.5	-1.0	2.4	0.3	-0.1
Net NBG credit	-0.6	-2.3	-2.9	1.7	0.3	-0.7	0.4	0.0	-0.5	-1.0	2.4	0.3	-0.1
Of which: Government deposits	0.0	-2.3	-2.9	1.9	0.4	-0.6	0.4	0.0	-0.5	-1.0	2.4	0.3	-0.1
Of which: Treasury bills	0.0	0.0	0.0	-0.2	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: NBG recapitalization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net commercial banks credit	-0.1	0.1	-0.5	-0.7	0.1	-0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Nonbank	-0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External	0.2	-0.6	-1.5	0.5	0.1	-0.3	0.8	0.3	0.0	-0.6	-0.5	-0.2	-0.2
Disbursements	1.7	0.7	0.6	1.0	1.8	1.1	2.3	1.4	1.2	2.2	0.8	1.4	1.4
Amortization	-1.5	-1.2	-2.1	-0.5	-1.7	-1.4	-1.5	-1.0	-1.2	-2.8	-1.3	-1.6	-1.6
Memorandum items:													
Overall balance excluding grants (commitments)	1.0	0.7	-2.6	-2.2	-4.8	-2.4	-4.7	-1.7	-1.0	-3.4	-7.2	-3.5	-2.5
Defense spending 4/	1.6	...	...	...	...	3.4	3.3	...	...	...	...	3.3	3.3
Social spending (commitments) 5/	6.3	...	...	...	...	7.6	7.9	...	...	...	...	8.6	8.6
Social spending (cash)	7.1	...	...	...	...	8.1	8.3	...	...	...	...	9.0	9.6
Nominal GDP (millions of lari)	9,970	2,477	2,839	2,982	3,300	11,600	11,660	2,811	3,251	3,378	3,640	13,080	13,080

Sources: Georgian authorities; and Fund staff estimates.

1/ 2005 tax revenue, social tax, and nontax revenue include some back tax payments from corporations privatized that year.
2/ 2004 extrabudgetary expenditure have been adjusted to exclude GEL 84 million in payment of pension arrears.
3/ Starting in 2005 capital spending includes expenditure previously undertaken by the Road Fund and recorded as current spending.
4/ Based on Ministry of Defense budget; excludes defense spending from the President's Fund.
5/ Social spending has been updated to more accurately reflect the authoirities measures in this area.

Table 4. Georgia: Accounts of the National Bank of Georgia, 2003–06

	2003 1/	2004		2005 2/							2006 2/				
	Dec.	Dec.		Mar.	June		Sep.		Dec.		Jan.	Mar.	June	Sep.	Dec.
	Actual	Actual 1/	Actual 2/	Actual	Prog. Est.	Actual	Prog.	Actual	Prog.	Actual	Actual	Proj.	Proj.	Proj.	Proj.
	(Contribution to reserve money growth in percent) 5/														
Net foreign assets	-4.7	79.8	77.1	-0.5	3.4	16.8	15.3	18.0	22.5	27.2	-0.5	0.3	7.4	21.9	28.0
Net domestic assets	18.6	-35.6	-32.8	-2.7	0.6	-11.7	0.8	-6.4	3.5	-7.5	-1.4	3.9	-0.3	-6.2	-3.0
Net claims on general government	5.2	-10.5	-10.5	-6.7	-1.7	-16.5	0.2	-10.4	5.6	-9.1	-0.5	0.0	-1.8	-5.1	3.7
Claims on rest of economy	6.7	0.1	-3.5	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on banks	1.2	-8.2	-8.2	1.3	1.3	3.8	0.1	5.0	-1.7	4.9	0.0	1.0	-0.5	-2.0	-6.0
Other items, net	5.4	-17.0	-10.6	2.6	1.1	1.0	0.5	-0.9	-0.4	-3.2	-0.9	2.9	1.9	0.8	-0.7
	(Percentage change since end of previous year)														
Reserve money (RM)	13.9	44.3	44.3	-3.3	4.0	5.1	16.1	11.6	26.0	19.7	-2.0	4.3	7.1	15.7	25.0
Currency in circulation (M0)	13.4	42.9	42.9	-2.7	4.0	2.7	15.8	10.4	25.1	20.0	-7.7	4.2	6.9	15.4	24.6
Required reserves	12.7	13.4	13.4	5.8	11.1	18.2	21.5	32.2	28.6	40.6	2.6	5.4	9.3	19.4	30.3
Balances on banks' correspondent accounts 3/	29.1	169.3	169.3	-21.8	-5.2	11.1	11.7	-4.7	31.8	-11.5	65.2	2.8	4.2	11.4	19.4
	(In millions of lari)														
Net foreign assets	-329	134	118	113	146	258	246	268	306	345	340	348	419	565	626
Gold	2	2	2	1	1	2	1	1	1	2	2	2	2	2	2
Foreign exchange reserves (including BIS account) 4/	413	802	679	688	698	810	806	828	881	882	877	861	948	1,110	1,148
Use of Fund resources	-622	-549	-463	-476	-454	-454	-462	-462	-477	-439	-439	-415	-430	-447	-424
Other foreign liabilities (net)	-122	-122	-100	-100	-100	-100	-100	-99	-100	-99	-99	-100	-100	-100	-100
Net domestic assets	909	703	719	696	724	621	725	665	748	656	642	696	653	594	626
Net claims on general government	783	722	722	666	707	584	723	635	769	646	641	646	628	595	683
Loans (incl. t-bills)	817	841	841	842	842	842	842	836	842	833	833	833	833	833	833
Deposits	-35	-120	-120	-176	-134	-258	-118	-202	-73	-187	-192	-187	-205	-238	-150
Claims on rest of economy	118	118	97	97	97	97	97	97	97	97	97	97	97	97	97
Claims on banks	6	-41	-41	-30	-30	-9	-40	1	-55	0	0	10	-5	-20	-60
Other items, net	2	-96	-59	-37	-50	-51	-55	-67	-63	-87	-96	-57	-68	-78	-94
Reserve money (RM)	580	837	837	809	870	879	971	933	1,054	1,001	982	1,044	1,072	1,159	1,252
Currency in circulation (M0)	473	676	676	658	703	695	783	747	846	811	749	846	868	937	1,011
Required reserves	81	92	92	98	103	109	112	122	119	130	133	137	142	155	169
Balances on banks' correspondent accounts 3/	25	68	68	53	64	76	76	65	90	60	99	62	63	67	72
Memorandum items:															
Growth of reserve money (in percent, relative to same period of previous year)	13.9	44.3	44.3	36.2	32.7	34.1	29.9	24.9	26.0	19.7	26.9	29.1	21.9	24.2	25.0
Growth of currency in circulation (in percent, relative to same period of previous year)	13.4	42.9	42.9	41.2	39.4	37.8	29.8	24.4	25.1	20.0	18.8	28.5	24.9	25.5	24.6
Foreign exchange reserves (in U.S. dollar million) 4/	192	373	367	372	377	438	436	447	476	477	474	466	512	600	620

Sources: National Bank of Georgia; and Fund staff estimates.

1/ Net foreign assets are valued at the program rate of 2.15 lari/US$, US$/SDR of 1.49 and US$/Euro of 1.27.
2/ Net foreign assets are valued at the program rate of 1.85 lari/US$, US$/SDR of 1.46 and US$/Euro of 1.21.
3/ Including overnight deposits from banks.
4/ Includes SDR holdings and foreign currency account with BIS which is used for debt service payments.
5/ Contribution is defined as change of asset stock over the end-period stock of reserve money from the previous year.

Table 5. Georgia: Monetary Survey, 2003–06

	2003 1/	2004		2005 2/							2006 2/			
	Dec	Dec.		March	Jun.		Sep.		Dec.		Mar.	Jun.	Sep.	Dec.
	Actual	Actual 1/	Actual 2/	Actual	Prog. Est.	Actual	Prog.	Actual	Prog.	Actual	Proj.	Proj.	Proj.	Proj.
	(Contribution to broad money growth in percent) 6/													
Net foreign assets	-0.7	45.6	43.2	-2.6	-0.4	4.4	6.2	4.8	10.2	-4.4	-2.2	-0.8	4.4	5.3
Net domestic assets	23.4	-3.0	-0.6	1.6	7.4	3.3	14.4	14.8	21.6	30.8	7.3	9.6	14.1	23.7
Domestic credit	27.8	26.2	11.7	2.8	9.5	8.1	16.8	24.4	24.6	47.2	7.6	12.3	19.1	31.5
Net claims on general government	6.1	-2.5	-2.5	-3.5	-0.1	-9.8	1.1	-7.9	4.4	-7.0	0.0	-0.9	-2.7	1.9
Public-guaranteed borrowing from DMBs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Credit to the rest of the economy	21.7	28.8	14.2	6.3	9.6	17.9	15.8	32.3	20.2	54.2	7.6	13.2	21.8	29.5
Other items, net	-4.3	-29.2	-12.3	-1.3	-2.1	-4.7	-2.5	-9.6	-3.0	-16.4	-0.3	-2.7	-5.1	-7.7
	(Percentage change since end of previous year)													
Broad money (M3)	22.8	42.6	42.6	-1.0	7.0	7.7	20.6	19.6	31.8	26.4	5.1	8.8	18.5	29.0
Broad money, excl. forex deposits (M2)	14.1	60.4	60.4	-4.0	5.8	5.2	21.7	16.1	35.6	26.5	5.7	9.9	20.3	31.7
Currency held by the public	13.0	39.5	39.5	-1.2	5.7	3.3	17.9	11.4	27.5	19.5	4.7	7.9	17.0	26.9
Total deposit liabilities	30.9	44.8	44.8	-0.8	7.9	10.7	22.5	25.2	34.8	31.1	5.4	9.3	19.4	30.3
	(In millions of lari)													
Net foreign assets	-285	198	173	135	167	239	267	245	327	106	65	90	191	207
Net domestic assets	1345	1314	1339	1362	1450	1389	1556	1562	1666	1805	1944	1989	2074	2259
Domestic credit	1672	1950	1796	1839	1940	1918	2050	2164	2168	2510	2655	2745	2876	3111
Net claims on general government	766	739	739	687	738	591	755	620	806	633	633	615	582	670
Credit to the rest of the economy	906	1211	1057	1152	1202	1327	1295	1545	1362	1877	2022	2129	2293	2441
Other items, net	-327	-636	-457	-476	-489	-529	-494	-602	-502	-705	-711	-756	-802	-852
Broad money (M3)	1060	1512	1512	1497	1618	1628	1823	1808	1993	1911	2009	2079	2265	2465
Broad money, excl. forex deposits (M2)	527	846	846	812	896	890	1029	982	1148	1070	1130	1176	1287	1409
Currency held by the public	442	616	616	609	651	636	726	686	785	736	771	794	862	934
Total deposit liabilities	619	896	896	888	967	992	1097	1121	1208	1175	1238	1285	1403	1531
Memorandum items:														
Growth of broad money (in percent, relative to same period of previous year)	...	42.6	42.6	34.0	36.6	37.5	38.0	36.8	31.8	26.4	34.2	27.7	25.3	29.0
Growth of credit to the rest of the economy (in percent, relative to end of previous year)	20.4	33.7	34.1	9.0	13.7	25.5	22.5	46.2	28.9	77.6	7.7	13.5	22.2	30.1
Growth of credit to the rest of the economy (in percent, relative to same period of previous year)	...	33.7	34.1	50.3	46.7	62.0	34.6	60.6	28.9	77.6	75.5	60.5	48.4	30.1
Growth of credit to the rest of the economy (in percent, relative to same period of previous year, at actual exchange rates)	...	20.6	...	39.6	...	53.9	...	57.1	...	73.2	...	...	...	...
M2 multiplier 3/	0.91	1.01	1.01	1.00	1.03	1.01	1.06	1.05	1.09	1.07	1.08	1.10	1.11	1.13
M3 multiplier 4/	1.83	1.81	1.81	1.85	1.86	1.85	1.88	1.94	1.89	1.91	1.92	1.94	1.95	1.97
M3 velocity 5/	8.90	7.75	7.75	7.96	...	7.64	...	7.14	6.65	6.78	6.81	6.66	6.26	5.98
Foreign exchange deposits in percent of total deposits	86.1	74.3	74.3	77.1	74.7	74.5	72.4	73.6	70.0	71.6	71.0	70.3	69.7	69.0

Sources: National Bank of Georgia; and Fund staff estimates.

1/ Net foreign assets are valued at the program rate of 2.15 lari/US$, US$/SDR of 1.49 and US$/Euro of 1.27.
2/ Net foreign assets are valued at the program rate of 1.85 lari/US$, US$/SDR of 1.46 and US$/Euro of 1.21.
3/ M2 divided by reserve money.
4/ M3 divided by reserve money.
5/ Cumulative GDP over the previous four quarters divided by four-quarter-average M3.
6/ Percentage change is defined as ratio over the end-period broad money stock of the previous year.

Table 6. Georgia: Prudential Indicators of Commercial Banks, 2003–05
(End-of-period)

	2003	2004	2005			
			Mar.	Jun.	Sep.	Dec.
Capital adequacy ratio (in percent)	20.3	18.8	18.3	17.3	17.1	17.5
Leverage ratio 1/	33.5	27.9	29.3	28.0	26.9	25.9
Nonperforming loans 2/	7.5	6.2	5.8	5.4	3.7	3.8
Specific provisions 2/	4.5	4.3	4.1	3.4	2.2	2.4
Loans collateralized by real estate 2/	31.9	33.5	34.7	32.6	32.2	30.8
Loans in foreign exchange 2/	87.7	86.7	81.9	80.7	76.7	76.2
Net foreign assets (in millions of lari)	42.5	54.6	21.0	-18.5	-22.1	-231.5
Net foreign assets (in percent of total assets)	3.2	3.2	1.2	-1.0	-1.0	-9.1
Net open foreign exchange position 3/	8.5	7.4	6.0	5.5	6.8	7.5
Liquidity ratio (in percent)	43.3	45.0	39.1	34.9	32.8	33.3

Source: National Bank of Georgia.

1/ Defined as the ratio of total capital to total liabilities; an increase in the ratio indicates an improvement.
2/ Percent of total loans.
3/ Percent of total regulatory capital.

Table 7. Georgia: Summary Medium-Term Balance of Payments, 2003–09
(In million of U.S. dollars)

	2003	2004	2005		2006	2007	2008	2009
			CR/05/314	Prel. Est.	Proj.			
Current account balance	-293	-429	-742	-472	-537	-447	-446	-464
Trade balance	-598	-719	-1,235	-907	-1,048	-1,032	-1,051	-1,101
Exports	730	1,272	1,386	1,403	1,522	1,645	1,769	1,892
Imports	-1,328	-1,991	-2,620	-2,310	-2,570	-2,677	-2,820	-2,993
Of which: Gas and oil pipeline	-180	-250	-259	-207	-100	0	0	0
Services and income (net)	42	-56	9	11	7	38	64	95
Services (net)	103	17	58	56	67	95	118	143
Factor income (net)	-61	-73	-49	-46	-59	-57	-55	-48
Of which: Interest (gross)	-55	-47	-37	-28	-43	-43	-43	-38
Transfers (net)	262	345	483	424	503	547	541	542
Official transfers	50	74	194	148	181	212	193	181
Of which: General government	18	41	74	26	57	66	43	32
Other transfers	213	271	289	277	322	335	348	361
Of which: Remittances	166	205	218	238	271	292	313	334
Capital account balance	244	780	788	586	620	507	535	567
Public sector	-30	-39	-4	-53	-44	47	130	167
Disbursements	71	70	146	61	79	95	98	101
Of which: World Bank	44	39	90	41	52	45	45	45
Amortization	-107	-137	-150	-142	-160	-149	-70	-45
Capital grants, incl. from MCC (beginning in 2006) 1/	6	28	...	28	38	101	101	111
Private sector	274	819	792	639	664	460	405	400
Foreign direct investment	335	503	731	415	390	235	210	190
Of which: Gas and oil pipeline	240	280	324	175	125	0	0	0
Other private capital, net	-61	316	61	224	274	225	195	210
Errors and Omissions	39	-203	...	-85	0	0	0	0
Overall Balance	-10	148	46	29	83	60	89	104
Financing	10	-148	-46	-29	-84	-62	-90	-100
Use of Fund resources, net	-48	-34	8	-9	-8	3	-32	-26
Purchases/disbursements	0	21	65	41	41	41	0	0
Repurchases/repayments	-48	-55	-57	-51	-49	-38	-32	-26
Program loans	0	24	20	13	20	15	10	5
Increase in reserves (-)	7	-192	-111	-91	-146	-80	-68	-79
Change in arrears (+, increase)	51	-52	0	0	0	0	0	0
Debt relief 2/	0	105	57	58	50	0	0	0
Paris Club rescheduling	0	43	57	58	50	0	0	0
Rescheduling of arrears	0	63	0	0	0	0	0	0
Financing gap	0	0	0	0	0	3	2	-4
Memorandum items								
Nominal GDP	3,984	5,193	6,303	6,409	7,522	8,352	9,258	10,065
Current account deficit (percent of GDP)	7.4	8.3	11.8	7.4	7.1	5.4	4.8	4.6
Current account deficit, excl. pipeline-related imports (percent of GDP)	2.8	3.5	7.7	4.1	5.8	5.4	4.8	4.6
Trade deficit (percent of GDP)	15.0	13.8	19.6	14.1	13.9	12.4	11.3	10.9
Merchandise export growth (percent)	32.1	74.1	9.6	10.3	8.5	8.1	7.5	6.9
Merchandise import growth (percent)	33.9	49.9	30.0	16.0	11.3	4.2	5.3	6.1
Nonpipeline-related merchandise import growth (percent)	17.2	51.7	33.7	20.8	17.5	8.4	5.3	6.1
Gross international reserves 3/	191	383	493	474	620	700	768	847
(In months of imports of goods and services)	1.3	1.7	1.8	1.9	2.2	2.4	2.5	2.6
(In months of imports of non-pipeline goods & services)	1.5	2.0	2.0	2.1	2.3	2.4	2.5	2.6
Public and publicly guaranteed external debt (nominal)	1,849	1,858	1,852	1,735	1,720	1,687	1,654	1,657
(In percent of GDP)	46.4	35.8	29.4	27.1	22.9	20.2	17.9	16.5
Debt service from the budget (cash)	59	106	118	111	143	183	102	71
(In percent of exports of goods and services)	4.5	5.4	5.5	5.1	6.1	7.2	3.7	2.4
Total external debt service (cash)	129	186	202	189	222	249	165	129
(In percent of exports of goods and services)	9.8	9.5	...	8.7	9.4	9.8	6.0	4.4

Sources: Georgian authorities; and Fund staff estimates.

1/ Previously classified as current grants.

2/ Includes the July 2004 Paris Club agreement on terms somewhat more generous than Houston terms.

3/ Projections at program exchange rates.

Table 8. Georgia: Quantitative Performance Criteria and Indicative Targets, 2005 1/ 2/

	Cumulative Changes from End-December 2004									
	Mar. 2005	Jun. 2005			Sep. 2005			Dec. 2005		
	Revised Actuals	Program Estimates	Adjusted target	Actuals	Performance Criteria	Adjusted target	Actuals	Indicative Targets	Adjusted Target	Prelim.
	(In millions of lari)									
1. Quantitative targets										
Floor on general govt. tax revenue	448.9	963.6		985.6	1565.2		1621.8	2106.6		2299.6
Ceiling on cash deficit of the general govt. 3/	-30.4	197.4	215.9	58.1	418.7	408.8	141.9	556.5	535.7	278.7
Ceiling on change in domestic expenditure arrears of the general govt.	-31.9	-60.6		-68.5	-95.6		-76.4	-149.2		-103.7
Ceiling on net credit of the banking system to the general govt. (NCG)	-52.6	-1.5		-148.0	16.1		-119.7	67.0		-106.1
Ceiling on reserve money	-27.4	33.7		42.8	134.7		96.9	217.5		164.9
	(In millions of U.S. dollars)									
Floor on total net international reserves (NIR) of the NBG	-2.4	15.3		75.8	69.3		81.3	101.8		122.9
Ceiling on contracting or guaranteeing of										
A. Nonconcessional medium- and long-term external debt	0.0	0.0		0.0	0.0		0.0	0.0		0.0
B. Short-term external debt (less than one year)	0.0	0.0		0.0	0.0		0.0	0.0		0.0
Ceiling on accumulation of external arrears	0.0	0.0		0.0	0.0		0.0	0.0		0.0
	(In millions of lari)									
2. Indicative target										
Ceiling on net domestic assets (NDA) of the NBG	-23.0	5.5		-97.5	6.4		-53.5	29.2		-62.4
	(In millions of lari)									
3. Baseline assumption on external project financing 3/	25.7	95.7		114.2	175.6		165.8	270.1		249.3

Sources: Georgian authorities; and Fund staff estimates.

1/ Section 1 of this table shows quantitative targets for 2005 based on cumulative changes from end-December 2004. The ceiling for the cash deficit of the government is adjusted, as indicated in footnote 3, for deviations from projected external financing, reported in Section 3 of the table. The indicative target is shown in Section 2. The continuous performance criterion for external arrears is defined in paragraph 21 of the July 2005 TMU.

2/ Quantitative targets for 2005 are based on accounting exchange rates of GEL 1.85/US$, US$1.46/SDR, and US$1.21/EUR.

3/ The program target on the cash deficit is adjusted in 2005 for deviations from projected disbursements of external project finance (Section 3) as specified in the July 2005 TMU, subject to a cap on the cumulative upward adjustment of GEL 100 million for 2005.

Table 9. Georgia: Structural Performance Criteria (*) and Benchmarks, 2005

Measure	Status	Comments
1. Submit a new Customs Code to parliament, which is harmonized with basic EU norms and standards and incorporates FAD recommendations, as described in paragraph 19 of MEFP. **End-September 2005 (*)**	Completed with a delay	The customs code was submitted to parliament in October.
2. Prepare a Medium Term Expenditure Framework (MTEF) for 2006-09 as part of the Basic Data and Directions document as mandated under the Budget Systems Law. **End-September 2005 (*)**	Observed	The 2006 budget includes the medium-term expenditure framework for 2006–09.
3. Formulate an action plan to reduce significantly the number of regulatory bodies and licenses required by private firms, as described in paragraph 26 of MEFP. **End-September 2005**	Observed	The law reducing significantly the number of regulatory bodies and licenses was adopted by parliament and signed by the president on June 24.
4. Publish 2004 oil and gas transit revenue according to international transparency standards, as a first step to annual publication of this data. **End-September 2005**	Observed	Gas transit revenues were posted on the GGIC website as of July 23 (http://www.ggic.ge/n1.htm) and oil transit revenues were published in the newspaper Sakartvelos Respublika on September 15, 2005.
5. Prepare a strategy for reducing the number of import tariff bands and the maximum tariff rate and discuss in parliament. **End-September 2005**	Not observed	The draft law devising the new tariff regime was submitted to parliament at end-February 2006.
6. Upgrade the *Fit and Proper* criteria for bank owners and managers to international standards, by submitting revisions to commercial banking law and related decrees. **End-December 2005**	Observed	The necessary amendments to the commercial banking law were submitted to parliament in October. Changes to supporting regulations will be completed once parliament approves the amendments.
7. Complete the transition to a treasury single account for central government expenditures and revenues. **End-December 2005 (*)**	Observed	On January 1, 2006 the treasury moved to the Single Treasury Account for general government revenues and central government expenditures.
8. Complete electronic re-registration of existing taxpayers and registration of new taxpayers. **End-December 2005**	Not observed	The re-registration has been completed for regions and in 70 percent of Tbilisi. The authorities expect to complete the remainder by end-March 2006.
9. Introduce a targeted poverty benefit to replace numerous in-kind benefits. **End-December 2005**	Not observed	The authorities have postponed implementation of the benefit scheme until July 2006.
10. Publish a strategy paper on pension reform to put the social security system on a sounder fiscal footing. **End-December 2005**	Observed	Parliament approved legislation that represents the first steps toward pension reform.

Table 10. Georgia: Macroeconomic Framework, 2004–09

	2004	2005		2006	2007	2008	2009
		CR/05/314	Prel. Est.	Proj.			
	(Percent change)						
Output, prices, money, and external trade							
Real GDP	6.2	8.5	7.7	6.4	5.0	5.0	5.0
Consumer price index (average)	5.7	9.4	8.3	5.3	4.0	4.0	4.0
Broad money (M3, lari)	42.6	31.8	26.4	29.0	15.8	15.5	16.6
Exports (US$)	74.1	9.6	10.3	8.5	8.1	7.5	6.9
Imports (US$) 1/	49.9	30.0	16.0	11.3	4.2	5.3	6.1
	(In percent of GDP)						
General government							
Total revenues and grants	21.7	21.7	23.4	22.9	25.0	24.8	25.1
Tax revenues	18.2	18.1	19.8	19.3	21.0	21.5	22.0
Nontax revenues 2/	2.3	2.5	2.7	2.2	1.8	1.6	1.6
Grants	1.2	1.2	0.9	1.3	2.2	1.7	1.5
Expenditures and net lending	18.6	25.2	24.9	25.0	25.3	25.6	26.0
Current expenditure	16.2	19.7	20.7	21.3	21.3	21.7	22.1
Noninterest	15.9	18.6	19.7	20.3	20.5	21.0	21.5
Interest	1.2	1.0	1.0	0.9	0.8	0.8	0.7
Capital expenditure and net lending	2.4	5.5	4.2	3.8	4.0	3.9	3.9
Primary balance	4.3	-2.4	-0.5	-1.3	0.5	0.0	-0.2
Overall balance (commitment basis)	3.1	-3.5	-1.5	-2.2	-0.3	-0.8	-0.9
Net change in expenditure arrears	-2.6	-1.3	-0.9	-0.4	0.0	0.0	0.0
Overall balance (cash basis)	-0.2	-4.8	-2.4	-2.6	-0.3	-0.8	-0.9
Financing	0.2	4.8	2.4	2.6	0.3	0.8	0.9
Privatization	0.9	3.4	3.6	2.6	0.7	0.3	0.1
Domestic financing	-0.9	0.6	-0.9	0.3	0.4	0.0	0.1
External financing (net)	0.2	0.8	-0.3	-0.2	-0.5	0.5	0.7
Disbursements (incl. in-kind)	1.2	2.3	1.1	1.4	1.4	1.3	1.1
Amortization	-1.5	-1.5	-1.4	-1.6	-1.9	-0.8	-0.5
Saving and investment							
Investment	26.6	28.9	26.4	26.6	26.2	26.4	26.4
General government	2.4	5.5	4.2	3.8	4.0	3.9	3.9
Nongovernment sector 1/	24.2	23.4	22.1	22.8	22.3	22.5	22.5
Of which : FDI	9.7	11.6	6.5	5.2	2.8	2.3	1.9
Gross domestic saving	18.3	17.1	19.0	19.4	20.9	21.6	21.8
General government	5.5	2.0	2.7	1.6	3.6	3.1	3.0
Nongovernment sector	12.8	15.1	16.3	17.9	17.2	18.5	18.8
Current account deficit 1/	8.3	11.8	7.4	7.1	5.4	4.8	4.6
	(In millions of U.S. dollars; unless otherwise indicated)						
Gross official reserves of the NBG 3/	383	493	474	620	700	768	847
(In months of imports of non-pipeline goods and services)	2.0	2.0	2.1	2.3	2.4	2.5	2.6
(In months of imports of goods and services)	1.7	1.8	1.9	2.2	2.4	2.5	2.6
External debt, public and guaranteed							
External debt stock	1,858	1,852	1,735	1,720	1,687	1,654	1,657
External debt service, total	169	180	167	196	225	138	101
Memorandum items:							
Nominal GDP (in millions of lari)	9,970	11,660	11,600	13,080	14,307	15,624	17,061
Nominal GDP (in millions of US$)	5,193	6,303	6,409	7,522	8,352	9,258	10,066
External debt stock (public and guaranteed; percent of GDP)	35.8	29.4	27.1	22.9	20.2	17.9	16.5
Domestic public debt (percent of GDP)	10.6	8.4	9.1	7.6	6.8	6.2	5.5
M3-velocity (M3 annual average)	7.8	…	6.8	6.0	5.4	5.1	4.8
Social sector expenditures (percent of GDP)	6.3	7.9	7.6	8.6	10.2	10.7	11.2
Social sector spending, cash basis (percent of GDP)	7.1	...	8.1	9.0	10.2	10.7	11.2

Sources: Georgian authorities; and Fund staff estimates.

1/ Large oil and gas pipeline projects are projected to increase imports, investment, and the current account deficit substantially in 2003–06.
2/ Sustained increase in nontax revenues from 2006 onward reflects transit fees from the BTC oil pipeline and the South Caucasus gas pipeline.
3/ International reserves are reported at current exchange rates and may differ from reserves at program rates as reported in the monetary accounts.

Table 11. Georgia: Indicators of Financial Obligations to the Fund, 2001–10
(In millions of SDR)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total Fund credit outstanding	228.6	228.0	194.3	171.3	164.9	159.5	161.6	139.5	121.5	107.4
In percent of quota	152.1	151.7	129.3	114.0	109.7	106.1	107.5	92.8	80.8	71.4
In percent of GDP	9.1	8.7	6.8	4.9	3.8	3.1	2.8	2.2	1.8	1.5
In percent of exports of goods and nonfactor services	23.5	22.2	14.7	8.7	7.6	6.8	6.4	5.1	4.2	3.5
Disbursements (PRGF)	27.0	22.5	0.0	14.0	28.0	28.0	28.0	0.0	0.0	0.0
Total obligations from existing and prospective drawings	14.8	24.9	35.3	38.1	35.3	34.4	27.0	23.2	19.0	15.1
Principal (repayments/repurchases)	12.0	23.1	33.8	37.0	34.4	33.4	25.9	22.1	18.0	14.1
Charges and interest	2.8	1.8	1.6	1.1	0.9	1.0	1.1	1.1	1.0	1.0
Total obligations to the Fund										
In percent of quota	9.8	16.6	23.5	25.4	23.5	22.9	18.0	15.4	12.7	10.1
In percent of GDP	0.5	0.7	0.9	0.7	0.6	0.5	0.3	0.3	0.2	0.1
In percent of exports of goods and nonfactor services	1.9	3.1	3.7	2.9	2.4	2.1	1.6	1.2	0.9	0.7
Net credit from the Fund	15.0	-0.6	-33.8	-23.0	-6.4	-5.4	2.1	-22.1	-18.0	-14.1
Net resources from the Fund	12.2	-2.4	-35.3	-24.1	-7.3	-6.4	1.0	-23.2	-19.0	-15.1

Sources: Fund Finance Department; and staff estimates and projections.

Table 12. Georgia: Proposed Schedule of Reviews and Disbursements
Under the PRGF Arrangement

	Test date	Board date	Amount
Board Approval		June 4, 2004	SDR 14 million
First Review	June 30, 2004	December 20, 2004	SDR 14 million
Second Review	December 31, 2004	July 20, 2005	SDR 14 million
Third Review	September 30, 2005	March31, 2005	SDR 14 million
Fourth Review	March 31, 2006	July 2006	SDR 14 million
Fifth Review	September 30, 2006	December 2006	SDR 14 million
Sixth Review	March 31, 2007	June 2007	SDR 14 million

GEORGIA: FUND RELATIONS

(As of January 31, 2006)

I. **Membership Status:** Georgia joined the Fund on May 5, 1992 and has Article VIII Status.

II. **General Resources Account:**	**SDR Million**	**Percent of Quota**
Quota	150.30	100.00
Fund holdings of currency	150.30	100.00
Reserve position in Fund	0.01	0.01

III. **SDR Department:**	**SDR Million**	**Percent of Allocation**
Holdings	6.71	N/A

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent of Quota**
PRGF Arrangements	162.54	108.14

V. **Latest Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn SDR Million)
PRGF	6/4/04	6/3/07	98.00	42.00
PRGF	1/12/01	1/11/04	108.00	49.50
PRGF	2/28/96	8/13/99	172.05	172.05

VI. **Projected Payments to Fund:** (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	**2007**	**2008**	**2009**	**2010**
Principal	33.44	25.94	22.11	17.96	14.10
Charges/interest	0.72	0.57	0.45	0.35	0.28
Total	34.15	26.50	22.56	18.31	14.38

VII. **Implementation of HIPC Initiative:**

Not applicable.

VIII. **Safeguards Assessments:**

Under the Fund's safeguards assessment policy, the National Bank of Georgia (NBG) is subject to an assessment with respect to the PRGF arrangement approved on June 4, 2004. The assessment was completed on December 10, 2004 and concluded that safeguards in place at the NBG appear generally adequate. However, certain vulnerabilities were identified in the internal audit and internal controls areas, and the safeguards assessment recommended measures to address them.

IX. **Exchange Arrangements:**

(a) Since April 29, 1993, the Tbilisi Interbank Currency Exchange (TICEX), established by the NBG and a group of commercial banks, has conducted periodic auctions to determine the exchange rate of the domestic currency vis-à-vis the U.S. dollar. These auctions are conducted daily. Foreign exchange bureaus are allowed to buy and sell foreign currency bank notes. Georgia's exchange rate regime is classified as "managed floating."

(b) Georgia maintains no exchange restrictions on the making of payments and transfers for current international transactions except for exchange restrictions maintained for security reasons, and notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

X. **Article IV Consultation:**

The 2003 Article IV consultation was concluded on October 17, 2003.

XI. **FSAP Participation:**

Two FSAP missions visited Tbilisi during May 1–15, and July 24–August 7, 2001. An FSAP update mission visited Tbilisi during February 15–28, 2006.

XII. **Technical Assistance:**

See Table 1 of this Appendix.

XIII. **Resident Representative:**

The fifth resident representative, Mr. Christiansen, took up his post on August 1, 2004, replacing Mr. Dunn.

XIV. **National Bank of Georgia Resident Advisors:**

Ms. Vance, MAE peripatetic banking supervision advisor to the NBG, commenced a series of visits to Tbilisi in September 1997. Mr. Nielsen, an MAE advisor, provided technical assistance to the NBG in May 1998. Mr. Viksnins was an MAE peripatetic advisor to the NBG president starting in October 1999. Mr. Fish was resident advisor on banking supervision from August 10, 1999 to January 31, 2002. Mr. Bernard Thompson provided peripatetic technical assistance in accounting and internal audit in March and August 2000. Mr. Wellwood Mason provided technical assistance on payment system issues on a peripatetic basis in 2002 and 2003. Mr. Howard C. Edmonds serves since September 2004 as a resident advisor on banking supervision issues.

XV. **Ministry of Finance Resident Advisors:**

Mr. Sharma was an FAD resident advisor and assisted the authorities in the development of a Treasury beginning in May 1997. Mr. Sainsbury, an FAD advisor, assisted the Ministry of Finance from June 1998 to November 1999. Mr. Chaturvedi was FAD resident advisor in 2001 and 2002 to assist the authorities in continuing the development of the Treasury and the Treasury Single Account, in revising the legislative framework, expenditure control systems, and budgeting issues. Between 2001 and 2003, Mr. Welling was an FAD peripatetic advisor to assist the State Customs Department in preparing and introducing measures for the custom reform and modernization program. In March 2005, Mr. Zohrab started advising the authorities on treasury-related reforms.

Table 1. Georgia: Fund Technical Assistance Missions, 2001–05

Subject	Type of Mission	Timing	Counterpart
	Fiscal Affairs Department (FAD)		
Public Expenditure Management	Assessment of Treasury system and preparing work plan for the resident advisor	Jun. 12–19, 2001	Ministry of Finance
Public Expenditure Management	Review of the draft Budget System Law	Mar. 14–Apr. 02, 2002	Ministry of Finance
Public Expenditure Management and Fiscal ROSC	Assessment of Treasury system and of observance of standards and codes	Jan. 16–30, 2003	Ministry of Finance
Public Expenditure Management	Assessment of Treasury System and implementation of Budget Systems Law	Sep. 29–Oct. 11, 2003	Ministry of Finance
Tax and Customs Administration	Assistance in taxation of excisable goods	Oct. 27–Nov. 13, 2003	Ministry of Finance
Tax Policy	Review of Tax Policy	June 8–21, 2004	Ministry of Finance
Public Expenditure Management	Assessment of Treasury system.	Nov. 8–23, 2004	Ministry of Finance
Revenue Administration	Modernizing Tax Administration	November 2005	Ministry of Finance

Table 1. Georgia: Fund Technical Assistance Missions, 2001–05

Subject	Type of Mission	Timing	Counterpart
Monetary and Financial Systems Department (MFD)			
Banking, foreign exchange reserve management, monetary programming, and research	Advisory	Feb. 26–Mar. 8, 2001	National Bank of Georgia
Payment Systems, Bank Supervision and Resolution, Internal Audit, Foreign reserve Management, and Research	Advisory	Oct. 23–Nov. 6, 2001	National Bank of Georgia
Payment Systems and Bank Resolution	Advisory	Mar. 11–19, 2002	National Bank of Georgia
Accounting and Audit, Anti-Money Laundering, Bank Supervision, and Monetary Operations	Advisory	Sep. 24–Oct 9, 2002	National Bank of Georgia
Payment Systems	Advisory	June 16–20, 2003	National Bank of Georgia
Government Securities Market, Deposit Insurance, Anti-Money Laundering	Advisory	April 20–30, 2004	National Bank of Georgia
Monetary Operations, Banking Sector Competition	Advisory	Oct. 24–Nov. 5, 2004	National Bank of Georgia
Liquidity management; trends in securities and insurance sectors	Advisory	April 18–29, 2005	National Bank of Georgia
Statistics Department (STA)			
National Accounts	Follow-up assistance	Mar. 26–Apr. 6, 2001	State Department of Statistics
Balance of Payments Statistics	Follow-up assistance	February 13–27, 2002	State Department of Statistics
Money and Banking	Follow-up assistance	March 2–15, 2002	National Bank of Georgia
Data ROSC	Assessment of observance of standards and codes	July 15–31, 2002	State Department of Statistics, National Bank of Georgia, Ministry of Finance
Balance of Payments Statistics	Follow-up assistance	May 20–June 3, 2003	State Department of Statistics

Table 1. Georgia: Fund Technical Assistance Missions, 2001–05

Subject	Type of Mission	Timing	Counterpart
Government Finance Statistics	Follow-up assistance	Nov. 5-18, 2003	State Department of Statistics, Ministry of Finance
National Accounts	Follow-up assistance	April 26–May 7, 2004	State Department of Statistics
National Accounts	Follow-up assistance	April 18–29, 2005	State Department of Statistics
Price Statistics	Follow-up assistance	May 23–June 3, 2005	State Department of Statistics
Balance of Payments Statistics/International Investment Position	Follow-up assistance	June 15–28, 2005	State Department of Statistics and National Bank of Georgia
	Legal Department (LEG)		
Tax Code	Follow-up assistance	Jan. 28–Feb. 9, 2001	Ministry of Finance, Tax Inspectorate of Georgia
Tax Code	Follow-up assistance	Jul. 13–24, 2001	Ministry of Finance, Tax Inspectorate of Georgia

GEORGIA: IMF-WORLD BANK RELATIONS

Partnership in Georgia's Development Strategy

1. The government's PRSP; Economic Development and Poverty Reduction Program (EDPRP), was presented to the Boards of IDA and the IMF in October and November 2003. A Joint Staff Advisory Note together with the Progress Report on the EDPRP was sent to the Boards of IDA and IMF in June 2005. The IMF completed the second review under the PRGF arrangement in July 2005. On September 15, 2005, IDA endorsed a new Country Partnership Strategy (CPS) for FY06–09, and approved the first in a program of three Poverty Reduction Support Operations (PRSOs).

2. The Fund has taken the lead in assisting Georgia in improving macroeconomic stability and pursuing fiscal reforms. The World Bank has taken the lead in the policy dialogue on structural issues, focusing on: (i) strengthening public expenditure management; (ii) improving performance of the public sector; (iii) reducing corruption; (iv) deepening and diversifying sources of growth; (v) protecting the environment; and (vi) reducing poverty. Georgia is one of the largest IDA borrowers in the CIS, with borrowing of US$816 million for 40 operations. The PRSO has supported further elaboration and implementation of the key elements of the government's poverty reduction strategy as described in the EDPRP and Progress Report. The PRSO program is built on four pillars: (i) strengthening public sector accountability, efficiency, and transparency; (ii) improving electricity and gas sector services; (iii) improving the environment for private sector development; and (iv) improving social protection, education and health care services. Other support has come in the form of project support and Analytic and Advisory Activities across a broad spectrum of areas including education, health care, social protection, energy, roads, water and sanitation, agriculture, agricultural research and extension, irrigation and drainage, forestry, environment, biodiversity, enterprise development, municipal development, judicial reform, and cultural heritage. A Public Expenditure Review (PER) was prepared in 2002, and a Trade Study in 2003. The PER is being followed by a series of annual programmatic PERs, the first of which is under preparation. A Country Procurement Assessment Report (CPAR) was prepared in 2002 and a Country Financial Accountability Assessment (CFAA) in 2003. Updates of these are scheduled for FY06. A series of annual programmatic Poverty Assessments are being implemented

3. Georgia became a shareholder and a member of IFC in 1995. As of January 1, 2006, IFC has invested around $137 million to finance projects in the financial, power, oil and gas, and manufacturing sectors. IFC continues to explore the investment opportunities in partnership with strategic investors in both the financial and real sectors of the country. In the financial sector, IFC has focused on supporting the development of the housing finance market, providing credit lines and technical assistance to the leading banks—the Bank of Georgia and TBC Bank. To reach small and medium enterprises, IFC helped to establish ProCredit Bank of Georgia, the country's first bank specializing in lending to micro and small enterprises. Most recently, IFC has provided a credit line to TBC Leasing to support the rapid growth of their portfolio of SME clients; this project grows out of two year's of

technical assistance to the Government and private sector to support the growth of the leasing sector. In oil transit, IFC has provided equity and credit to local and international companies, including investments by British Petroleum and other sponsors in the construction of the Baku-Supsa Early Oil Pipeline and the Baku-Tbilisi-Ceyhan Pipeline. Other investment projects have been in electricity distribution (AES-Telasi), mineral water (GGMW), and glass bottle production (Ksani Glass Factory). IFC has also provided donor-supported technical assistance to strengthen its client banks, introduce new financial products (including leasing and housing finance), support public-private partnerships in the energy sector, and to improve the business climate and corporate governance practices. The Foreign Investment Advisory Service (FIAS), a joint facility of IFC and the World Bank, carried out an Assessment of Administrative Procedures for Doing Business in 2003. FIAS finalized an advisory project in July 2004 to assist the Government in its efforts to remove administrative obstacles to investment to improve the business environment for private businesses, and the Private Enterprise Partnership (PEP) did an extensive study of the barriers to SMEs, finalized in early 2005. PEP and FIAS are currently holding joint consultations with the Government to identify concrete steps to be taken for improvements to the business environment.

4. Table 1 summarizes the division of responsibilities between the two institutions. In a number of areas—for example, the social sectors, rural development, environment, infrastructure, and judicial reform—the Bank takes the lead in the dialogue and there is no related conditionality in the IMF-supported program. The Bank is also leading the dialogue on private sector development and energy, and Bank analysis serves as inputs into the Fund program. In other areas—the financial sector, public expenditure management, and civil service reform—both institutions have worked together. Finally, in areas like monetary policy and domestic customs revenue, the IMF takes the lead.

IMF-World Bank Collaboration in Specific Areas

Areas in which the World Bank leads and there is no direct IMF involvement

5. In the **social sectors**, IDA updates Georgia's Poverty Assessment based on quarterly household data. IDA's focus has been to improve execution of budgetary expenditures for health, education and poverty benefits and to raise the efficiency in the use of scarce public resources. Through the Social Investment Fund credits, IDA is focusing in particular on areas with high poverty levels to provide basic infrastructure to the poorest communities. Through the PRSO program, IDA is strengthening the dialogue with the government on social protection reform (safety nets, pensions, poverty benefits, labor market institutions and policies).

6. In **education,** the Adaptable Program Credit addresses a broad spectrum of educational reform issues, aimed at improving learning outcomes of primary and secondary students through curriculum reform, development of a national assessment and examination system, training of teachers, provision of learning materials, and development of capacity to make better use of physical, financial, and human resources. It also tackles key financing issues through the introduction of a per capita based formula for financing basic education.

While the investment needs of school buildings are substantially higher than is currently affordable, the Social Investment Fund projects continue to assist in financing urgent repairs to school facilities in many communities. The first PRSO is supporting the government's efforts in institutionalizing systemic changes initiated with its education reform strategy.

7. In **health**, IDA credits support the government in improving health care financing, exploring risk-pooling options, introducing a new system of primary health care, and improving the focus of publicly-funded services to the poor and on priority public health interventions. SAC III and the SRS Credit have supported hospital restructuring. In addition, IDA will be engaged in policy work in health sector reform in the context of the Medium-Term Expenditure Framework (MTEF) and the PRSO program.

8. In **infrastructure,** support is being provided through the Secondary and Local Roads Project, the Municipal Development and Decentralization Project II and the Social Investment Fund Project. These projects provide financing at the community level for critical infrastructure needs, primarily for school and health facility heating and repair, small hydropower schemes to provide electricity, drinking water and sanitation rehabilitation, as well as transportation infrastructure rehabilitation. IFC supported the privatization of Tbilisi electricity distribution through an investment in AES-Telasi, and IFC Advisory Services advised the government on the management contract for UEDC. The recently approved Infrastructure Pre-Investment Facility project is to facilitate infrastructure investments of strategic importance and/or special complexity by providing technical assistance to assess the feasibility and effectiveness of investments, focusing on energy and transport sectors,

9. In **rural development**, IDA credits have supported development of private sector farming and agro-processing improvements, agricultural credit, irrigation and drainage, and agricultural research. IDA credits have also been supporting creation of local institutions, such as rural credit unions and water users associations. A recently approved Rural Development Project is to develop the productivity and profitability of the private agriculture sector with the aim to increase incomes and employment and reduce poverty in rural areas.

10. A **Judicial Reform** Project has provided funds for development of new court administration and case management procedures, rehabilitation and construction of courthouses, a computerized network system, assistance for judicial training, and an extensive public information and education outreach effort to inform citizens of their rights and communicate the government's reform efforts.

Areas in which the World Bank leads and its analysis serves as input into the IMF program

11. The Bank leads the dialogue on structural reforms through the PRSO program. Institution building and technical assistance have been supported through the Structural Reform Support Project. The Bank also leads in the areas of:

a) **Private Sector Development**. The PRSO program focuses on improving investment climate and reducing constraints to private sector development in Georgia. IDA has also been supporting private sector participation in other areas, such as energy, urban services and agriculture. The IMF has worked with the authorities to initiate audits of the accounts of three major state-owned enterprises.

b) **Energy**. The energy system is in poor condition, with unreliable supply and unsustainable debts. However, under the PRSO program, the Georgian authorities have made progress and payment collections and service levels have improved substantially in the power sector. The Government of Georgia has been working with IDA and other donors, including the Fund, to introduce more private management and ownership, and to implement a series of short-term action plans and longer-term steps to improve the overall functioning of the sector. IDA has also provided additional funding to the power sector in 2004. The Fund has been focusing on reducing quasi-fiscal losses in the sector, especially through improved bill collections, while the pursuit of tariff policies at cost-recovery levels would be facilitated by a Bank-assisted review of the tariff policy methodology. The Georgian authorities prepared the Energy Sector Strategic Action Plan for 2005–08 which is being implemented and updated periodically under the PRSO program. In a new operation, the Bank will finance a feasibility study for a major, new hydropower plant that could add about 20 percent to the country's hydropower capacity.

c) **Public Sector Management**. The first PRSO supports, inter alia, administrative and civil service reform, improvements in public expenditure management and strengthening financial accountability. The recently approved Public Sector Financial Management Reform Support Project is to provide technical assistance and capacity building in the first three areas. The Fund is providing technical assistance in support of tax and customs administration reform.

d) **Municipal Finance:** The Municipal Development and Decentralization Project II has been assisting the government to review the current intergovernmental fiscal relation, and to suggest an equalization transfer system to compensate for horizontal fiscal disparities across local governments.

Areas of shared responsibility

12. The Bank and the Fund have been working jointly in the following main areas:

a) **Poverty Reduction Strategy.** Both institutions have been working closely with the government to support the development of the PRSP (or EDPRP as it is known in Georgia), through seminars and workshops, direct staff input, and donor coordination. A JSAN on the progress with implementation of the government's EDPRP was issued in June 2005.

b) **Budget Planning and Execution.** The annual programmatic Public Expenditure Reviews and the PRSO program will provide the underpinnings for systemic changes in expenditure management, development of an MTEF, and improvements in financial accountability. The Public Sector Financial Management Reform Support Project will finance technical assistance and necessary investment to support budget planning and management processes within the MoF and line ministries and to support introduction of an integrated public financial management system. The Fund is focusing on treasury reform within the ministry of finance.

c) **Financial Sector Reforms.** The joint Financial Sector Assessment Program has supported: (i) strengthened banking and non-banking supervision; (ii) introduction of international accounting standards; (iii) consolidation of banks through higher capital requirement ratios; (iv) anti money-laundering legislation; (v) strengthening the regulatory environment and removing impediments for development of viable nonbank financial institutions; and (vi) strengthening the payment system. IFC has worked to strengthen the banking sector through investment and technical assistance, and has supported the development of the financial leasing market through technical assistance. The Fund has focused on banking supervision, anti-money laundering legislation, and improvements in monetary control instruments with extensive technical assistance from its Monetary and Financial Systems Department.

Areas in which the IMF leads and its analysis serves as input into the World Bank program

a) **Fiscal Framework and reforms in tax policy and tax and customs administration.** The Fund's focus on prudent fiscal policy has served as an important framework for IDA's work on public expenditure management. The Fund's Fiscal Affairs Department is now taking the lead in the areas of tax policy and tax and customs administration reform.

b) **Economic Statistics.** IMF technical assistance has been conducive to improvements in national accounts, price, monetary and government financial statistics. The Bank's grant on Statistical Capacity Building will build on the recommendations of Fund TA to strengthen the quality of national accounts statistics.

Areas in which the IMF leads and there is no direct World Bank involvement

a) **Monetary Framework**. The IMF collaborates closely with the NBG in the design and implementation of a monetary program that aims at rebuilding international reserves while keeping inflation low and remonetizing the economy.

A. World Bank Group Strategy

13. On September 15, 2005, the World Bank Executive Board endorsed the new Country Partnership Strategy (CPS) for FY06-09 designed to assist Georgia with deeper institutional reform as well as more fundamental infrastructure improvements. *The CPS builds on the EDPRP, as well as emerging Government strategic thinking on the development framework. In doing so, it targets several goals: (i)* ***Generating growth and job creation*** *by removing barriers to private sector development and improving infrastructure, finance and markets; (ii)* ***Enhancing human development and social protection*** *through improved education, health, social protection, and community services; and (iii)* ***Strengthening public sector management and budgetary processes*** *to enable Georgia to better plan and meet its own development goals.* Along with the CPS, the first PRSO, of a series of three single tranche annual Poverty Reduction Support Operations was approved of which US$13.5 million is a regular IDA credit and US$6.5 million is an IDA grant. Other recent operations include a US$5 million Infrastructure Pre-Investment Facility Project, a US$3 million Public Sector Financial Management Reform Support Project, a US$24 million Reform Support Credit, a US$20 million Secondary and Local Roads Project, a US$3.6 million Electricity Market Support Project, a US$10 million Rural Development Project, and a US$5 million Irrigation and Drainage Community Development Project Additional Funding for flood control. The Bank continues its discussion with the government on a more comprehensive medium-term reform strategy that would be supported by future Poverty Reduction Support Operations and technical assistance operations.

Table 1. Georgia: Bank-Fund Collaboration on Georgia

Area	Specialized Advice from the Fund	Specialized Advice from the Bank	Key Instruments
Economic Framework/ Management	Monetary policy, exchange rate, fiscal, and trade policies, economic statistics	Economic growth, economic statistics	*IMF:* PRGF performance criteria and benchmarks on monetary and fiscal targets. *IDA:* The PRSO program; macromonitoring; Trade and Transport Facilitation Project; Financial Sector Advisory Work; Policy Options Report.
Budget	Budget framework, tax policy and administration, customs, debt management, extra-budgetary funds	Budget management, Public Expenditure Review, Country Procurement Assessment, Country Financial Accountability Assessment	*IMF:* PRGF performance criteria on overall fiscal balance and revenue collection. *Bank:* The PRSO program; Programmatic Public Expenditure Review
Public Sector Reform	Public asset management, audit of 3 problematic state-owned enterprises	Civil service reform (including pay and employment reform), anti-corruption agenda, decentralization	*IMF:* PRGF *IDA*: the PRSO program, and the Public Sector and Financial Management Reform Project
Social/Poverty	Prioritization of expenditure cuts to protect social spending	Poverty analysis; reforms in education, health, social protection; support to community driven development	*IMF:* PRGF *IDA*: Support through the PRSO program and IDA Credits for Education, Health and Social Investment Funds, Programmatic Poverty Assessment, SRS support for hospital restructuring, Pensions and Social Assistance Note, Policy work in health sector reform under the MTEF.
Private Sector Development		*Costs of Doing Business* Surveys. Support for improved legislation and regulatory framework for private sector	*IDA:* The PRSO program; Business Environment Study, Integrated Trade Development Strategy, Labor Market Study. *IFC:* investments and technical assistance.
Infrastructure		Private sector participation in infrastructure	*IDA*: Support though ongoing and proposed IDA Credits for Municipal Development and Decentralization Project II (MDDP II), Secondary and Local Roads, and Transport, Infrastructure Pre-Investment Facility. *IFC:* investments and advisory services.
Energy		Reforms and sector improvements	*IDA:* The PRSO program. Support through ongoing credits for Power, Energy Transit, technical assistance, and joint donor policy dialogue.
Rural development		Reforms in agriculture, irrigation, forestry and, environment	*IDA:* Support though Rural Infrastructure and Water Resource studies; ongoing rural Credits, and proposed Credits for Rural Development, Rural Telecommunications, Community Based Tourism.

Questions may be referred to Ms. R. Quintanilla (202-473-7673), Ms. Afsaneh Sedghi (202-473-7518), or Mr. A. Cholst (202-458-0324).

GEORGIA: RELATIONS WITH THE EBRD
(As of December 31, 2005)

1. As of December 31, 2005, the European Bank for Reconstruction and Development (EBRD) had signed 49 investments in Georgia with cumulative commitments totaling US$401.3 million.[11] Current Portfolio Stock equals to US$259.8 million. The EBRD's first operation, a power rehabilitation project, was signed in December 1994. Since then, the pace and composition of portfolio growth has varied significantly from year to year. Current portfolio includes thirty three private sector projects (of which five projects are regional). The ratio of private sector projects in the portfolio now stands at 80 percent.

2. During 2004, all operations signed in Georgia were in the private sector and amounted to US$95.2 million. The energy sector accounted for the largest share of signings – US$78.6 million. The Bank also provided an additional SME line of credit to a local bank for US$2.7 million, an equity increase in a local partner bank and expanded its Trade facilitation program by US$10.9 million. Financial support to the local production sector was also provided, including a US$1.1 million equity investment to a local private sector refreshment drinks producer and a US$1.2 million equity investment in a private local wine producer.

3. During 2005, the Bank signed 18 transactions in Georgia for US$105.9 million in total of which all but one were in the private sector and all were without sovereign guarantees. These included: three DIF equity investments (US$5.3 million) all in agribusiness; two MCFF risk sharing facilities with local banks (US$10.0 million); the first ever municipal transport project with no SG (US$3.4 million); one regional energy project (US$29.4 million); a wine bottling project (US$7.3 million); a SME credit line (US$10.0 million); two MCFF sub-loans (US$5.0 million); two bank capital increases (US$1.5 million); the first ever syndicated loan to a local bank (US$20.0 million in total, of which US$7.0 million on EBRD's account); the first loan to a local leasing company (US$3.0 million); and TFPs with three partner banks (US$24.1 million).

4. The EBRD is helping Georgia to benefit from its privileged location, transforming it into a regional transportation and natural resources hub. Georgia is part of the 'Early Transition Countries' (ETC) initiative. Launched in April 2004, the initiative aims to increase investments in the Bank's seven poorest countries. The initiative builds on international efforts to address poverty in these countries. Through this initiative, the EBRD will focus its efforts on private sector business development and selected public sector interventions. It aims to stimulate market activity by using a streamlined approach to financing, focusing on smaller projects, mobilizing more investment, and encouraging ongoing economic reform. The Bank will accept higher risk in the projects it finances in the ETCs, while still respecting the principles of sound banking.

[11] Evaluated at an exchange rate of US$1.183 per Euro.

Table 1. Georgia: EBRD Portfolio for Georgia
As of December 31, 2005 (US$, million)

Project Name	Date of Agreement	Outstanding Amount
Public Sector Projects		
Power Rehabilitation Project	19-Dec-94	6.1
Georgia State Electro system	22-Dec-98	27.0
Georgia: Trans-Caucasian Rail Link Project	22-Dec-98	11.1
SOCAR - South Caucasus Gas Pipeline (regional)	4-Nov-04	9.0
Private Sector Projects		
Bank of Georgia Equity and Convertible Loan	16-Jul-98	2.4
Bank of Georgia – SME Loan	27-Jul-03	3.5
Bank of Georgia Capital Increase	16-Nov-05	1.0
MCFF Bank of Georgia Full Recourse Portion	14-Jun-05	5.0
MCFF TBC Bank Full Recourse Portion	13-Jun-05	5.0
MCFF TBC Bank Lomisi Ltd Sub Loan	03-Aug-05	3.5
MCFF - TBC Bank Nola Ltd Sub-Loan (NRP)	2-Dec-05	1.5
TBC Bank - SME Credit Line	19-Dec-03	6.0
TBC Bank SME Credit Line III	26-Sept-05	10.0
TBC Bank Syndicated Loan	20-Dec-05	7.0
TBC Leasing, Senior Debt	20-Dec-05	3.0
Intellectbank (Sub Project of Georgia SME)	11-Nov-97	0.5
TbilComBank (Sub Project of Georgia SME)	12-Dec-96	0.6
TbilcreditBank (Sub Project of Georgia SME)	12-Dec-96	0.0
United Georgian Bank	20-Nov-97	3.2
ProCredit Bank, Georgia (Formerly MBG)	30-Mar-00	2.6

ProCredit Bank, Georgia - Senior Loan	11-Oct-01	6.0
TFP: Bank of Georgia (Guarantee & Pre-export)	2-Mar-01	17.2
TFP: TBC Bank (Guarantee & Pre-export)	17-Aug-99	4.5
TFP: United Georgian Bank	31-Mar-01	1.9
JSC Channel Energy Poti Port	19-Mar-02	10.2
Tbilisi Public Transport	29-Jul-05	3.7
Georgian Wines	29-Sep-99	0.6
Georgian Wines & Spirits Ltd	10-March-05	7.3
DIF Iberia Refreshments	25-Sep-03	2.2
DIF Teliani Valley	20-May-2004	1.1
DIF Delidor	17-June-05	1.5
DIF-Lomisi Ltd	20-Dec-05	3.0
Baku-Tbilisi-Ceyhan (BTC) Pipeline (regional)	03-Feb-04	62.5
Lukoil Overseas : South Caucasus Gas Pipeline (regional)	28-Jul-05	29.4
Regional Fund Investments		0.7
Total		**259.8**

1/ US$ amounts calculated at an exchange rate of US$1.183 U.S. dollars per Euro, as of December 31, 2005.

GEORGIA: STATISTICAL ISSUES

1. The Fund has provided Georgia with substantial technical assistance in the compilation of macroeconomic statistics (Appendix I, Table 1). Despite improvements in the areas of national accounts, price, monetary, and government finance statistics, the quality of macroeconomic statistics remains poor, reflecting deficiencies in statistical methodologies, coverage, and insufficient resources. Problems are particularly acute in the compilation of national accounts, balance of payments, foreign trade, and fiscal statistics. Nonetheless, the core statistical indicators compiled by the authorities are provided on a timely basis and are generally adequate for surveillance and program monitoring. The data module of the Report on the Observance of Standards and Codes (ROSC), prepared in July 2002 was published on the Fund's external website on May 27, 2003. In August 2005, the authorities notified the Fund of their commitment to participate in the IMF's General Data Dissemination System (GDDS), and appointed a national GDDS coordinator. As a next step to formal GDDS participation, the authorities will need to prepare GDDS metadata and plans for statistical improvement.

Real sector

2. National accounts statistics follow the concepts and definitions of the *System of National Accounts 1993,* with GDP estimates by production and expenditure compiled annually and quarterly. Revisions of the national accounts follow an established schedule. Preliminary national accounts estimates are available after four months, and a final estimates after 13 months. The 2002 data ROSC mission found that data sources used for the compilation of national accounts statistics were inadequate. The coverage of the business register is not comprehensive because of the lack of economic census data. The coverage of units in terms of value added is relatively good for industry, satisfactory for transport and communications, and poor for agriculture, retail trade, construction, catering, and services. Administrative sources used to estimate the non-observed economy are limited, and data for imports and exports of services (taken from the balance of payments) are inadequate. The main weakness of the statistical techniques used for national accounts are the compilation of the constant price estimates as well as the assessment and validation of source data. Given the sizeable infrastructure investment underway, technical assistance will need to focus on refining statistical coverage of such projects. A technical assistance mission in April/May 2004 proposed a number of improvements in the estimation of national accounts from the expenditure side. An April 2005 follow-up mission identified a problem related to the volume measure of taxes on products; as a result, GDP data for 2004 were revised.

Money and banking

3. A March 2002 STA mission found that the authorities had implemented many of the recommendations made by the December 2000 mission, but in a piecemeal manner that left a number of methodological problems unresolved. To address them, the mission advised the National Bank of Georgia (NBG) (1) to break down resident data beyond the subsectors of "general government" and "the rest of the economy," in order to provide more disaggregated

information about the sectoral distribution of credit; (2) to incorporate all Fund-related accounts transparently in the central bank survey; and (3) to distinguish restricted deposits of insolvent banks from the deposit liabilities that qualify for inclusion in broad money. The mission also reviewed implementation of the NBG's new chart of accounts (introduced January 1, 2001) and associated changes in procedures for compiling monetary statistics to ensure error-free data classification. The July 2002 data ROSC found that most elements in the data quality assessment framework for monetary statistics were fully or largely observed, and recommended improvements in the statistical coverage of nonbank depository corporations and the provision of documentation on metadata. It also recommended increased transparency regarding access by governmental agencies to monetary statistics prior to their release to the public.

4. In response to a request from STA, the NBG has recently compiled and submitted to STA a pilot set of monetary data using the framework of the new Standardized Report Forms (SRF). Subsequent STA review of the data validated the resulting monetary aggregates. STA is in the process of converting its monetary database into the SRF format for publication in the *IFS* supplement. The NBG has been providing regular updates of these data to STA.

Government finance

5. Government finance statistics (GFS) on a cash basis are reported to STA for publication in the *GFS Yearbook.* Classification broadly follows the analytic framework of the 1986 *Government Finance Statistics Manual*, but the concepts and definitions of revenue, expenditure, and financing differ from the international standard in significant respects. In addition, the central treasury and line departments employ differing accounting systems, with the treasury having a single-entry cash basis. The single-entry system hampers the treasury's capacity to reconcile bank statements and hinders the reporting of information on accounts payable. Another issue concerns the limited budget classifications available for expenditure. Discrepancies can arise when matching budget appropriations with the classified expenditure because the locally developed structure of expenditure codes changes frequently. Consequently, statistical performance and reliable budget reporting could improve once the treasury adopts internationally accepted accounting standards, including a unified treasury general ledger maintained on a double-entry cash basis. There are substantial differences in the classification systems of different government subsectors. Bridge tables linking national classification codes and *GFSM 2001* codes were established by a GFS mission in 2003 and used in 2004 to report 2004 GFS in the *GFS Yearbook*. The authorities plan to compile and disseminate government finance statistics on a *Government Finance Statistics Manual 2001 (GFSM 2001)* basis starting in 2007.

Balance of payments

6. A June 2005 balance of payments (BOP) statistics mission found that the authorities have partially implemented the recommendations of the 2002 data ROSC and 2002 and 2003 BOP missions. The SDS: (1) expanded the data sources for several of the balance of payments items, such as transportation, travel, insurance, communications, government

services, and current and capital transfers; (2) implemented new software for the database of customs declarations; and (3) produced the balance of payments in the standard format recommended by the Fund, with the separate identification of exceptional financing transactions. The mission also found that the Customs Department (CD) improved the trade data collection system by (1) installing in all of the customs offices the ASYCUDA client-server system, which is designed to maintain the customs declarations database in real time; (2) elaborating and implementing the instructions for completing customs declarations; and (3) improving verification of customs declarations. However, SDS failed to improve staffing arrangements; on the contrary, during the latest SDG reorganization, the number of permanent staff was reduced, while communication equipment was upgraded. The June 2005 BOP statistics mission focused on (1) analyzing the situation in which the NBG plans to assume the responsibility for the compilation of the balance of payments; (2) reviewing estimation methods for compiling data on various components of the balance of payments, with particular attention for the estimation of workers' remittances and compensation of employees; and (3) identifying data sources, collecting preliminary data, and producing a partial international investment position statement.

GEORGIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(as of February 28, 2006)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items: Data Quality – Methodological soundness[7]	Memo Items: Data Quality – Accuracy and reliability[8]
Exchange Rates	1/31/06	2/3/06	D	W	M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	1/31/06	2/3/06	D	W	M		
Reserve/Base Money	1/06	2/3/06	M	M	M	O, LO, LO, O	O,O,O,O,LO
Broad Money	1/06	2/20/06	M	M	M		
Central Bank Balance Sheet	1/06	2/3/06	M	M	M		
Consolidated Balance Sheet of the Banking System	1/06	2/20/06	M	M	M		
Interest Rates[2]	1/31/06	2/3/06	W	W	M		
Consumer Price Index	1/06	2/7/06	M	M	M	O,LO,O,O	LO,LO,O,O,O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	1/06	2/21/06	M	M	M	LNO,LO,LNO, O	LO,O,LO,O,O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	1/06	2/21/06	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	01/06	2/14/06	M	M	M Domestic not disseminated		
External Current Account Balance	Q3/05	12/30/05	Q	Q	Q	O,LO,LO,LO	LNO,LNO, LNO,LNO, LNO
Exports and Imports of Goods and Services	01/06	2/22/06	M	M	M		
GDP/GNP	Q3/05	10/25/05	Q	Q	Q	O,LO,O,LO	LNO,LNO,LNO, LO,LO
Gross External Debt	1/06	2/14/06	M	M	M		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC (published on May 27. 2003, and based on the findings of the mission that took place during July 15 – 31, 2002) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[8] Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

Georgia—Debt Sustainability Analysis

1. **Georgia is at moderate risk of debt distress.** The baseline scenario is sustainable. Domestic debt is negligible and all external debt indicators are well below the relevant debt-burden thresholds. Contributing factors to the moderate risk rating are Georgia's uncertain regional political outlook and weak record in meeting debt service obligations under the previous administration.

2. **Under the baseline scenario, debt ratios are on a rapid downward trend (Table 1a and Figure 1a).** Public debt falls from 41.1 percent of GDP at end-2005 to just 21.9 percent at end-2009 and continues to decline thereafter (Table 1a).[1] In net present value (NPV) terms, public debt is also expected to fall by about half before the end of the decade. The exercise assumes (i) real GDP growth of just over 5 percent in the medium term and 3½ percent over the long term; (ii) a budget deficit including net lending of 1 percent of GDP over the medium term; (iii) clearance by end-2007 of expenditure arrears of 1.1 percent of GDP at end-2005; and (iv) clearance by end-2008 of energy-related debt to Turkmenistan of more than one percent of GDP at end-2005. The fiscal deficit is funded through external financing and privatization receipts through 2009. The share of concessional debt is declining from over 37 percent of new external borrowing in 2003, to an average of about 24 percent over the medium term. The share of domestic debt is decreasing steadily over the medium and long term.

3. **Georgia's external debt level is also deemed sustainable under the baseline scenario with external debt projected to decline steadily from 2006 (Table 1b and Figure 1b).** Georgia's external debt is estimated at around 27 percent of GDP at end-2005, equivalent to less than 100 percent of exports in NPV terms. The projected gross external debt accumulation over the medium term is moderate at about $100 million a year, and total debt is declining as a share of GDP to about half of the end-2003 stock by end-2006. With limited private external borrowing, projected capital flows from FDI and transfers (both private and official, including about $300 million from the MCA) will be the main sources to finance a shrinking trade deficit that is projected to stabilize at about 8 percent of GDP in the long run, provided export values grow at around 6 percent.[2]

---

[1] Public debt is defined on a gross basis and excludes debt owed by state-owned enterprises. It also excludes contingent liabilities from the Soviet era. At the end of 2005, about 75 percent of general government debt was denominated in foreign currency, while debt to the NBG accounted for about 18 percent. General government expenditure arrears and treasury bills accounted for the remaining liabilities.

[2] For further details on recent developments in Georgia's debt statistics as well as the long run baseline scenario, see The World Bank's Georgia Country Partnership Strategy, October 26, 2005.

4. **Alternative scenarios and bound tests are constructed to examine the sensitivity of the baseline projection of public and publicly guaranteed debt to a range of potential shocks (Tables 2a and 2b).** Most of these factors would not jeopardize Georgia's debt sustainability. On exception is a return of export value growth from about 10 percent in 2005 to about 2 percent (the historical average of 2 1/2 percent minus one standard deviation of about 1/2 percent). Even if limited to 2 years, the NPV of debt-to-exports ratio would reach unsustainable levels of more than 150 percent, even if the gap were financed at better than commercial terms (30 percent grant element). With official reserves low (at about 2 months of non-pipeline imports), this could erode hard gained exchange rate stability. Another exception occurs at long run growth of about 3 percent. At this threshold debt dynamics begin changing and NPV of debt to GDP and debt to revenue rise substantially.

Table 1a.Georgia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2000–25

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate			Projections						
	2003	2004	2005	Historical Average 5/	Standard Deviation 5/	2006	2007	2008	2009	2010	2011	2006-11 Average	2016	2025	2016-25 Average
Public sector debt 1/	60.8	46.4	41.1			34.3	28.9	24.0	21.9	21.3	21.1		19.4	15.5	
Of which foreign-currency denominated	46.9	33.9	27.1			22.9	20.2	17.9	16.4	16.0	16.2		15.8	11.5	
Change in public sector debt	-2.2	-14.4	-5.3			-6.8	-5.4	-4.8	-2.1	-0.6	-0.2		-0.2	-0.5	
Identified debt-creating flows	-4.4	-20.2	-9.1			-5.8	-4.0	-2.2	-0.9	-1.0	-0.7		-1.0	-0.4	
Primary deficit	0.4	-4.3	0.5	1.6	3.0	1.3	-0.5	0.0	0.2	-0.2	-0.2	0.1	-0.3	-0.2	-0.3
Revenue and grants	16.2	21.7	23.4			22.9	25.0	24.8	25.1	25.6	25.3		25.0	25.0	
of which: grants	0.6	1.2	0.9			1.3	2.2	1.7	1.5	1.7	1.1		0.0	0.0	
Primary (noninterest) expenditure	16.6	17.4	23.9			24.1	24.5	24.9	25.4	25.4	25.1		24.7	24.8	
Automatic debt dynamics	-4.5	-13.9	-5.5			-4.0	-2.4	-1.9	-1.0	-0.8	-0.6		-0.7	-0.2	
Contribution from interest rate/growth differential	-5.3	-7.3	-5.4			-3.0	-2.1	-1.7	-1.1	-0.8	-0.6		-0.7	-0.2	
Of which: contribution from average real interest rate	1.0	-3.7	-2.2			-1.3	-0.4	-0.3	-0.2	0.0	0.2		0.0	-0.2	
Of which: contribution from real GDP growth	-6.3	-3.5	-3.2			-1.8	-1.6	-1.4	-0.9	-0.8	-0.8		-0.7	0.0	
Contribution from real exchange rate depreciation	0.9	-6.6	-0.1			-1.0	-0.4	-0.3	0.1	0.1	0.1		...	...	
Other identified debt-creating flows	-0.3	-1.9	-4.1			-3.0	-1.0	-0.3	-0.1	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-0.3	-0.9	-3.6			-2.6	-0.7	-0.3	-0.1	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	-1.1	-0.5			-0.4	-0.3	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	2.2	5.8	3.9			-1.0	-1.5	-2.7	-1.2	0.4	0.5		0.9	0.0	
NPV of public sector debt	13.9	12.5	34.9			29.2	25.2	21.9	20.6	19.7	19.1		15.2	10.7	
Of which: foreign-currency denominated	0.0	0.0	20.9			17.8	16.5	15.7	15.1	14.4	14.2		11.6	6.7	
Of which: external	...	...	20.9			17.8	16.5	15.7	15.1	14.4	14.2		11.6	6.7	
NPV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	3.8	5.1	5.2			5.8	3.5	3.9	3.9	3.6	3.7		3.3	3.2	
NPV of public sector debt-to-revenue ratio (in percent) 3/	85.8	57.4	149.2			127.9	101.0	88.1	81.9	77.1	75.5		60.9	42.9	
Of which: external	...	...	89.4			77.8	66.3	63.2	60.0	56.2	56.2		46.5	26.8	
Debt service-to-revenue ratio (in percent) 3/ 4/	24.2	24.4	14.2			15.2	12.5	11.5	10.2	10.0	9.7		6.9	3.6	
Primary deficit that stabilizes the debt-to-GDP ratio	2.6	10.1	5.8			8.1	4.9	4.9	2.3	0.4	0.1		-0.1	0.2	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	11.1	6.2	7.7	5.9	3.3	6.4	5.0	5.0	5.0	3.5	3.5	4.7	3.5	3.5	3.5
Average nominal interest rate on forex debt (in percent)	2.3	1.2	1.1	2.4	0.9	0.8	1.3	1.1	1.2	1.2	1.2	1.1	1.0	0.8	1.0
Average real interest rate on domestic currency debt (in percent)	5.5	-3.3	-1.4	0.7	4.0	0.0	1.2	3.1	4.4	8.1	8.7	4.3	8.0	1.7	5.9
Real exchange rate depreciation (in percent, + indicates depreciation)	2.0	-16.3	-0.4	-1.5	14.7	-4.1	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	3.5	9.6	8.0	10.3	11.5	6.0	4.2	4.0	4.0	4.0	3.0	4.2	3.0	3.0	3.0
Growth of real primary spending (deflated by GDP deflator, in percent)	16.7	11.1	48.1	11.6	17.4	7.3	6.5	6.7	7.1	5.2	0.8	5.6	-0.4	3.8	3.5
Grant element of new external borrowing (in percent)	37.4	34.0	30.1	33.8	3.7	31.0	20.3	22.5	23.1	26.3	25.7	24.8	10.5	0.0	...

Sources: Georgian authorities; and Fund staff estimates and projections.

1/ Public sector comprised of general government.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues including grants.

4/ Debt service is defined as the sum of interest and amortization of medium- and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 1b. Georgia: External Debt Sustainability Framework, Baseline Scenario, 2000–25 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Estimate	Projections								
	2003	2004	2005			2006	2007	2008	2009	2010	2011	2006-11 Average	2016	2025	2016-25 Average
External debt (nominal) 1/	**46.4**	**35.8**	**27.1**			**22.9**	**20.8**	**18.4**	**16.9**	**16.5**	**16.7**		**16.8**	**13.3**	
Of which public and publicly guaranteed (PPG)	46.4	35.7	27.0			22.9	20.8	18.4	16.9	16.5	16.7		16.8	13.3	
Change in external debt	-5.3	-10.6	-8.7			-4.2	-2.1	-2.4	-1.5	-0.5	0.2		-0.1	-0.1	
Identified net debt-creating flows	-8.9	-12.2	-5.9			0.5	1.5	1.7	1.9	1.7	0.8		-0.4	0.2	
Noninterest current account deficit	**6.2**	**7.6**	**6.8**	**6.1**	**1.2**	**6.7**	**5.1**	**4.7**	**4.4**	**3.9**	**3.0**	**4.6**	**1.9**	**2.5**	**2.3**
Deficit in balance of goods and services	15.0	13.8	14.1			13.9	12.7	11.7	11.3	10.6	10.0		8.4	7.8	
Exports	18.3	24.5	21.9			20.2	20.3	19.7	19.4	18.9	19.2		18.7	17.4	
Imports	33.3	38.3	36.0			34.2	33.0	31.4	30.6	29.6	29.2		27.2	25.2	
Net current transfers (negative = inflow)	-6.7	-6.7	-6.6			-6.7	-6.7	-6.0	-5.5	-5.3	-5.3		-3.9	-2.8	
Other current account flows (negative = net inflow)	-2.1	0.4	-0.7			-0.5	-0.8	-1.0	-1.3	-1.5	-1.7		-2.6	-2.5	
Net FDI (negative = inflow)	**-8.4**	**-9.7**	**-6.5**	**-6.1**	**3.1**	**-5.2**	**-2.9**	**-2.3**	**-1.9**	**-2.0**	**-2.1**	**-2.7**	**-2.1**	**-2.0**	**-2.1**
Endogenous debt dynamics 2/	**-6.7**	**-10.1**	**-6.3**			**-1.1**	**-0.7**	**-0.7**	**-0.5**	**-0.2**	**-0.2**		**-0.2**	**-0.3**	
Contribution from nominal interest rate	1.0	0.7	0.5			0.4	0.4	0.3	0.4	0.4	0.4		0.3	0.2	
Contribution from real GDP growth	-4.9	-2.2	-2.2			-1.5	-1.1	-0.9	-0.8	-0.5	-0.6		-0.6	-0.5	
Contribution from price and exchange rate changes	-2.8	-8.6	-4.6			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**3.6**	**1.6**	**-2.8**			**-4.7**	**-3.6**	**-4.1**	**-3.4**	**-2.1**	**-0.5**		**0.3**	**-0.3**	
Of which exceptional financing	-1.5	2.2	0.3			1.0	0.8	0.6	0.8	0.7	0.5		1.0	0.3	
NPV of external debt 4/	...	...	20.9			17.8	17.0	16.2	15.5	14.8	14.6		12.4	7.3	
In percent of exports	...	...	95.7			87.9	83.9	82.1	80.3	78.3	76.1		66.0	42.3	
NPV of PPG external debt	**...**	**...**	**20.9**			**17.8**	**17.0**	**16.2**	**15.5**	**14.8**	**14.6**		**12.4**	**7.3**	
In percent of exports	...	...	95.6			87.8	83.9	82.1	80.3	78.3	76.1		66.0	42.3	
Debt service-to-exports ratio (in percent)	26.7	17.9	15.8			15.9	13.3	7.5	5.2	6.8	6.7		5.3	5.1	
PPG debt service-to-exports ratio (in percent)	26.7	17.7	15.7			15.8	13.3	7.5	5.2	6.8	6.7		5.3	5.1	
Total gross financing need (billions of U.S. dollars)	0.1	0.1	0.3			0.4	0.4	0.3	0.4	0.4	0.3		0.2	0.4	
Noninterest current account deficit that stabilizes debt ratio	11.4	18.2	15.6			10.9	7.2	7.1	5.9	4.3	2.8		2.1	2.6	
Key macroeconomic assumptions															
Real GDP growth (in percent)	11.1	6.2	7.7	5.9	3.3	6.4	5.0	5.0	5.0	3.5	3.5	4.7	3.5	3.5	3.5
GDP deflator in U.S. dollar terms (change in percent)	5.7	22.7	14.7	3.4	13.0	10.2	2.7	5.6	3.5	5.0	1.2	4.7	3.5	-3.4	2.8
Effective interest rate (percent) 5/	2.3	1.9	1.8	2.6	0.5	1.8	1.8	1.4	2.2	2.3	2.2	1.9	1.9	1.2	1.8
Growth of exports of G&S (U.S. dollar terms, in percent)	32.1	74.1	10.3	33.4	28.7	8.5	8.1	7.5	6.9	6.2	6.2	7.3	6.0	0.0	5.6
Growth of imports of G&S (U.S. dollar terms, in percent)	33.9	49.9	16.0	25.8	20.4	11.3	4.1	5.3	6.2	5.0	3.4	5.9	6.0	0.0	5.2
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	32.6	32.0	32.1	33.7	33.6	33.5	32.9	33.2	0.0	33.2

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that NPV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2a. Georgia: Sensitivity Analysis for Key Indicators of Public Debt 2006–25

	Estimate	Projections						
	2006	2007	2008	2009	2010	2011	2016	2025
NPV of Debt-to-GDP Ratio								
Baseline	29	25	22	21	20	19	15	11
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	29	26	24	23	23	23	23	22
A2. Primary balance is unchanged from 2005	29	25	22	21	21	20	19	18
A3. Permanently lower GDP growth 1/	30	26	23	23	24	24	30	49
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	29	26	24	23	23	23	25	26
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	30	29	29	28	28	27	26	24
B3. Combination of B1-B2 using one half standard deviation shocks	30	28	27	26	26	25	25	23
B4. One-time 30 percent real depreciation in 2007	30	33	30	29	28	27	25	22
B5. 10 percent of GDP increase in other debt-creating flows in 2007	29	33	29	27	26	25	21	14
NPV of Debt-to-Revenue Ratio 2/								
Baseline	128	101	88	82	77	76	61	43
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	127	106	96	92	90	92	92	89
A2. Primary balance is unchanged from 2005	125	101	89	84	81	81	76	73
A3. Permanently lower GDP growth 1/	129	104	94	92	92	96	122	196
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	128	105	96	93	91	93	99	105
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	129	117	117	112	108	108	105	96
B3. Combination of B1-B2 using one half standard deviation shocks	129	113	109	104	100	100	99	91
B4. One-time 30 percent real depreciation in 2007	129	133	120	115	110	108	99	87
B5. 10 percent of GDP increase in other debt-creating flows in 2007	127	131	116	108	102	101	82	57
Debt Service-to-Revenue Ratio 2/								
Baseline	15	13	11	10	10	10	7	4
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	16	13	12	10	10	10	8	7
A2. Primary balance is unchanged from 2005	16	13	12	11	10	10	8	6
A3. Permanently lower GDP growth 1/	16	13	12	11	11	11	10	14
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	15	13	12	11	11	10	9	8
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	16	13	12	11	11	11	10	9
B3. Combination of B1-B2 using one half standard deviation shocks	16	13	12	11	11	11	10	8
B4. One-time 30 percent real depreciation in 2007	16	13	12	11	11	10	9	7
B5. 10 percent of GDP increase in other debt-creating flows in 2007	16	13	13	11	11	11	9	6

Sources: Country authorities; and Fund staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).

2/ Revenues are defined inclusive of grants.

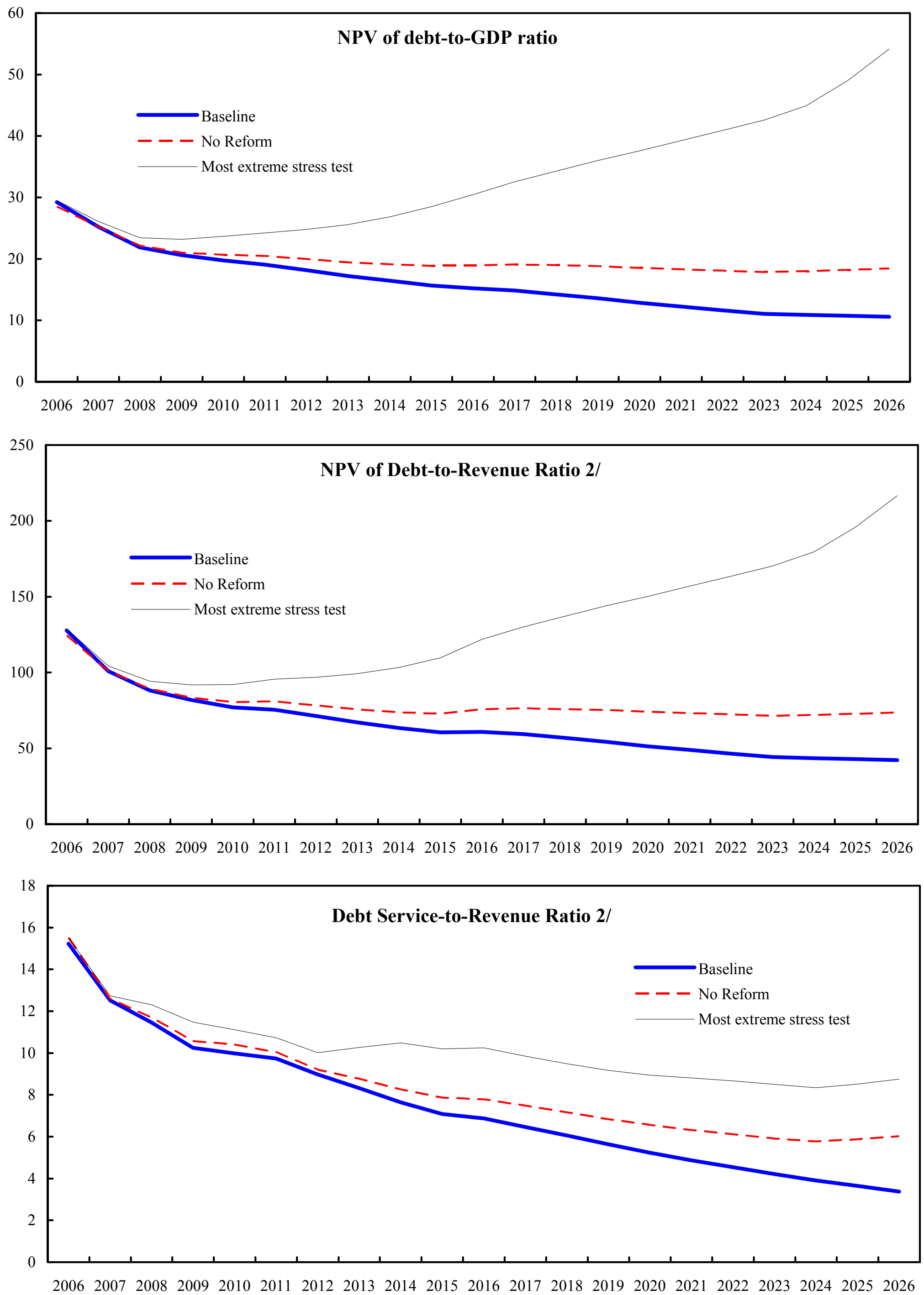
Table 2b. Georgia: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2006–25
(In percent)

	Estimate	Projections														
	2006	2007	2008	2009	2010	2011	**2016**	2017	2018	2019	2020	2021	2022	2023	2024	2025
NPV of debt-to-GDP ratio																
Baseline	18	17	16	16	15	15	**12**	12	11	11	10	9	9	8	8	7
A. Alternative Scenarios																
A1. Key variables at their historical averages in 2006-25 1/	18	15	14	13	13	13	**11**	10	9	8	8	7	6	5	5	9
A2. New public sector loans on less favorable terms in 2006-25 2/	18	18	18	18	17	17	**16**	16	15	15	14	13	13	12	12	12
B. Bound Tests																
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	18	17	17	16	16	15	**13**	12	12	11	11	10	9	8	8	8
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	18	19	22	21	20	20	**16**	16	15	14	13	12	11	10	10	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	18	19	21	21	20	19	**16**	16	15	14	13	12	11	11	10	10
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	18	18	17	16	16	15	**13**	12	12	11	10	10	9	8	8	8
B5. Combination of B1-B4 using one-half standard deviation shocks	18	19	20	19	18	18	**15**	15	14	13	12	11	10	10	9	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	18	24	23	22	21	21	**17**	17	16	15	14	13	12	11	11	10
NPV of debt-to-exports ratio																
Baseline	88	84	82	80	78	76	**66**	64	62	59	56	53	49	46	45	42
A. Alternative Scenarios																
A1. Key variables at their historical averages in 2006-25 1/	88	73	71	68	67	67	**57**	53	50	46	42	38	34	31	27	50
A2. New public sector loans on less favorable terms in 2006-25 2/	88	91	92	91	90	89	**86**	85	83	81	78	75	72	69	70	68
B. Bound Tests																
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	88	84	82	80	78	76	**66**	64	62	59	56	53	49	46	45	42
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	88	111	153	149	146	142	**120**	115	110	104	98	91	85	78	77	72
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	88	84	82	80	78	76	**66**	64	62	59	56	53	49	46	45	42
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	88	88	86	85	82	80	**69**	67	65	62	58	55	51	48	47	44
B5. Combination of B1-B4 using one-half standard deviation shocks	88	86	85	83	81	79	**68**	66	63	61	57	54	50	47	46	43
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	88	84	82	80	78	76	**66**	64	62	59	56	53	49	46	45	42
Debt service-to-exports ratio																
Baseline	16	13	7	5	7	7	**5**	5	6	6	6	5	5	5	5	5
A. Alternative Scenarios																
A1. Key variables at their historical averages in 2006-25 1/	14	9	7	5	6	5	**3**	3	3	3	3	3	3	3	3	2
A2. New public sector loans on less favorable terms in 2006-25 2/	14	9	7	6	7	6	**5**	6	6	6	6	6	6	6	6	7
B. Bound Tests																
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	14	9	7	6	6	6	**5**	5	5	5	5	5	5	5	5	5
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	14	10	10	9	10	10	**10**	9	9	9	9	9	9	8	9	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	14	9	7	6	6	6	**5**	5	5	5	5	5	5	5	5	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	14	9	7	6	6	6	**5**	5	5	5	6	5	5	5	5	5
B5. Combination of B1-B4 using one-half standard deviation shocks	14	9	7	6	6	6	**5**	5	5	5	5	5	5	5	5	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	14	9	7	6	6	6	**5**	5	5	5	5	5	5	5	5	5

Source: Staff projections and simulations.

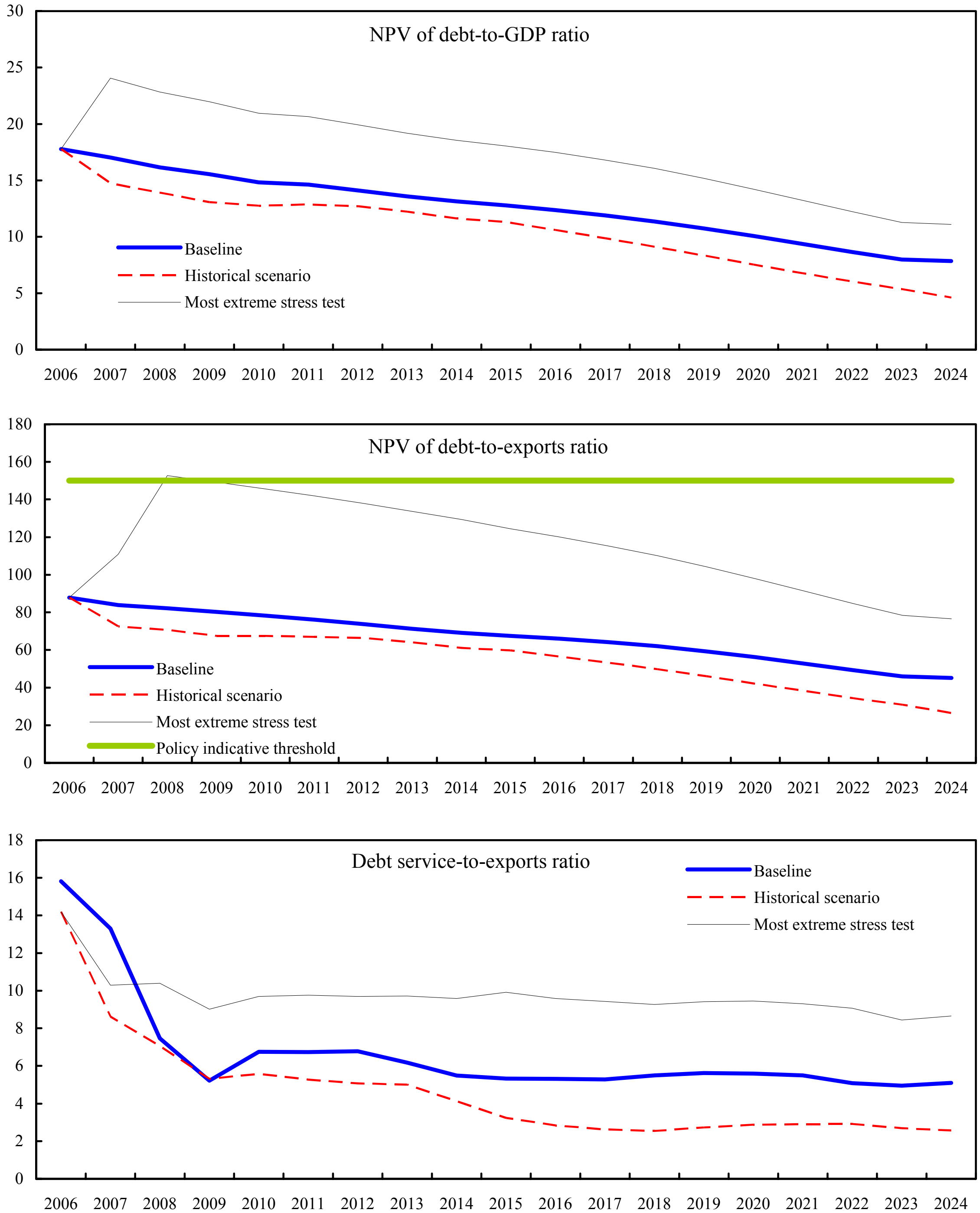
1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure 1a. Georgia: Indicators of Public Debt Under Alternative Scenarios, 2006-2026 1/



Source: Staff projections and simulations.
1/ Most extreme stress test is test that yields highest ratio in 2016.
2/ Revenue including grants.

Figure 1b. Georgia: Indicators of Public and Publicly Guaranteed External Debt
Under Alternative Scenarios, 2006–25
(In percent)



Source: Staff projections and simulations.

March 14, 2006
Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
700 19th Street N.W.
Washington, D.C. 20431

Dear Mr. de Rato:

The attached Memorandum of Economic and Financial Policies (MEFP) describes the 2006 policies supported by the International Monetary Fund as Trustee under a three-year Poverty Reduction and Growth Facility (PRGF) arrangement. The memorandum proposes performance criteria for end-March 2006 and end-June 2006, and outlines our broad macroeconomic objectives and policies for 2006. These policies are consistent with the Economic Development and Poverty Reduction Program (EDPRP) presented to the IMF and World Bank in October 2003 and with the Annual Progress Report of our EDPRP, which was submitted in January 2005.

The Government of Georgia believes that the policies set forth in the attached memorandum will achieve the objectives of the program, but it will take any additional measures that may become appropriate for this purpose. The government will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

We request hereby the completion of the third review under the PRGF arrangement and we request waivers for nonobservance of two structural performance criteria for end-September 2005. The first of these performance criteria required submission of a Customs Code to parliament, but we encountered delays because of the need to ensure extensive consultations with the private sector on provisions of the proposed law. The Customs Code was submitted to the parliament on October 17.

The other structural performance criteria required the clearance of budget arrears by end-September 2005. Given our concerns over the possible inflationary consequences of making these payments, we decided it would be best to delay clearing the arrears. We have subsequently continued clearing arrears and in the attached MEFP have committed to clear the arrears by end-2006. We also propose the deletion of the performance criterion on a floor for general government tax revenue.

Georgia will conduct discussions with the Fund for the fourth review of its program under the PRGF arrangement before end-June 2006.

Sincerely yours,

/s/
Zurab Nogaideli
Prime Minister of Georgia

/s/	/s/
Aleksi Aleksishvili	Roman Gotsiridze
Minister of Finance	President of the National Bank

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

Introduction

1. The government's economic program for 2006, which is supported by a PRGF arrangement, aims to achieve poverty reduction through sustained, rapid, and equitable economic growth in an environment of low inflation. This Memorandum of Economic and Financial Policies reviews our progress to date in the implementation of the program and describes our economic policies and strategy through 2006.

Current Economic Developments and Performance

2. The government's economic policies in 2005 ensured macroeconomic stability and improved growth prospects. In the first nine months of 2005, economic growth was 7.7 percent, driven primarily by the rapid expansion of agriculture, banking, trade and communication sectors. Preliminary estimates indicate that real GDP growth in 2005 was about 8 percent. Inflation for 2005 was 6.2 percent. Despite significant increases in prices for tobacco and alcohol (mainly due to increased excise taxes) and petroleum products, inflationary pressures were avoided.

3. Macroeconomic stability was ensured by controlling inflation through careful coordination and implementation of monetary and fiscal policies. The overall fiscal deficit (on a cash basis) for 2005 was 2.4 percent of GDP. This is less than projected and reflects limited administrative capacity in some line ministries and our decision to delay some expenditure because of concerns over inflationary pressure. For example, our decision to postpone clearing some budget arrears was because of our concern for inflationary pressure.

4. Monetary policy has also been supportive of the need to contain inflationary pressures. During 2005, reserve money increased only by 19.7 percent, which is below the target envisaged by the program. Despite concerns in early 2005 about significant foreign currency inflows and the possible instability for the national currency, the appreciation of the lari has been modest and smooth. During 2005, the lari appreciated by 2.5 percent against

the U.S. dollar in nominal terms and appreciated by 3.1 percent in real effective terms. Gross international reserves of NBG increased by 24 percent to $474 million in 2005, which is about 2.1 months of non-pipeline imports.

5. Fiscal performance in 2005 was stronger than projected at the time of the second review under the PRGF arrangement. For 2005, the cumulative fiscal deficit on a commitments basis was GEL 177 million compared with a projection of GEL 407 million, while the cash deficit was GEL 279 million. Underpinning the strong fiscal performance last year was strong revenue collection. For 2005, revenues collected by the Customs Department increased by 66 percent as compared with 2004. This improvement is due to restructuring of the Customs Department that included elimination and streamlining operations and functions, introducing a new staff management system, reducing staff by 9.5 percent and increasing salaries. As part of our efforts to strengthen the Customs Department, we are in the process of examining and recertifying the department's staff. Customs units moved to a one-window principle, which significantly simplified the customs clearance procedures. In addition, technical equipment was improved due to the assistance of donor organizations. As a result of these measures, the level of corruption has been significantly reduced.

6. Tax administration has continued to improve. During 2005, tax revenues increased to GEL 2,300 million, which is a 27 percent increase compared with 2004. The improved collection of tax revenues was due largely to expansion of the tax base and improvements in tax administration. Improvements in tax administration, including the introduction of better data processing and management systems, have allowed continued strong performance in collection of tax revenues, despite a significant reduction in tax rates and the number of taxes as part of the liberalization of the Tax Code. We estimate that the ratio of tax revenues to GDP was at least 19.8 percent for 2005, which is a significant improvement compared with 2004.

7. As part of government's effort to improve the budget process, we have introduced a medium-term expenditure framework (MTEF). The first stage in this process was the preparation of our Basic Data and Directions (BDD) document, which identified the major

trends of the state budget based on the principle of medium-term projection of expenditures. The BDD was submitted to parliament for discussion in May 2005. The second phase of the MTEF process was to apply these expenditure guidelines to the activities of various parts of government. The strategic priorities and spending projections for 2006-2009 for key line ministries were submitted to parliament as part of the proposed budget for 2006. We recognize that the MTEF process should be refined and improved, but believe it has already made a contribution to a more transparent and coherent budget process. For the purpose of strengthening and institutionalizing of MTEF process, government adopted a decree that establishes a clear link between line ministries strategies and strategic priorities reflected in the BDD. Additionally, the format of key documents was revised to facilitate the inclusion of line ministries' strategies into BDD. Also the calendar for preparing the MTEF was clarified.

8. The government's structural reform program continues to make good progress, despite some delays. A new Customs Code was developed and submitted to parliament on October 17, 2005. The submission of the Customs Code to parliament was delayed, which meant that the structural performance criterion for end-September was missed, because of the need to ensure extensive consultation with the private sector on the provisions of the proposed law. The new Customs Code will significantly simplify the customs procedures. Since the proposed legislation has been submitted to parliament and passage is expected shortly, we request a waiver for this structural performance criterion.

9. Our civil service reform strategy is under preparation and will serve as the basis for an implementation action plan. Medium-term action plans were developed for each ministry and discussed at a government session. For the purpose of increasing the efficiency, quality and flexibility of the state management, the number of ministries has been reduced from 18 to 13. Additionally, numerous state departments and other units were consolidated and subordinated to their respective ministries.

10. There has been a significant improvement in the business environment since 2003. In June, parliament approved the law on "Licenses and Permissions," which constitutes a major reform of the legislation governing the issuance of licenses and permits. The main principles

of public sector regulation were redefined for the purpose of simplifying the system and eliminating impediments. As a result, the list of the activities for which licenses and permits are required was reduced by about 85 percent. Licensing procedures were improved and simplified by introducing the principles of "one-window for approval" and "silence is consent." We have also simplified the requirements for standardizing and certifying commodities sold in Georgia. This reform liberalizes the domestic market by reducing excess administrative barriers, introducing voluntary quality standards for commodities while maintaining compulsory technical regulations with respect to safety, and recognizing the technical certification of commodities by other countries.

11. Government recently approved proposals for a significant liberalization of our trade regime. We were unable to submit the proposed legislation to parliament on time (structural benchmark for end-September) because of the need for extensive consultations with the business community. We have, however, completed the consultation process and submitted the proposed legislation to parliament. If approved, the new tariff regime will move from 16 bands to 3 and will reduce the maximum tariff from 30 percent to 12 percent for 2006. Further, the legislation also would eliminate the 12 percent band beginning in 2007 and eliminate all tariffs in 2008. We believe that the implementation of the new trade regime will enhance the prospects for economic growth.

12. The government is continuing negotiations with external creditors under the auspices of the 2004 Paris Club agreement. As of end-February 2006, we signed restructuring agreements with six Paris Club creditors and two non-Paris Club creditors, which leaves four agreements (one with Paris Club members and three with non-Paris Club creditor countries) to be concluded. In order to continue negotiations, we have received another extension from the Paris Club and expect to sign agreements with the remaining external creditors by end-February 2006.

13. Georgia made important steps towards combating money laundering. In particular, we ratified 1990 Council of Europe Convention "on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime" (the Strasbourg Convention), adopted the Law

"On Facilitating the Prevention of Illicit Income Legalization" (in force since January 2004) and established the Financial Monitoring Service (FMS) at the NBG. The FMS became a member of the Egmont Group in June 2004. The Service conducts its activities in close cooperation with MONEYVAL and in accordance with Financial Action Task Force (FATF) recommendations and EU directives. The FMS has elaborated detailed regulations on financial monitoring for different kinds of monitoring entities from which it receives information concerning suspicious and above threshold (GEL 30,000) transactions. The information received by the FMS is systemized and analyzed and, in case of raising the grounded supposition that a transaction may be related to illicit income legalization or terrorism financing, is forwarded to Special Service of Criminal Prosecution of Illegal Income Legalization at the General Prosecutor's Office of Georgia.

14. In 2005, the FMS submitted draft amendments to the Criminal Code of Georgia and Criminal Procedure Code of Georgia to parliament that would assure compliance of Georgian legislation on provisional measures and confiscation of property with the provisions of the Strasbourg Convention. These amendments were approved by parliament in December 2005.

15. The amendment to the legislation which would upgrade the Budget Systems Law (BSL) to an organic law was submitted to parliament in March 2005, where its passage requires a constitutional majority. Passage of the proposed draft has been delayed because of opposition in parliament. Government is now in the process of proposing technical amendments to the BSL. Following their approval, the government will continue to make its best efforts to secure passage of an amendment that would upgrade the BSL to an organic law.

16. We are also requesting a waiver for missing the end-September performance criterion relating to the clearance of arrears. As noted, we have been concerned about the inflationary consequences of making these payments and prefer to delay payments rather than risk higher inflationary pressures. Additionally we wish to ensure that all claims for payment are legitimate and so we are vetting the claims carefully, which is a time-consuming process. As

of end-December 2005, the stock of claimed arrears was GEL 182 million, which is greater than at end-June 2005 because more claims have been submitted. The process of verifying claimed arrears and clearing them continues. For 2005, we cleared GEL 104 million of verified arrears leaving a stock of GEL 182.1 million in claimed arrears and GEL 59 million in verified arrears at end-2005. While we cleared fewer arrears in 2005 than anticipated under the program, we feel the delay is justified. During 2006, we plan to complete the evaluation of all arrears claimed as of end-2005 and clear all those that are verified. We will ensure that clearing verified arrears in excess of those included in the 2006 budget will not increase the overall fiscal deficit.

Economic Policies for 2006

17. The government's economic reform program for 2006 and beyond aims at further improving the macroeconomic environment as a means of encouraging broad-based growth in support of poverty reduction. The main sources of economic growth will continue to be industry, agriculture, trade, transport and communications. The primary areas for reform are privatization of the remaining state-owned enterprises and properties; enhancing the business environment; reforming the judiciary; developing the financial sector; and revising the labor code. As a result of the ongoing reform process, we anticipate further growth of foreign direct investment over the medium term.

18. According to the government's 2006 Economic Program, real growth of GDP in 2006 is projected to be 6.5 to 7.5 percent and end-period inflation for 2006 is projected to be 5-6 percent. Our target for gross international reserves of the NBG is 2.3 months of non-pipeline imports. The current account deficit is projected to stabilize at 7.4 percent of the GDP. As was true in 2005, our program for enhancing macroeconomic stability will require disciplined fiscal and monetary policies and careful coordination of the two.

19. The MTEF that we prepared in 2005 (and consisted of the BDD and appendices to the 2006 budget law) will be updated during the course of 2006. Particular emphasis will be given to identifying expenditure priorities for 2007-10 and to refining and extending

strategies for individual line ministries. In addition, we will ensure consistency between the annual BDD and the subsequent budget. In order to enhance transparency of the budget process, both the BDD and the detailed strategies and spending plans will be posted on appropriate websites.

20. In order to strengthen macroeconomic coordination and planning, we are preparing a medium-term strategic action plan for 2006-09 that incorporates the main elements of strategy documents that were prepared in the past few years, including the EDPRP, Individual Policy Action Plan and the EU Neighborhood Policy Paper. Additionally, we have begun preparing our PRSP progress report, which we expect to complete by end-September 2006.

Fiscal Policy

21. The proposed budget law for 2006 that was approved by parliament projects tax revenues of 19.3 percent of GDP. Additionally, we anticipate continued improvements in tax and customs administration. For 2006, the overall fiscal deficit on a commitment basis is projected at 2.2 percent of GDP. In 2006, we will clear the outstanding stock of verified arrears. Hence, by end-2006 the entire stock of verified arrears will be completely cleared and no new arrears will be accumulated. The overall fiscal deficit on a cash basis is projected to be 2.6 percent of GDP.

22. A large element of the anticipated improvement in tax collections will be derived from reform of the Customs Code and through better administration. We expect the new Customs Code to take effect on April 1, 2006 and believe it will significantly simplify customs procedures. Other reforms include upgrading information and data processing systems, introducing a harmonized system of commodity nomenclature; and improving technical equipment at key customs clearance points. Further improvements in tax administration include simplifying tax declaration procedures and allowing electronic filing of tax returns for selected tax payers.

23. In 2005, the government did not borrow from the NBG and no such borrowing is planned. The NBG will submit to parliament an amendment to existing legislation that prohibits government borrowing from the NBG under all circumstances (structural performance criterion for end-March 2006).

24. Improved revenue collection will allow the government to increase expenditures in several key areas. Total allocations for social spending are budgeted at 8.6 percent of GDP. As part of our effort to increase social sector expenditures, we began a comprehensive reform of the education sector in 2005 that will continue in 2006. The main goal of the reform is to bring the education system of Georgia in compliance with international standards. From 2006, the education system will be funded from the state budget.

25. In line with our EDPRP, another priority in the social sphere is the government's effort to eliminate extreme poverty. We increased the minimum pension to GEL 28 per month (equivalent to about $15) as of January 1, 2005. In 2006, we plan to increase the minimum pension by GEL 10 to GEL 38 per month, with an increase of 5 lari per month on March 1, 2006 and a further 5 lari on September 1, 2006. Additionally, we plan to introduce our poverty alleviation program on June 1, 2006 (structural performance criterion for end-June 2006). The guiding principle of this reform is that social assistance will no longer be exclusively oriented to certain categories of the population (e.g., single pensioners, disabled, and IDPs). Instead, social assistance will be targeted on those households living below the extreme poverty line. Cash benefits for households below the poverty line shall be determined in accordance to the current level of living conditions and family size. The state will supplement the income of households at least to the level of the extreme poverty line. The main outcome indicator will be that at least 60 percent of those identified as extremely poor will be covered by the program.

26. Beginning January 1, 2006, the cost of gas imported from Russia increased significantly. Whereas the average cost of gas was $64 per thousand cubic meters (tcm) in 2004 and 2005, the cost in 2006 is $110 per tcm. In order to mitigate the impact of higher gas prices, we plan to delay increasing the gas tariff for households until May 2006. The

difference between the import price of gas and the price paid by households will be borne by the budget at a projected cost of GEL 35 million. Once our poverty alleviation program is operational (June 1, 2006), we will assess the case for using this vehicle to compensate low-income households for higher gas tariffs.

27. In addition, there will be some new developments in local and central budgets in 2006. Specifically, a draft law on Budget of Local Self-Management Units was submitted to parliament in November 2005. The proposed law will regulate the preparation of local budgets and their approval as well as the methodology for calculating transfers to be received by the local budgets.

28. The privatization process will continue in 2006. The guiding principle for privatization is that the state should own only those properties that are essential for performance of the state functions. During 2006, it is envisaged to carry out privatization in a transparent manner with an emphasis on enterprises in the energy distribution, power generation and communication sectors. The amount generated from this is estimated to be GEL 338 million or 2.6 percent of GDP.

29. We are working to strengthen the financial management of Legal Entities of Public Law (LEPLs). We have begun the process of establishing a database of all central government LEPLs and expect the database to be populated by end-March 2006 (structural performance criterion for end-March). We are currently refining a system for financial monitoring of LEPL activities through the line ministries. We will prepare operational guidelines for financial management and reporting that ensure adequate financial monitoring of LEPLs. The preparation of the operational guidelines is already advanced and will be completed by end-June 2006.

30. In early 2004, several quasi-fiscal funds were established outside the government to meet critical expenditure requirements in the aftermath of the Rose Revolution. In order to enhance fiscal transparency and accountability the Army Development Fund and the Law Enforcement Fund ceased operations on January 1, 2006. Further, in January 2006 it was

publicly announced that the two funds would be liquidated by end-March 2006. The Reform and Development Fund now operates as an NGO and does not have any fiscal functions. Any other funds, which continue to operate and finance general government expenditures will report their financial activities on a current basis and will be treated as part of the general government.

31. The reform of the treasury will continue in 2006. As agreed at the time of the second review under the PRGF arrangement, the single treasury account system became fully functional by end-2005. Expenditure and income accounts were merged into a single treasury account. In the mid-term, we will introduce a new classification of the budget and a new methodology of registration, which will be based on cash-based method indicated in GFS 2001. These and all other necessary activities will be introduced in order to continue consolidation of public finances into the treasury system.

Monetary Policy

32. A disciplined monetary program that features a flexible exchange rate regime is central to our macroeconomic strategy for 2006 and beyond. Based on a target for end-year inflation of 5-6 percent, the program projects an increase in money demand of 12 percent during 2006 and an increase in the money multiplier of 3 percent over the same period. Reserve money growth would thus be limited to 25 percent and broad money growth to 29 percent. We plan to increase gross foreign reserves to about 2.3 month of non-pipeline imports or about $620 million. The NBG will intervene in the foreign exchange markets only as necessary for smoothing sharp fluctuations, especially in light of the large capital inflows expected in 2006. Further, we will submit amendments to existing legislation to parliament that would prohibit government borrowing from the NBG under all circumstances (structural benchmark for end-March 2006).

33. We are determined to improve the operation of financial markets in Georgia by fostering the development of markets for safe assets of various maturities and to strengthen the NBG's ability to conduct monetary policy by increasing its portfolio of marketable securities. By end-March 2006, the government together with the NBG will agree on

measures to achieve those objectives, including securitizing all existing NBG claims on the government at the rate of GEL 40–50 million per year with maturities of 2–5 years (structural benchmark for end-March). In addition, the NBG will begin issuing CDs with a maturity of up to one year.

34. To upgrade banking supervisory policy and implement the Basel Core Principles for Effective Banking Supervision, the NBG is planning to make changes to the Law on Activities of Commercial Banks regarding consolidated supervision and definitions of bank insiders, Fit and Proper Criteria for bank administrators and significant shareholders. To improve banking sector transparency, the NBG is publishing standardized forms about financial data of commercial banks in NBG's bulletin and sending them electronically to each bank. The NBG is planning to prepare the regulation on transparency of commercial banks, which will specify details on information subject to be disclosed regularly. Additionally, as agreed at the time of the second review we will require banks to publish their quarterly statements and to post them on the NBG's website to improve transparency. The NBG has already completed the consolidation of bank supervision department into a single structure, downsized it and introduced new management there. This process of consolidation and introduction of efficiency gaining measures will be extended to the rest of the NBG.

35. In order to strengthen the commercial banking sector and ensure that it is able to support future economic growth, we plan to enhance the bank supervision function at the NBG. Further, we will prepare a Banking System Development Strategy for 2006-2009 by end-March 2006 (structural benchmark for end-March 2006). At the same time, the NBG will continue closing or merging all commercial banks that do not comply fully with prudential requirements. Additionally, we have submitted legislation to parliament that will eliminate restrictions on the percent of total shares in a commercial bank that can be owned by an individual or legal entity (structural benchmark for end-March 2006). In effect, this will allow an individual or legal entity to own 100 percent of a commercial bank.

36. Following the recent on-site inspection of one Georgia's larger commercial banks, the NBG concluded that the bank should be either liquidated or sold. In order to avoid a broad loss of confidence in the banking system the NBG, working in collaboration with the government, introduced an interim management to the commercial bank and arranged for the sale of the bank to the most competitive bid from a sound local commercial bank. Furthermore, the buyer requested a short-term credit line from the NBG as a contingency measure. If this credit line is activated, the injection of this additional liquidity into the system may complicate the implementation of the monetary policy. The NBG will, however, use its monetary policy tools (including short-term CDs) to help mop up any excessive liquidity.

37. Further, the NBG will fully implement the recommendations of the 2004 Safeguards Assessment Report of the IMF's Finance Department, particularly by formally documenting all its internal control processes, including key operating policies and procedures. Moreover, an FSAP update mission visited Tbilisi recently to study some of the important issues, including the recent surge in the private sector credit, pertaining to the financial stability.

Structural Reforms

38. The government recognizes the importance of an aggressive structural reform program as a means of fostering growth and international competitiveness. Of particular importance is the need to improve the business environment and strengthen the protection of property rights.

39. An important element of this reform was parliament's approval in June 2005 of a new law on Licensing and Permits. This law greatly simplified the regulatory environment for enterprises, not least by reducing the number of licenses and permits from more than 950 to 150. We are currently in the process of implementing this new regulatory framework, which will require amending dozens of individual laws. We are also preparing a new system of government supervision of food and medicine. The proposed legislation will be prepared in parallel with the restructuring of the Ministry of Agriculture. We are also preparing

legislation aimed at establishing a system of self-regulation for professional activities/fields. The initial draft on the accounting and auditing fields is already developed.

40. During 2006, the energy sector rehabilitation will be continued. In 2004 quasi-fiscal deficit of the sector amounted to 4 ½ percent of GDP (caused mainly by low collection rates, non-payment of electricity consumed in Abkhazia, and energy theft), financed partially by transfers from the government, but mostly through debt and the run-down of the stock of capital. We are committed to rehabilitating energy sector facilities so that electricity can be supplied 24 hours per day to all paying customers. For these purposes, the 2006 budget has appropriated more than GEL 247 million, about 1.9 percent of GDP, to investment in the energy sector. We project that the quasi-fiscal deficit for 2005 was about 4 percent of GDP and will be reduced further in 2006.

Program Monitoring

41. Completion of the fourth review under the PRGF arrangement, scheduled for mid-June 2006, will require observance of the structural performance criteria for end-March 2006 shown in Table 1 and the quantitative performance criteria in Table 2, while the end-June structural criterion and end-September quantitative performance criteria will apply to the fifth review, currently scheduled for mid-December 2006. The review will focus on progress in resolving arrears and progress toward developing a system of financial monitoring for LEPLs. It will also take stock of ongoing and planned steps to add momentum to structural reforms, especially in the areas of energy, public sector operations, the business climate, and trade liberalization.

Table 1. Georgia: Structural Performance Criteria (*) and Structural Benchmarks, 2005–06

Measure	Timing
Upgrade the *Fit and Proper* criteria for bank owners and managers to international standards, by submitting revisions to commercial banking law and related decrees.	End-December 2005
Complete the transition to a treasury single account for central government expenditures and revenues. (*) (MEFP, para 31)	End-December 2005
Complete electronic re-registration of existing taxpayers and registration of new taxpayers.	End-December 2005
Introduce a targeted poverty benefit to replace numerous in-kind benefits.	End-December 2005
Publish a strategy paper on pension reform to put the social security system on a sounder fiscal footing.	End-December 2005
Submit to parliament amendments to existing legislation that would prohibit government borrowing from the NBG under any circumstances. (*) (MEFP, paras 23 and 32)	End-March 2006
Submit legislation to parliament that will eliminate restrictions on the percent of total shares in a commercial bank that can be owned by an individual or legal entity. (MEFP, para 35)	End-March 2006
Establish and populate a database of all central government LEPLs. (*) (MEFP, para 29)	End-March 2006
Prepare a Banking System Development Strategy for 2006-2009. (MEFP, para 35)	End-March 2006
Prepare a detailed strategy for securitizing government debt to the NBG with the aim of providing additional tools of monetary policy and improving the operation of financial markets in Georgia. (MEFP, para 33)	End-March 2006
Introduce a poverty alleviation program targeted on households living in extreme poverty. (*) (MEFP, para 25)	End-June 2006

Table 2. Georgia: Quantitative Performance Criteria and Indicative Targets, 2006 1/ 2/

	Stocks End-Dec. 2005	Mar.	June	Sep.	Dec.
	Actuals	Performance Criteria	Indicative Targets	Performance Criteria	Indicative Targets
			(In millions of lari)		
1. Quantitative targets					
Ceiling on cash deficit of the general government	...	34.7	65.4	138.2	345.6
Ceiling on net credit of the banking system to the general govt. (NCG)	633.1	0.0	-17.7	-50.7	37.0
Ceiling on reserve money	1001.5	42.9	70.8	157.4	250.4
			(In millions of U.S. dollars)		
Floor on total net international reserves (NIR) of the NBG	186.5	1.8	40.2	118.7	151.6
Ceiling on contracting or guaranteeing of					
A. Nonconcessional medium- and long-term external debt	0.0	20.0	20.0	20.0	20.0
B. Short-term external debt (less than one year)	0.0	0.0	0.0	0.0	0.0
Ceiling on accumulation of external arrears	0.0	0.0	0.0	0.0	0.0
			(In millions of lari)		
2. Indicative target					
Ceiling on net domestic assets (NDA) of the NBG	656.3	39.5	-3.5	-62.2	-30.1

Sources: Georgian authorities; and staff estimates.

1/ Section 1 of this table shows quantitative targets for 2006; for stock variables, they are based on cumulative changes from end-December 2005 projections. The indicative target is shown in Section 2. The continuous performance criterion for external arrears is defined in paragraph 21 of the July 2005 TMU.

2/ Quantitative targets for 2006 are based on accounting exchange rates of GEL 1.85/US$, US$1.46/SDR, and US$1.21/EUR.

Statement by IMF Staff Representative
March 31, 2006

1. The following information has become available since the issuance of the staff report. These developments do not the change the thrust of the staff appraisal.

2. Estimated real GDP growth for 2005 has been revised upward to 9.3 percent, reflecting both a stronger than expected 2005 performance and a modest downward revision of 2004 GDP. Inflation in the twelve months that ended in February fell further to 5.1 percent of GDP.

3. The authorities appear to be on track to meet the indicative quantitative targets and performance criteria for end-March. Fiscal and monetary performance through end-February was well in line with program targets.

4. A Memorandum of Understanding between the Ministry of Finance and National Bank of Georgia has been signed. The agreement includes a securitization schedule for the non-marketable government debt held by the NBG, thereby creating more instruments of monetary policy. In addition, legislation to eliminate commercial bank ownership restrictions was passed by parliament, and amendments to prohibit government borrowing from the NBG were submitted to parliament.

5. The authorities' trade liberalization strategy is being discussed in parliament. However, the three-year plan reported in the staff report has faced objections. As a result, the authorities now plan to pass the trade reform in three stages. In the first stage, the highest tariff rate of 30 percent would be reduced to 12 percent, and the number of import tariff bands would be reduced from sixteen to three (at 0, 5 and 12 percent), as had been discussed in EBS/06/40.

6. The authorities are making good progress toward establishing and populating the LEPL database, and appear to be on track to meet the related end-March structural performance criterion.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 06/42
FOR IMMEDIATE RELEASE
April 19, 2006

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2005 Article IV Consultation with Georgia

On March 31, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Georgia.[1]

Background

The breakup of the Soviet Union brought a steep fall in living standards in Georgia, among the worst for any transition country. Following a period of hyperinflation in the mid-1990s, the Georgian authorities had some success in stabilizing the political and economic situation, only to experience a temporary setback during the Russian crisis. Economic growth started to pick up in 2000, but fiscal performance was poor, resulting in insufficient spending on priority items and the build-up of domestic arrears.

Georgia's economy has performed well over the last two years, and the fiscal turnaround has been impressive. Since the change in government in late 2003, Georgia has demonstrated strong fiscal performance and a renewed commitment to press ahead with structural reforms, including the privatization of state-owned enterprises and further legal, fiscal, and financial reforms. Prudent macroeconomic policies have resulted in robust growth rates of about 7 percent on average in 2004–05, and average CPI inflation of about 7 percent over the same period. Significantly improved fiscal revenues have allowed for many spending initiatives to be undertaken while maintaining fiscal stability. The new government has also shown its resolve

---

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

to combat corruption, including by reorganizing parts of the public sector and by prosecuting corrupt high-ranking officials of the previous government. More recently, the government has focused on creating a business-friendly environment, including by reducing the administrative hurdles to economic activity.

Strong fiscal performance over the last two years enabled a significant increase in government spending. In 2005, the Georgian authorities implemented a comprehensive tax reform, simplifying and streamlining major taxes, eliminating nuisance taxes, and lowering most tax rates. Nonetheless, tax collections rose from 14.5 percent of GDP in 2003 to an estimated 19.8 percent of GDP in 2005, resulting in a cash deficit that was substantially lower than budgeted in the last two years. At the same time, the government eliminated a large part of the outstanding domestic arrears. The Georgian authorities have started a process of fiscal decentralization by devolving some fiscal responsibilities to local bodies.

Over the past two years, monetary developments have been characterized by high reserve money growth, continued remonetization of the economy, and, more recently, a credit boom. After a period of lax monetary policy in late 2004, the National Bank of Georgia (NBG) stepped up its efforts to contain the monetary expansion, in line with its target for inflation. Underexecution of the budget has also contributed to the slowdown of reserve money growth due to higher-than-expected government deposits at the central bank. Interest rates on treasury bills have continued to decrease since the political turmoil in late 2003, but no treasury bills have been issued since mid-2005 in light of the government's limited financing needs. Available data indicate that the banking system remains strong.

In 2004, the lari appreciated by 12 percent against the U.S. dollar. This appreciation resulted in a substantial improvement of Georgia's external debt situation. Excluding imports related to two pipelines, the current account deficit increased somewhat as a share of GDP over the past two years, reflecting stronger aid inflows and related imports. Gross international reserves have slowly increased to 2.1 months of nonpipeline imports at end-2005.

The authorities submitted a Poverty Reduction Strategy Paper (PRSP) progress report to the Executive Boards of the Fund and the World Bank in March 2005. Although the availability of data is scarce, it appears that there has been limited progress toward reducing poverty.

Executive Board Assessment

Executive Directors broadly agreed with the thrust of the staff appraisal. They commended the authorities for their impressive progress over the last two years, including in maintaining macroeconomic stability, turning around the fiscal position, and combating pervasive corruption. Directors welcomed the authorities' efforts to push ahead with further structural reforms, which will improve public sector operations and the business environment and foster private sector development, so as to put the economy on a path to sustained growth.

Directors supported the authorities' economic program for 2006, which—based on sound macroeconomic policies—aims at bolstering growth and keeping inflation at single-digit rates, while carrying forward the structural reform agenda. In this context, they noted the need for further progress on reducing widespread poverty.

Directors endorsed the authorities' plans to increase public spending in priority areas, based on their assurances that fiscal sustainability will be maintained. They welcomed the introduction of a medium-term expenditure framework, which should help to improve fiscal planning and expenditure control. Directors cautioned that the authorities' intentions to decentralize fiscal responsibilities may lead to a weakening of fiscal transparency, and stressed the need to monitor closely the Legal Entities of Public Law (LEPLs) in a transparent way, and to ensure their full accountability. Against the backdrop of continued high poverty, Directors encouraged the authorities to strengthen the social safety nets, including by introducing the targeted poverty benefit as planned.

Directors welcomed the gains from the far-reaching tax reform enacted by the authorities in 2005, while encouraging them to continue strengthening tax administration. They regretted that the authorities cleared fewer domestic arrears than foreseen under the program, but noted the authorities' commitment to eliminate the remaining stock of outstanding verified claims by the end of 2006. Directors urged the government to resist additional spending pressures that may arise ahead of local elections in the fall.

Directors viewed the current stance of monetary policy as appropriate, and welcomed the vigorous efforts by the National Bank of Georgia (NBG) to contain inflation. At the same time, they observed that a stronger fiscal position contributes to new challenges in the conduct of macroeconomic policy, which will require enhanced coordination efforts between the fiscal and monetary authorities. They noted that the extremely small treasury bill market makes effective liquidity management more challenging. In this context, they welcomed the recent memorandum of understanding between the NBG and the ministry of finance on securitizing some of the outstanding nontradable debt held by the NBG, which will provide the central bank with much-needed monetary policy instruments. They encouraged the authorities to strengthen the autonomy of the central bank.

Directors observed that the improved economic outlook for Georgia and strong capital inflows could put some appreciation pressures on the exchange rate. They agreed that the authorities should monitor developments closely, and endorsed the authorities' commitment to a floating regime, with foreign exchange interventions limited to smoothing temporary and extreme fluctuations.

Directors commended the authorities for their continued efforts to strengthen the financial system. They noted that strong credit growth requires robust banking supervision practices to avoid the pitfalls associated with a credit boom. In this context, Directors looked forward to discussing the ongoing Financial Sector Assessment Program (FSAP). Update in the context of the next review. Going forward, Directors welcomed the NBG's strategy to attract international interest in the Georgian financial sector and to consolidate the banking sector and foster competition.

Directors welcomed the substantial progress achieved in fighting corruption, improving governance and transparency, and enhancing the business climate. They endorsed the authorities' structural reform agenda, which is geared toward removing bottlenecks in infrastructure and energy, and they recommended strengthening legal institutions to further entrench the principles of good governance and foster the enforcement of creditor and property rights. Directors stressed the importance of moving ahead with the privatization agenda. They welcomed the planned liberalization of the trade regime as a bold step toward strengthening Georgia's competitiveness.

Directors broadly agreed with the findings of the recent debt sustainability analysis, noting that the appreciation of the national currency in 2004 and the government's repayment efforts have eased the debt burden considerably. Directors welcomed the bilateral agreements reached in the wake of the July 2004 Paris Club debt rescheduling, and urged the authorities to finalize as soon as possible the outstanding agreements with Paris Club and other bilateral creditors on comparable terms.

Directors noted that the provision of data by the authorities is adequate for surveillance and program monitoring purposes, but encouraged the authorities to further strengthen the statistical database, with technical assistance from the Fund, particularly in the compilation of national accounts, balance of payments, and fiscal statistics.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Georgia: Selected Economic and Financial Indicators, 2002–05

	2002	2003	2004	2005 1/
(Percentage change relative to previous year, unless otherwise indicated)				
National income and prices				
GDP at constant prices	5.5	11.1	5.9	9.3
Consumer price index, end-of-period	5.4	7.0	7.5	6.2
Money and credit (end-of-period)				
Reserve money	18.4	13.9	44.3	19.7
Broad money (including foreign exch. deposits)	17.9	22.8	42.6	26.4
(In percent of GDP, unless otherwise indicated)				
Public Finance				
Total revenue and grants	15.8	16.2	21.7	23.4
Tax revenue	14.4	14.5	18.2	19.8
Total expenditure and net lending	17.8	18.7	18.6	24.9
Fiscal balance, commitment basis	-2.0	-2.5	3.1	-1.5
Fiscal balance, cash basis	-1.9	-1.3	-0.2	-2.4
External sector				
Trade balance	-12.9	-15.0	-13.8	-14.1
Current account balance (excl. pipeline imports)	-5.5	-2.8	-3.5	-4.1
External debt	51.7	46.3	35.8	27.1
Gross international reserves in months of imports 2/	1.1	1.5	2.0	2.1
Exchange rate				
Exchange rate, lari/U.S. dollar, period average	2.20	2.15	1.92	1.81

Sources: Georgian authorities; and Fund staff estimates.

1/ Preliminary estimates for some variables.

2/ Gross international reserves are calculated based on imports of goods and services, excluding pipeline-related import.

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 06/68
FOR IMMEDIATE RELEASE
March 31, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Third Review of Georgia's PRGF Arrangement and Approves US$20.2 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) completed today the third review of Georgia's performance under the three-year program supported by the Poverty Reduction and Growth Facility (PRGF). In completing the review, the Board approved the authorities' request for waivers for the nonobservance of the end-September 2005 quantitative performance criterion on the clearance of domestic expenditures arrears and the end-September 2005 structural performance criterion on the submission to the parliament of a new customs code.

The Executive Board approved the PRGF arrangement on June 4, 2004 (see Press Release No. 04/107) for an amount equivalent to SDR 98 million (about US$141.2 million). Completion of the third review will enable Georgia to draw SDR 14 million (about US$20.2 million), bringing total disbursements under the arrangement to SDR 56 million (about US$80.7 million).

Following the Executive Board discussion of Georgia's economic performance, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, said:

"Georgia's economy continues to perform well, bolstered by a further improvement in the fiscal position and monetary policy geared at controlling inflation. The new administration continues to demonstrate strong ownership of the program supported under the Poverty Reduction and Growth Facility and has pushed ahead with structural reforms. Against the backdrop of the tax reform that took effect in January 2005, the Georgian authorities have further strengthened their revenue position, which enabled higher spending on priority items without endangering fiscal sustainability. More focused spending has also contributed to a slowly improving poverty situation.

"The government has advanced its structural reform agenda, including by upgrading revenue administration, promoting transparency in government operations, and facilitating private sector activities. Further progress is needed, however, to safeguard fiscal sustainability and transparency, enhance growth prospects, and encourage additional private sector investment, including from abroad.

"The thrust of the authorities' economic program for 2006 is to continue economic growth and poverty reduction while maintaining macroeconomic stability and keeping inflation at single-digit rates. Public spending priorities for 2006 will focus on shielding the poor from adverse economic conditions and on improving the environment for private investment, including by upgrading infrastructure and providing more reliable energy supply.

"Going forward, higher government spending against the backdrop of sizable capital inflows will require enhanced coordination between the fiscal and monetary authorities. The authorities should continue to aim at strengthening the capacity of the National Bank of Georgia to effectively manage liquidity fluctuations," Mr. Kato said.

Statement by Yuri Yakusha, Alternate Executive Director for Georgia and Elvira Eurlings, Advisor to Executive Director
March 31, 2006

Economic developments

Georgia's macroeconomic performance in 2005 was impressive. Recent calculations show that real GDP grew by 9.3 percent, reflecting a significant improvement over 2004 when growth was about 6 percent. The 2005 growth rate has been broad-based with double-digit growth in several sectors like construction, communications, financial intermediation and agriculture. This broad-based growth is a crucial element of the authorities' policy to expand job opportunities and reduce poverty. At the same time, sound and coordinated monetary and fiscal policies kept inflation under control. Real growth of GDP in 2006 is projected to be 6.5 to 7.5 percent and end-period inflation for 2006 is estimated to stabilize around 5-6 percent. Moreover, last December, Georgia received its first international credit rating. Standard and Poor's Rating Service assigned a 'B+' long term and 'B' short-term sovereign credit rating with a positive outlook, emphasizing the 'authorities' strong political commitment to prudent financial policies and market-oriented structural reforms.'

The cooperation between the Georgian authorities and the Fund has been fruitful. The authorities are pleased that all but two end-September performance criteria in the program supported by the Poverty Reduction and Growth Facility have been met, in most cases even with wide margins, in particular in the fiscal field.

Fiscal policy

In 2005, the authorities continued their impressive fiscal consolidation policy. Efforts to strengthen tax administration, crack down on corruption, smuggling and tax evasion and contain expenditures resulted in a general government deficit of 2.4 percent of GDP, well below the budgeted 4.8 percent. The impressive fiscal performance was specifically underpinned by continuous strong revenue collection, in particular by a reorganized and streamlined customs department, where subsequently collected revenues increased by 66 percent compared with 2004. More in general, despite the reduction in tax rates and the number of taxes as part of the liberalization of the Tax Code, tax revenues in 2005 still rose to 19.7 percent of GDP, which is a 26.4 percent increase compared with 2004. For 2006, expansion of the tax base and improvements in tax administration will continue. The 2006 budget prudently projects tax revenues of 19.3 percent of GDP, leading to an overall fiscal deficit of 2.6 percent of GDP (cash basis), financed by privatization proceeds. Part of the revenue collection will be derived from the gains of the new Customs Code in terms of more simplified procedures, which is expected to take effect this year.

Improved revenue collection will allow the government to increase expenditures in several key areas, for example in the social area. Total allocations for social spending will increase compared to last year and are now budgeted at 8.6 percent of GDP. A priority in the authorities' social policy agenda is the eradication of extreme poverty. To this end, the authorities increased the minimum pensions and they will introduce a targeted poverty benefit program in June this year. As of now, already 300 thousand statements were submitted from people eligible for social assistance by the government. Ways will also be explored to make the poverty program instrumental for compensating low-income households for the higher gas tariffs. The authorities are also in the process of drafting their PRSP progress report, which is expected to be completed by end-September this year. The structural performance criterion on preparing a medium-term expenditure framework (MTEF) was met.

In the area of fiscal transparency and accountability, significant progress has been made. In particular, in early 2004, several quasi-fiscal funds were established outside the government to meet critical expenditure requirements in the aftermath of the Rose Revolution. Now, after two years when the need for these separate funds has subsided, the authorities decided that, in order to enhance budget transparency and avoid any off-budget spending, these funds would cease their operations on January 1 this year and would be liquidated by the end of March. One remaining fund will be converted into an NGO and will be privately financed and controlled.

Privatization is an important component of the economic reform process in Georgia, and will continue to play a distinctive role in the economic development of the country going forward. The authorities will continue to aim at carrying out privatizations in a transparent manner with an emphasis on enterprises in the energy distribution, power generation and communication sectors.

Prudent fiscal policies also contributed to containing the current account deficit. Moreover, recent preliminary data show that export growth actually increased compared to last year while import growth has been slower. For 2006, the current account deficit is projected to stabilize around 7 percent of GDP.

Monetary policy and financial sector reform

Sound monetary management has continued to underpin macroeconomic stability, aiming for low inflation as the primary objective, while maintaining a flexible exchange rate regime. Despite concerns in early 2005 about significant foreign currency inflows, the appreciation of the lari has been modest and smooth (the lari appreciated by 3 percent in real effective terms). Consumer price inflation in 2005 equaled 6.2 percent which is well below the expectation of 7 percent and the 2004 level of 7.5 percent. The target on arrears clearance was missed given the authorities' concerns over the possible inflationary consequences of making these payments at the end of last year. At the same time, the process of verifying claimed arrears continued and this year, the authorities are strongly committed - as laid down in the Memorandum of Economic and Financial Policies - to complete the evaluation of all arrears claimed as of end-2005 and clear all those that are verified by the end of 2006.
For 2006, the NBG will continue to carefully manage liquidity and is fully committed to the objective of maintaining single-digit inflation around 5-6 percent. Gross foreign reserves will increase to about 2.3 month of non-pipeline imports.

As highlighted by staff, the banking sector has performed well in 2005 and credit to the private sector grew by 83 percent, albeit from a very low level. Nonetheless, Georgia's level of monetization remains below 20 percent of GDP, resulting in a much lower credit to the private sector than seen in most other transition economies. Moreover, as stated in the interesting Selected Issues paper, the expansion of credit in the banking sector is accompanied by longer maturities, lower lending rates and de-dollarization. Some of the factors contributing to the rapid credit expansion have been the increased confidence in future prospects for the country, legalization of businesses that started in 2004 and continued in 2005, increased banking competition and improved access to relatively low-cost credit. At the same time, the National Bank of Georgia (NBG) is committing equal efforts to guide this substantial credit expansion in a prudent manner by strengthening its supervisory activities. Draft legislation concerning the introduction of a deposit insurance system is ready and the process of imposing increased minimum capital requirement has been brought forward and is now expected to be implemented in July next year. Moreover, work is continuing to increase transparency and consolidation of the overall financial sector and ease the entrance of foreign banks.

Furthermore, the NBG is committed to stimulate the development of financial markets, foster financial sector stability and strengthen the independence of the NBG, as reflected in its upcoming Banking Sector Development Strategy. In addition, the NBG together with the government reached agreement on an overall reform package to streamline NBG's balance sheet and operations and strengthen the NBG's ability to conduct monetary policy by increasing the NBG's portfolio of marketable securities, including the total amount of government debt held by the NBG. An FSAP update mission has visited Georgia recently and the authorities are in the process of studying the staff's recommendations.

Structural reforms

The World Bank recently ranked Georgia among the top global reformers in the CIS region. According to the Doing Business study, reforms in Georgia have made it easier to start a business, have cut the number of activities that require licenses from 950 to 150, eased the cost of separating redundant workers and cut the time and cost to register property. At the same time, there are still areas that need attention, such as further simplifying tax collection and enhancing investors' protection.

Furthermore, after an extensive consultation process, the authorities submitted ambitious legislation to parliament concerning their trade policy. When adopted, the new tariff regime will be considerably liberalized, by moving from 16 bands to 3 and reducing the maximum tariff from 30 percent to 12 percent for 2006. Further consultations to ultimately eliminate tariffs altogether will continue going forward. The implementation of the new trade regime will dramatically enhance the prospects for trade, investment and economic growth. In addition, the European Union and Georgia are enhancing their cooperation through the EU/Georgia Action Plan, which will encourage and support Georgia's objective of further economic integration.

The end-September structural performance criterion concerning the parliamentary submission of the Customs Code faced some delay due to the need to ensure extensive and satisfactory consultations with the private sector on provisions of the proposed law. The Customs Code was nonetheless submitted to the parliament in October and passage is expected soon.

As highlighted by staff, the authorities chose - in the context of improving government services - to convert some budgetary organizations into Legal Entities of Public Law (LEPLs). In this way, reforms could be implemented in a more straightforward manner, while the LEPL Management would still ensure that activities were performed according to existing standards. Although the authorities believe this reform will promote more efficiency and therefore constitutes the way forward, they do recognize some potential risks associated with this reform, such as a weakening of monitoring and reporting practices. Therefore, as recommended by staff, the authorities are finalizing a database of all LEPLs through which effective financial monitoring of LEPL activities can be facilitated. In addition, operational guidelines are being prepared concerning financial management and reporting requirements which will be completed by end-June 2006. Moreover, the authorities will continue to study international best practices.

The authorities are also committed to rehabilitate energy sector facilities so that electricity can be supplied 24 hours per day to all paying customers. For these purposes, the 2006 budget has appropriated more than 1.9 percent of GDP to investment in the energy sector. Furthermore, parliament adopted in December last year legislation that would assure compliance of Georgian legislation on provisional measures and confiscation of property with the provisions of the Strasbourg Convention.

The authorities request a waiver for nonobservance of the two performance criteria for end-September 2005 and subsequently request completion of the third review under the PRGF. This will signal to the international and business communities that Georgia is well on track with its ambitious reform agenda. In closing, we would, on behalf of the authorities, like to once again thank staff and management for their dedicated work and policy advice to Georgia.