Georgia: Continued Reverberations of the Crisis

By Revaz Sakevarishvili, Tbilisi

Abstract

The economic situation in Georgia is continuing to deteriorate. GDP shrunk 3.9% in 2009. Most importantly, foreign investment has dropped off considerably. Foreign loans have replaced this investment, but such assistance is likely to run out by the end of the year. At the same time many domestic projects are on hold due to a lack of capital, foreign remittances are dropping as a result of the on-going international crisis and the Georgian currency is losing value.

Georgia's Economy is Shrinking

Few people trust official statistics in Georgia since they are either too optimistic or designed to fit the wishes of the government. But even official statistics cannot hide trends in Georgia during the last few years driven by the 2008 War and the global financial crisis.

According to Georgia's official statistics agency, SakStat, Gross Domestic Product dropped 3.9% in 2009 to 17.9 billion GEL (9.7 billion USD); GDP per capita fell to 4,092 GEL (2,200 USD) (for comparison: in 2008 GDP was 19.7 billion GEL and GDP per capita was 4,353 GEL). The main concern is not just the falling GDP, but the fact that while Georgia is moving toward liberalism and deregulation, the state still makes up the largest share of the economy—public administration comprises 16% of the economy, surpassing industry (15%), trade (14%), transport and communication (12%) and agriculture (10%).

In 2009, when Georgia started spending the 4.5 billion USD mobilized by the Donor Conference in Brussels, the state was the biggest player in economy. As events evolved, state spending was supposed to increase the size of the economy by 4%. The current budget and investment statistics point exactly to that.

Foreign Investments Are Crucial

In 2009, the government had to cut the state budget twice—first by 500 million GEL and then by 120 million GEL, bringing it down to 7.18 billion GEL overall. As for the 2010 budget, planners determined that is would be 6.76 billion GEL, 440 million GEL less than the 2009 budget. In other words, the budget of Georgia rapidly dropped by more than 1 billion GEL from its previous size. No less important is the fact that in 2010 the state budget has one unique characteristic: every fourth lari to be spent—25% of the budget—comes from foreign loans. The Georgian government is trying to expand the country's GDP through foreign borrowing. It is simple arithmetic: in 2007, at the peak of investment activities, foreign investments in Georgia comprised 2 billion USD. In 2008, this figure fell to 1.56 billion GEL, and in 2009 it dropped even more—to 760 million GEL.

Currently the billions accumulated at the Brussels Conference compensate for the lack of investments. However, though this support continues through the end of this year, there is nothing to replace it.

Due to its small size, Georgia will never become an economy that can survive based on the consumption of its domestic market. On the other hand, Georgia does not have sufficient exportable resources enabling it to take a leading economic position on the global stage. Consequently, foreign investments are critically important for Georgia, since they can ensure its sustainable development.

The significant growth the Georgian economy achieved in 2004—2008 was mainly the result of foreign investments. At that time, they reflected a growing trend: in 2005, 450 million USD were invested into Georgia, in 2006—1.19 billion USD and in 2007, 2.14 billion USD. The 12% increase achieved in 2007, ensuring a high rating for Georgia, was the result of efforts provided by the private businesses which sustained these investments. While current increases are ensured by the big infrastructure projects sponsored by the state, most of these projects are financed from resources obtained through foreign loans. Without new money to replace the funds collected at the donor conference, failure for the Georgian economy is inevitable.

Few Sources of Local Capital

There are numerous difficulties facing efforts to increase locally generated resources. The crisis is continuing in several market segments. One example is illustrative: The Revenue Service of the Ministry of Finances drew up payment agreements (basically debt restructuring plans) with more than 50 companies in the first five months of 2010, with a total value exceeding 10 million GEL.

According to the Revenue Service, the number of applications from companies is constantly increasing and by mid-June 2010, approximately 600 companies had expressed a desire to restructure their debts. This practice became possible following the amendment made to the Tax Code on 21 December 2009, which promised entrepreneurs with debts greater than 10,000 GEL, the possibility to restructure their debt rather than the need for bankruptcy. Now several companies are applying to the Ministry of Finances each day with a request to use this scheme. Investors are also applying to the state asking it to defer their debt obligations.

Tax-Free Industrial Zones Not Developing

As many companies are struggling with debt, the government has had little success in launching tax-free industrial zones. In the most recent setback, the presentation of the Poti tax-free industrial zone was delayed. The operator of this industrial zone, "RAK Georgia Holding," did not explain the delay, but it most likely was the result of the overall economic conditions.

Currently, Tbilcement is the only Georgian company operating in the Poti zone. According to the government, 22 Georgian companies should construct new enterprises in the zone. Additionally, the South Korean company LG—a leader in the production of the consumer electronics—is expected to open a plant there.

Overall, of the six planned industrial zones, only the one in Kutaisi is operating, though with shortcomings. The fortune of Kutaisi's second industrial zone, to be constructed by the Chinese company Hungly Industry remains uncertain. The Israeli company Terra—1 has not yet started construction on the Tbilisi zone. Construction should have started in autumn 2009, but definitive plans are not yet in place. The situation is the same with the Rustavi industrial zone. An Estonian business group bought the territory of the former Chimbochko factory for its construction in 2007, though again no actual work has begun. The construction of one more industrial zone was planned in Khelvachauri, but the government of Ajara never found an investor interested in developing it.

Projects on Hold

The crisis is also visible in projects started and frozen in Tbilisi years ago. The construction of the five star Inter Continental Hotel in Tbilisi has been terminated due to a lack of necessary investment. The construction of the Hyatt is also frozen and the management has not specified a resumption date. It should be finished this year, though the financial crisis halted construction. Additionally, the total cost of the project was cut from 150 million USD to just 70 million USD. All these projects should have been implemented by direct foreign investment, but now there is little hope in this regard.

Official statistics continue to reveal alarming trends. The volume of investments made in the first quarter of 2010 was the smallest in the last five quarters. According to SakStat, in January–March 2010, compared to same period of 2009, the volume of investments made in Georgia fell about 42% and comprised just 76 million USD, while in the first quarter of 2009 this figure reached 130 million USD. If we compare the data from the first quarter of this year with the previous quarter, the decrease is even larger—exceeding 70%. The volume of investments comprised 254 million USD in the fourth quarter of 2009.

Investment Falls Short of Expectations

Given the relative success of the fourth quarter 2009—254 million USD—the Georgian government expected investments of at least of the same volume this year, ultimately totaling 1 billion USD annually. Unfortunately, actual investment comprised just 7% of what was anticipated in the first quarter of this year.

The countries investing in Georgia have changed radically from previous years. According to the data from the first quarter of 2010, the biggest investor in the country is Turkey, with investments making up 26.8% of the total. Previously, Turkey had invested 30.3 million USD in Georgia, a relatively low figure for this country. According to the volume of investments, the Czech Republic occupies second place with investments of 18.8 million USD, which is 26.1% of the total investments made in the first quarter. Third is Egypt with 18 million USD—23.8%, then comes Japan with 20.7%, followed by a variety of other countries with minor investments. It is obvious that the leaders of the previous years—the United Arab Emirates, Holland, Great Britain, Cyprus, Denmark, China, Kazakhstan and Azerbaijan are no longer active.

The slumping investor interest caused the government to trim back its privatization plan. This plan has been steadily decreasing for several months already. According to the changes made to the 2010 budget, the government cut the privatization plan from 210 to 170 million USD. In the first quarter, income from privatization was 21 million; accordingly it is hard to say that the plan will be implemented when just 10% was carried out in the first quarter. The privatization plan results for 2009 were also terrible: the Ministry of Economy managed to collect just 30 million GEL out of the planned 70 million.

Size of Remittances Shrinking

The amount of money sent home by Georgian workers abroad has been dropping. The volume of money transfers from abroad fell from 74.4 million USD in April 2010 to 71.1 million USD in May 2010. Clearly, processes taking place in international markets are impacting the domestic situation in Georgia, reflecting the greater integration of Georgia's economic and labor resources in the world economy.

For example, the recent crisis in Greece has had a serious impact on the welfare of a significant part of the Georgian population. Greece is one of the leaders in the list of countries in which the share of Georgian labor migrants is high. This flow had been increasing until recently. There are no statistical data regarding legal or illegal labor migrants traveling to Greece, however, according to informal statistics, the number of Georgian migrants in Greece might be 100,000—150,000.

Thanks to the economic crisis, the condition of the Georgian labor migrants in Greece has become much more difficult. Many enterprises are being closed and people are losing jobs, including many Georgians. Even the salaries of those who continue to work, especially women employed as cleaners or nurses, are falling by as much as 50%.

All these problems are directly reflected in the money flows coming to Georgia from Greece and threatening the financial welfare of many families in Georgia who depend on this income. The money transfers from Greece comprise more than 7% of the total transfers from abroad and rank third behind flows from Russia and the US. Most likely, Greece's position will drop significantly due to its deepening crisis.

Georgian Currency Weakening

This series of negative external and internal events has inevitably weakened the value of the Georgian currency. The lari has declined steadily from the beginning of the year to the middle of June, depreciating 10% against the dollar during the last five months. The Monetary Policy Committee increased the interest rate from 5% to 6.25% in the middle of June. The 5% rate had been in effect since 25 November 2009; before that, starting in July 2008 it had been steadily decreasing and gradually was reduced to 5% from 12%. Now, the 5% rate that had been in effect for 6.5 months has started to rise significantly. The Monetary Policy Committee made the abovementioned decision at an extraordinary meeting held earlier than planned. The Committee members acted in order to prevent high levels of inflation. In May 2010 the annual inflation indicator was 4%. Committee members feared that inflation would jump to 6% unless they took action.

In June, the annual increase of the money aggregate M3 exceeded 40%. The government says that the increase of the money supply resulted from the fiscal stimulus of the economy, on one hand, and the flow of credits into the economy, increased from the beginning of this year, on the other. Much of this spending resulted from political efforts prior to the elections. The risks of inflation rise when the increase in the money mass starts to outpace economic growth.

According to the preliminary data, the commodity trade deficit deepened in May, like in March and April, which was the result of domestic demand. The deepening trade deficit, lower-than-expected capital inflows in the first part of the year and the appreciation of the dollar on the world market caused the depreciation of the Georgian lari against the dollar.

Taking into consideration the factors mentioned above and in order to keep inflation within the targeted level in the midterm period, the Monetary Policy Committee of the World Bank decided to adopt a stricter policy toward Georgia. This decision is yet another indicator of the worsening economic situation in the country.

About the Author

Revaz Sakevarishvili is a director of the Econometer analytical center, author & anchor of Capital TV show on Imedi TV, and economics analyst of Radio Free Europe/Radio Liberty.