REGIONAL ECONOMIES

THE ECONOMY OF "ROSE" GEORGIA: FLOWERING OR FADING?

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In the days of the Soviet Union, Georgia was one of the most flourishing Soviet republics due to its protected tea and wine market and its attractive Black Sea resorts. The breakup of the U.S.S.R., the opening by the FSU republics of their borders to broad imports following the "parade of sovereignties," and wars within the country led to a sharp decline in Georgia's economic indicators, but in recent years the situation has begun to improve (see Table 1).

Nevertheless, living standards in Georgia remain low. Official unemployment is around 13% of the working age population.[1] But independent experts believe[2] that from 2003 to the beginning of 2005 unemployment rose by 20% to around 47% of the working age population.[3] Most large industrial enterprises remain at a standstill or operate at less than full capacity.

During the years of independence, over 1 million people[4]—the most employable and active part of the population—have left the country. A significant proportion of Georgia's population subsists, for the most part, on remittances from relatives working abroad. Experts estimate the annual amount of remittances from Georgian "guest workers" living in Russia alone at $1-2 billion. According to an IMF analytical report on the economic prospects of the

[1] See: [http://www.statistics.ge], 20 November, 2006.

[2] See: [http://www.materik.ru/index.php?country=5], 20 November, 2006.

[3] Official unemployment statistics do not include people living in rural areas or city dwellers in possession of garden plots.

[4] See: [http://www.businessuchet.ru/content/download.asp?r=1D66DA02-51E8-4208-BCB0-1EC670DC3083], 20 November, 2006.

Table 1

Main Indicators

	2008 (P)	2007 (P)	2006 (P)	2005 (E)	2004	2003	2002
Income per capita, US$	2,353	2,020	1,681	1,480	1,134	813	730
Nominal GDP, billion lari	17.1	15.3	13.3	12.1	9.9	8.0	7.4
Nominal GDP, US$ billion	10.3	8.9	7.5	6.7	5.2	3.7	3.4
GDP per capita, US$ thousand	2.4	2.0	1.7	1.5	1.1	0.8	0.7
Real GDP growth, %	4.7	7.1	6.2	8.7	6.2	11.1	5.5
Real GDP growth per capita, %	5.7	8.2	7.3	9.7	6.9	11.8	6.3
Total public debt, % of GDP	32.1	33.2	35.5	37.1	44.7	62.1	62.3
Real investment, % change	7.2	6.1	8.7	14.1	31.9	21.3	6.7
Real exports, % change	7.9	11.3	14.0	13.0	3.8	21.1	25.5
Unemployment (average number of people applying for benefits), %	16.5	16.3	15.7	14.7	12.6	11.5	12.6
Consumer price index (average), % change	6.0	6.0	6.0	6.0	5.7	4.7	6.7

Note: P—projection, E—estimate.

Source: Standard & Poor's [http://www.sandp.ru/article.php?pubid=2350&sec=cr].

Middle East and Central Asia, remittances from abroad in 2005 accounted for over 5% of Georgian GDP.[5] The country's Minister of State Kakha Bendukidze estimates this amount at 4% of GDP.

In the opinion of analysts, the business environment in Georgia is not conducive to a reduction or elimination of existing investment risks, while the political situation impedes socioeconomic development. Thus, although small and medium enterprises make up 97% of all active companies, their share of Georgia's GNP is only around 10% (compared to 60% in EU countries).

[5] See: [http://www.ruvr.ru/main.php?lng=rus&q=10702], 20 November, 2006.

The government has taken some steps to improve the country's regulation and auditing systems: health inspectors no longer "cruise" around cafes and restaurants, and it is possible to start a business even without prior registration. Nevertheless, international standards are still a long way off, which is why small business is mostly concentrated in trade.

Budget Revenue Sources

In the period since the Rose Revolution, the state budget has almost quadrupled from $500 million to $1.8 billion. At the same time, this can hardly be qualified as a real success, because the increase in budget revenues is mostly due to "one-off" factors: privatization of large state-owned enterprises, confiscation of financial resources from a number of local "oligarchs," and foreign infusions.

It should be noted that as soon as Mikhail Saakashvili came to power, he put the "large-scale privatization" program on the list of priorities. According to official data,[6] in 2005 privatization contributed over 446 million lari (about $250 million) to the country's budget,[7] and this makes up, according to estimates by the IMF mission, 3.5% of GDP. The state has sold such large facilities as the Georgia Shipping Company ($93 million), Georgian Telecom ($5 million), the Rustavi Steel Factory ($27 million) and JSC Madneuli, the country's only copper concentrate plant ($35.1 million). Overall, more than 1.5 thousand enterprises have been privatized in the republic, so that today very few large facilities remain in the hands of the Georgian state (perhaps only the postal service, long-distance gas pipeline, railroad and Inguri Hydroelectric Power Station on the border with Abkhazia).

According to the projections of Georgian experts, privatization may continue until the end of 2008, whereupon the bulk of the country's economy will be controlled by private (mostly foreign) capital and the budget will be deprived of privatization revenue.

As regards the second source of revenue, for local "oligarchs" the authorities have introduced a practice known as "voluntary payment of ransom" for release from prison. Oligarchs jailed without "excessive" legal procedure are released only when their ill-gotten millions are returned to the treasury. Clearly, such actions have nothing to do with legality, but evoke public sympathy. For example, Gia Jokhtaberidze (son-in-law of ousted Shevardnadze) paid $15 million for his release. Similarly, the seized funds and property of Aslan Abashidze (ex-leader of Ajaria who fled the country) and of his followers have gone into the budget as well.

After Abashidze's flight from Batumi, the state confiscated his property, estimated at $100 million. According to Roman Gotsiridze, President of the National Bank of Georgia, "the country's budget was doubled at a stroke. Where did this money come from? Aslan Abashidze profited from trade with Turkey: $50 million went into the personal budget of this biggest feudal lord."[8] Today these funds go into the state treasury, but this move has won Saakashvili many influential enemies.

Georgia has become "addicted" to foreign aid. When Saakashvili took office, foreign infusions[9] multiplied 2.5 times, from $48 million in 2003 to $124 million in 2004. In 2005, Georgia

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[6] See: [http://www.statistics.ge], 20 November, 2006.

[7] Significant revenues from privatization have helped to reduce Georgia's net external debt. According to the Georgian Ministry of Finance, the total amount of external public debt ($1.68 billion) and sovereign credit as of 31 August, 2005, was $1.77 billion (or 3.16 billion lari).

[8] See: *Vedomosti*, 23 October, 2006.

[9] Ibidem.

received some $138 million from the U.S. government alone (about 14% of total budget revenue).[10] In 2006, according to preliminary IMF estimates, foreign "donations" to Georgia were expected to reach $174 million. But this assistance does not seem to benefit the country, as is evident from the current state of its economy. Let us recall in this context that under the Marshall Plan postwar Germany received only $1.3 billion. Of course, the dollar at that time was more "weighty," but then Georgia is no larger than Bavaria (except for the fathomless pockets of the local elite).

Another source of budget revenue (up to 47%) is transit freight (in contrast to the sources listed above, this is a relatively stable source). Thus, during the seven-year operation of the Baku-Supsa oil pipeline used to supply Azerbaijani oil to world markets, a total of 330 tankers have sailed from the Black Sea port of Supsa, bringing over $30 million into the Georgian budget in the form of oil transit fees. When the Baku-Tbilisi-Ceyhan pipeline comes into operation, Georgia will be getting over $50 million per year for oil transit. In addition, at the end of 2006 it was planned to start supplying natural gas by the South Caucasus Pipeline. Over the next few years, the amount of gas received by Georgia through this pipeline will increase from 200 million to 800 million cubic meters (mcm); of these, transit fees will constitute 300 mcm, and the Georgian government will be able to purchase the remaining 500 mcm at reduced prices.

It should be noted that these pipelines can be profitable only given full capacity utilization. For the oil pipeline, the figure is 50 million tonnes per year, and for the gas pipeline, over 6 billion cubic meters. Azerbaijan's current potential obviously falls short of these figures. In 2005, the republic exported 13 million tonnes of oil, while its gas supplies to the foreign market were insignificant. Consequently, both these pipelines will probably have to be connected to supply sources in Central Asian countries.

Statistics and Reality

An assessment of the current state of the Georgian economy suggests a pessimistic conclusion: neither Georgia's accession to the WTO nor the Rose Revolution have radically changed the situation. Economic activity in Georgia is mostly concentrated in the service sector (especially financial services), which accounts for 57% of GDP, in agriculture (cultivation of grapes, citrus fruit and tea)—21% of GDP, in mining (manganese and copper) and the food industry (alcoholic and nonalcoholic drinks)—23%. Accordingly, the export structure is dominated by citrus fruit, tea, wine, scrap metal, manganese ore, ferrous and nonferrous alloys, reexported fuel, and mineral water. Imports include natural gas, electricity, oil products, flour, grain, machinery and equipment.

This structure has resulted in a trade deficit, which has been growing every year (see Table 2). Thus, in 2005 Georgian exports totaled $0.87 billion, and imports, $2.46 billion.[11] But in the first half of 2006 the trade deficit already reached $1.58 billion, swelling by 82.2% from the same period of 2005.[12] Exports grew by 26%, whereas imports jumped about 61%.[13] The republic's export losses only from the Russian ban on imports of Georgian wine and mineral water are estimated at $35-40 million.[14] Nevertheless, the Russian Federation remains one of Georgia's major trading partners.

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[10] See: [http://www.materik.ru/index.php?country=5], 20 November, 2006.

[11] See: [http://www.wn.ru/finance/news/07.02.2006/2.html].

[12] See: [http://www.izvestia.ru/news/news116774/?print], 20 November, 2006.

[13] See: *Transition Report 2006*, *EBRD*, available at [http://www.ebrd.com/pubs/econo/6813r.pdf], 20 November, 2006].

[14] See: *Spirtnye napitki i pivo*, No. 30, 19 October, 2006.

Table 2

Macroeconomic Indicators

	2000	2001	2002	2003	2004	2005 (E)	2006 (P)
GDP, real % change	1.9	4.7	5.5	11.1	6.2	9.3	7.5
Share of industry in GDP, %	17.3	16.6	17.6	17.7	16.1	15.6	—
Share of agriculture in GDP, %	20.2	20.7	19.3	19.3	16.4	14.8	—
Privatization proceeds, cumulative total, % of GDP	23.0	23.1	23.3	23.6	34.5	38.1	—
Trade balance, US$ million	–398	–486	–439	–598	–719	–907	–1,048
Net FDI, US$ million	153	80	122	335	503	415	390
External debt, US$ million	1,582	1,712	1,858	1,954	2,039	2,137	—
Unemployment, % of labor force	10.4	10.3	11.9	10.7	12.5	13.8	—
Average monthly wage before taxes and deductions, % change	7.1	30.8	20.5	10.4	19.9	22.5	—
Consumer prices at year-end, % change	4.6	3.4	5.6	7.0	7.5	6.4	8.0
Public spending, % of GDP	19.2	18.3	17.8	18.7	19.5	24.9	—

Note: P—projection, E—estimate.

Source: *Transition Report 2006, EBRD* [http://www.ebrd.com/pubs/econo/6813r.pdf].

In the first six months of 2006,[15] trade between the two countries totaled $324.1 million, up 45% from the first sixth months of 2005. In this period, Georgian exports to Russia fell by 14.6%, whereas imports from Russia increased by 68.5%. In the first half of 2006, trade with Russia amounted to 15.8% of Georgia's total foreign trade turnover (down 0.7% from a year ago).

Georgia's other major trading partners include Turkey, Ukraine, Azerbaijan, Germany, Britain and the United States.[16] According to the Georgian Statistics Department, the trade turnover between

[15] See: [http://www.izvestia.ru/news/news116774/?print], 20 November, 2006.
[16] See: [http://russian.people.com.cn/31519/3408935.html], 20 November, 2006.

Georgia and Turkey in 2006 was $243.8 million.[17] The fact that Turkey is a key trading partner is not surprising. Now that Ankara has finally granted Georgia GSP-plus status under the General System of Preferences, this enables Turkish companies to produce some 7,000 goods items in Georgia with subsequent duty-free importation into Turkey.

So, the country makes a living from exports of raw materials and agricultural products, as well as imports of "foreign-made" goods. In July 2006, it adopted a new Customs Code, which reduced the number of commodity groups subject to import tariffs to a total of three. Customs duties will no longer be levied on machines and mechanisms, Georgia's main import items. At the same time, imports of agricultural products and building materials will be subject to a maximum duty of 12%.[18]

Given the current wage level,[19] consumer demand cannot be expected to increase in the next few years. Living standards remain low. Over half of the population is living below the poverty line,[20] and this is understandable. Wage rises are closely connected with mass layoffs, and the National Poverty Reduction Program, approved in Washington by the World Bank and the IMF and carried out with difficulty by the former authorities, has been shelved by the present government. The project is said to be outdated, but no one has expressed any desire to bring it up to date.

The budget deficit is another persistent problem. In 2004, it amounted to $133 million. Under the Georgian Law on the State Budget for 2006, budget revenues are projected at $1.7 billion, and expenditures, at $1.8 billion, with the deficit to be covered out of the funds provided under U.S. programs (in terms of U.S. aid per capita, Georgia is second only to Israel).

The country's economy depends to a significant extent on the volume of agricultural production, but its agroindustrial complex, which provides employment for half of Georgia's working age population, is going through a difficult period. Only a small part of the former collective-farm lands has passed into the ownership of the farmers, in addition to the private subsidiary plots that were already in their possession. In spite of this land shortage, private farms account on average for over 90% of total agricultural output, including 80% for grapes and cereals, 94% for fruits and vegetables, and 95% for meat and milk. The Georgian mass media, too, speak of a critical situation in agriculture, where the real decline in production in the first quarter of 2006 compared to the same period of the previous year was 8.3%.[21]

In the opinion of experts,[22] if the Russian market is closed to Georgian wine and local producers are unable to enter new markets, the demand for grapes will fall sharply, and this will be a blow to thousands of farmers in Kakheti, which has 60% of Georgia's vineyards.

The authorities and foreign investors have expressed a particular interest in privatizing the most profitable energy facilities, the Batumi and Poti ports, etc., whereas agricultural facilities—vineyards, tea and tangerine plantations—are of little interest both to the authorities and to foreign investors, because there is no reliable market for such products. Clearly, Russia alone can become such a market for Georgia, but for the current Georgian leaders everything depends on global geopolitics, which, in Tbilisi's view, dictate a confrontation with Moscow.

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[17] See: [http://www.168.am/ru/articles/2259-pr], 20 November, 2006.

[18] See: *Transition Report 2006, EBRD.*

[19] According to the Georgian State Statistics Department, the official average wage at year-end 2004 was 140 lari (about $78) per month. In the agricultural sector, hotel and restaurant business, education and health care, the respective figures were 53 lari ($30), 65 lari ($36), 75 lari ($42) and 83 lari ($46) per month. The average pension was 28 lari ($15). By comparison (January 2005 data), the price of meat was $3-3.5 per kg, cheese, $3-4.2 per kg, and gasoline, $0.8 per liter. The country has 900 thousand pensioners; the number of people working under oral or written contracts is around 600 thousand, i.e., there are more than two dependents per person.

[20] See: [http://www.businessuchet.ru/content/download.asp?r=1D66DA02-51E8-4208-BCB0-1EC670DC3083], 20 November, 2006.

[21] See: *Akhali taoba*, 28 June, 2006.

[22] See: [http://www.civil.ge/rus/print.php?id=10626], 20 November, 2006.

The weakest point of the Georgian economy is a shortage of energy, especially natural gas, whose share in the country's energy balance is about 24% (Georgian gas consumption is close to 4.7 mcm per day in summer and about 7 mcm in winter). Cuts in gas supplies to consumers are a permanent feature of Georgian life, which is due to unsettled debt owed to supplier companies. Frequent accidents at electric power stations cause power outages now in western, now in eastern Georgia. Nevertheless, the collection rate for electricity charges has been raised from 12% in 2003 to 78% at the end of 2005.[23]

Georgia's socioeconomic problems are compounded by a high degree of corruption. Based on the results of 2005, a Transparency International report has ranked Georgia among the most corrupt countries in the world (130th place on a list of 160 states). And this despite the fact that according to a World Bank report published in July 2006 ("Anti-Corruption in Transition 3"), in 2002-2005 the level of corruption in Georgia fell most significantly compared to other transition economy countries.[24] IMF experts believe that today some 3% of corporate earnings are used to bribe officials. According to EBRD data, this percentage is twice as high as in Russia. The influential German newspaper *Frankfurter Rundschau* regards the widely advertised anticorruption campaign merely as a "smokescreen" for the ongoing redistribution of property in favor of the new ruling elite.

A negative influence on the situation in the country is also exerted by its growing militarization. Since the change of government, the budget of the Georgian Defense Ministry has multiplied (doubling in 2004 compared to 2003, and quadrupling in 2005 compared to 2004) and has exceeded 3% of GDP,[25] reaching the highest level among the CIS states. In the structure of 2006 state budget expenditures, defense spending makes up 18% of the total and is the top expenditure item.[26] In 2003-2005, the United States alone spent $70 million on training Georgian military personnel and on arms supplies.

Such an excessive increase in military spending, which outruns real economic growth and makes a huge dent in Georgia's more than modest budget, suggests that the republic's leaders may have a desire to resolve many problems by force of arms. In fact, a thirst for revenge can even justify a much heavier military burden: it has long been known that a short victorious war is the best way to distract the people's attention from current socioeconomic problems. Consequently, an improvement of the people's socioeconomic position remains outside the interests and priorities of the new Georgian leaders.

Can Tourism Drive the Economy?

The Georgian government hopes that tourism, which has fallen into decay because of domestic instability in the republic, will once again become a driving force behind the country's economy. Today tourists are gradually returning to Georgia's once-popular resorts, and investors are beginning to buy up Soviet-period hotels in order to turn them into modern five-star hotels.

Of course, Georgia's Black Sea coast is an excellent "lure" for attracting investors and tourists, but there are many obstacles to the implementation of such projects. Thousands of refugees who have found shelter in Ajarian hotels after the suspension of the Georgian-Abkhaz conflict are a big problem. Compensation in the amount of $7,000 can hardly induce them to leave their hotel rooms. For example, the Medea Hotel is located in one of Batumi's most expensive areas: close to a boulevard

[23] See: *Transition Report 2006, EBRD.*

[24] In October 2006, the World Bank approved a $20 million loan to Georgia for fighting corruption and improving the investment climate.

[25] See: [http://www.kavkaz-uzel.ru/newstext/news/id/1058048.html], 20 November, 2006.

[26] Ibidem.

overlooking the sea. This place has already been chosen as a site for the construction of a Radisson hotel. The problem is that some of the refugees have no intention of leaving the Medea.

Ajaria faces the same problems as the whole of Georgia: unemployment, visa regime, and Russian import restrictions on agricultural products, which means that Ajarian producers have virtually no market for their output, leaving it to rot. If the conflict drags on, this could worsen the situation still further, and although Georgian President Saakashvili declared in 2005 that by 2007 Ajaria's Black Sea coast would become a resort of global importance, many are skeptical about this. Even U.S. Ambassador to Georgia Richard Miles takes a very skeptical view of the prospects for the development of tourism. As he put it, tourism will provide a basis for the new Georgian economy, but it cannot be developed to the full extent as long as the breakaway provinces problem remains unresolved.

Investors from Distant Countries…

Investment in the Georgian economy is of great importance for its further development. Thus, Firebird Management LLC, a New York hedge fund specializing in FSU countries, has acquired a 14% stake in the Bank of Georgia, the second largest commercial bank in the country. A Swiss-American company has bought the presidential complex for renovation. In 2004, such transactions generated $438 million of direct investment, a figure which, according to IMF data, was five times higher than in 2001.

In 2005, foreign direct investment in the Georgian economy was around $447.8 million (10% less than in 2004),[27] making up 61% of GDP.[28] But most of the total (over 70%) was investment by British Petroleum (BP) in the construction of the Baku-Tbilisi-Ceyhan oil pipeline and the South Caucasus gas pipeline through Georgian territory. Their completion will lead to a significant reduction in FDI. Thus, in 2004 BP investment totaled $359.7 million, whereas in 2005 it was only $264.5 million.[29]

The Swiss company Wissol Petroleum has recently acquired 50% of the shares of CanArgo Standard Oil, with the remaining 50% held by Georgian private individuals. The company, which has 33 gasoline stations in all regions of Georgia, plans to expand this network in the near future (two new gasoline stations are to be opened in Tbilisi, and another five in different parts of the country). Gasoline is to be imported from European refineries.

According to the EBRD,[30] 243 companies have been privatized since August 2005, and another 137 are up for sale. In May 2006, Greenoak, a group of Dutch companies which already owns the Batumi oil terminal, won a contract ($92 million) for the lease and operation of the Batumi Seaport for a term of 49 years.

At the same time, there are examples "to the contrary" as well. In particular, KLM Royal Dutch Airlines has decided to wind down its business in Georgia, giving the low level of income as the reason for closing its representative office. Based on business analysis for 2005, KLM has decided that its income in Georgia falls short of what it expected two years ago. The last Amsterdam-Tbilisi-Amsterdam flight was performed by KLM on 23 March, 2006.

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[27] See: [http://www.finmarket.ru/z/nws/news.asp?id=472558], 20 November, 2006.
[28] See: [http://www.sandp.ru/article.php?pubid=2350&sec=cr], 20 November, 2006.
[29] See: [http://www.finmarket.ru/z/nws/news.asp?id=472558], 20 November, 2006.
[30] See: *Transition Report 2006, EBRD.*

The Austrian Schinhoffer concern, which planned to build a plant for the production of high-quality sausage, has also left the country. In addition to providing at least 1,500 jobs, this plant would have enabled local farmers to supply for processing vast amounts of meat. In the opinion of experts, this caused concern both among importers of Brazilian and Indian meat and among local sausage makers, whose products could not compete with Austrian quality. As a result, Georgian officials began to work against the Austrians (whose sausage was conveniently found to contain harmful substances) and the investor said "auf Wiedersehen."

In June 2005, Russia's mining and smelting group Evrazholding decided not to acquire the state-owned manganese mine (JSC Chiatura Manganese) or the Vartsikhe Hydropower System, for which it had already paid $20 million (the whole complex was evaluated at $132 million). The findings of the Russian company's experts that the assets to be acquired were unprofitable and could not generate income were given as the official reason for this decision.[31] In the opinion of Vladimer Papava, former Georgian economics minister and now member of parliament, this was a case of sheer fraud: "I do not know whether the Russians were deceived or not, but I will say one thing: as a minister, I saw for myself that both these facilities were unprofitable and that no serious investor would have bought them."[32]

Nevertheless, for 2006 the Georgian Statistics Department projected an almost two-fold increase in FDI inflows into the country's economy. It was expected that BP investment would total $195 million; investment by TAV-Urban Georgia LLC in the construction of a new building for the Tbilisi International Airport, $65 million; investment in the construction of the Kulevi Oil Terminal, $45 million; investment from Kazakhstan, around $100 million; and investment by the new mobile phone operator Bloomfin Ltd, around $90 million. At least $185 million is to come from privatization, including $50 million from the sale of the state-owned stake in JSC United Telecommunications Company and $115 million from the sale of energy facilities. The total volume of other investments is projected at $20 million, and reinvestments, at $40 million. Overall, the figure could reach $740 million.[33] It should be noted that FDI in Georgia (see Table 2) is in no way comparable even to Kazakhstan, where FDI inflows in 2004 were close to $4 billion, to say nothing of Russia.

…and from Nearby Countries

Kazakhstan is becoming one of the biggest investors in Georgia, focusing on energy, tourism and construction. Whereas in 2003 trade between the two countries barely reached $10 million, today it exceeds $60 million, while investment in the Georgian economy in the first five months of 2006 reached $300 million. If the current investment trend continues, the amount of Kazakh investment in 2006 could exceed $1 billion.

Kazakhstan's private businesses and state companies are both active in the republic. The main infusions into the Georgian economy are made by a financial-industrial group which includes the TuranAlem Bank[34] with its own representative office in Tbilisi and by the national company KazMunaiGaz (which makes its investments in cooperation with Russia's Gazprom).

[31] See: [http://www.vz.ru/economy/2006/11/12/56777.html], 20 November, 2006.

[32] In the fall of 2006, Britain's Stemcor UK Ltd acquired the assets of JSC Chiatura Manganese for $14.15 million and a 40-year license for manganese production for $5.5 million.

[33] See: [http://www.finmarket.ru/z/nws/news.asp?id=472558], 20 November, 2006.

[34] As of 1 June, 2005, TuranAlem's assets totaled $5.3 billion, and its equity capital, $578 million. Its shareholders are the European Bank for Reconstruction and Development (EBRD), Reiffeisen Zentralbank (RZB), International Finance Corporation (IFC), German Investment and Development Company (DEG), and Netherlands Development Finance Company (FMO). The rating assigned to the Bank by Standard & Poor's (BB-) is the highest among financial institutions in the CIS.

The former plans to build a refinery in Georgia with a capacity of 5 million tonnes of crude oil per year. The implementation of this project will require $350 million of investment, and this money will come not only from Kazakhstan, but also from a number of Western banks. The financial-industrial group has also acquired (for $90 million) the country's largest telecom company, Georgian Electrical Communications; in addition, it wants to buy about 20 tourist facilities in Ajaria. The Kazakh side plans to invest up to $200 million in Ajarian tourist projects over the next few years.[35]

The national company KazMunaiGaz is also involved in the tourist business: it has bought the well-known Likani-Borjomi health resort complex together with the land parcel for $10 million. The State Food Corporation, the leading operator in Kazakhstan's grain market (with some 40% of the country's annual wheat exports), has also shown an interest in Georgia. As part of its project to create a route to the Black Sea that would provide an alternative to congested Russian and Ukrainian ports, next year it plans to build new terminals in the Georgian port of Poti.

Active cooperation in underway on gas projects as well, and this is only natural: "gas cooperation" is of political as well as economic importance for both Georgia and Kazakhstan because it reduces their dependence on Russia. One example here is the acquisition by state-owned KazTransGaz (in May 2006) of JSC Tbilgazi, a bankrupt Tbilisi gas distribution company (now limited liability company KazTransGazTbilisi). Having paid $12.5 million for this company, KazTransGaz is planning not only to invest over $82 million in the gas distribution network of the Georgian capital (which, according to Georgian specialists, "is in a catastrophic state"), but also to achieve breakeven performance within two years.[36]

However, in order to create effective demand in the Georgian market and to make business profitable, the Kazakhstan company, given the low living standards of a vast majority of the local population, will have to address a number of macroeconomic problems, if not to boost the whole Georgian economy. This is undoubtedly a noble and long-term task which can produce good economic results in the future, but it is clearly beyond the power of KazTransGaz. That is why it is obviously premature to say that the Georgian "gas game" is worth the candle (especially considering Gazprom's desire to double the price of gas supplies). The main thing is that state-owned KazTransGaz should be aware of the large social component in the gas business. High (by Georgian standards) gas tariffs can lead to conflicts with Georgian consumers.

Kazakhstan's assurances that this is a purely commercial transaction are open to doubt. As KazTransGaz General Director Serik Sultangaliev said back in December 2005, the decision to invest in JSC Tbilgazi was taken on the direct instructions of Kazakhstan President Nursultan Nazarbaev. Moreover, he admitted that economically speaking this project was "not entirely attractive" and emphasized that "the Kazakh side intends to provide assistance to the brotherly Georgian people." So, by extending a helping hand to post-Rose Revolution Georgia, Kazakhstan is trying to pull it out of the "gas noose."

In Lieu of a Conclusion

According to experts,[37] GDP growth in Georgia will probably peak in 2006-2007 (at 7.0-8.0%), and when the main investments in oil and gas pipelines are completed it will go down to about 4.5% per year. In an attempt to attract investors, Mikhail Saakashvili has simplified the tax code, privatized state-owned corporations and invited Western-educated technocrats to work in government. In partic-

[35] See: [http://www.rosinvest.com/news/163460/].
[36] See: *Invest-Kazakhstan*, No. 3, 2006, p. 39.
[37] See: [http://www.sandp.ru/article.php?pubid=2350&sec=cr], 20 November, 2006.

ular, the tax reform was accompanied by a tax amnesty: all tax offenses committed prior to 2004 were forgiven. The reform was quite effective:[38] government tax revenues rose from 14.5% of GDP in 2003 to 18.2% in 2004 and 19.8% in 2005. In nominal terms, Georgia's GDP in 2005 exceeded 11 billion lari compared to under 10 billion lari in 2004.

Nevertheless, there is growing inflationary pressure on the economy due to high oil prices, rising public expenditures, and foreign capital inflows. According to EBRD data,[39] in July 2006 inflation reached 14.5%, significantly exceeding the 6% benchmark of the National Bank of Georgia. Such inflationary pressure is fraught with grave danger, and the task of curbing inflation should be high on the government's agenda.

The illusion that the victory of the Rose Revolution can lead to rapid economic growth in Georgia is being dispelled. Public disappointment is associated with the fact that living standards remain low. Moreover, recent research shows that they have dropped by 40% even compared to the Shevardnadze period; the economy is in a slump, and territorial conflicts remain unresolved.[40]

The present regime takes the credit—and not without reason—for raising wages and pensions, and also for the practical elimination of government arrears on these payments. Nevertheless, this cannot "turn around" the critical situation, because the main social problems—unemployment and inflation—have not been resolved, while wage rises are closely connected with mass redundancies. What is more, the state has virtually abandoned its efforts to regulate labor relations: the law that regulates them is the contract between employer and employee.

The promises made to the people by the country's "rose" leaders are falling like the petals of fading roses. And this is quite understandable: the management team has been replaced, but the rules of the game have remained the same. In effect, the Georgian economy is still subsidized (as noted above, the republic is second in the world in terms of per capita aid provided under U.S. programs of assistance to foreign states). The World Bank has ranked Georgia as the country with the highest absolute poverty level in the region.

Many of the enterprises inherited from the Soviet Union are unlikely to be restarted ever again. The situation in agriculture remains grave, because old markets have been lost and it is necessary to change the sector's entire structure so as to adapt it to new markets, a process that will take time and money. In these conditions, it will be very difficult to curb inflation.

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[38] See: *Vedomosti*, 23 October, 2006.

[39] See: *Transition Report 2006, EBRD.*

[40] See: *Parlamentskaia gazeta*, 28 September, 2005.