Georgia's Foreign Debt and Sustainable Development

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1. Background Information

According to the data of the Finance Ministry of Georgia, the foreign debt of Georgia is USD 4,206 billion as of 2011 with USD 3,015 billion making a share of international financial institutions. The diagram below gives the dynamics of Georgia's foreign debt for 1996-2011.

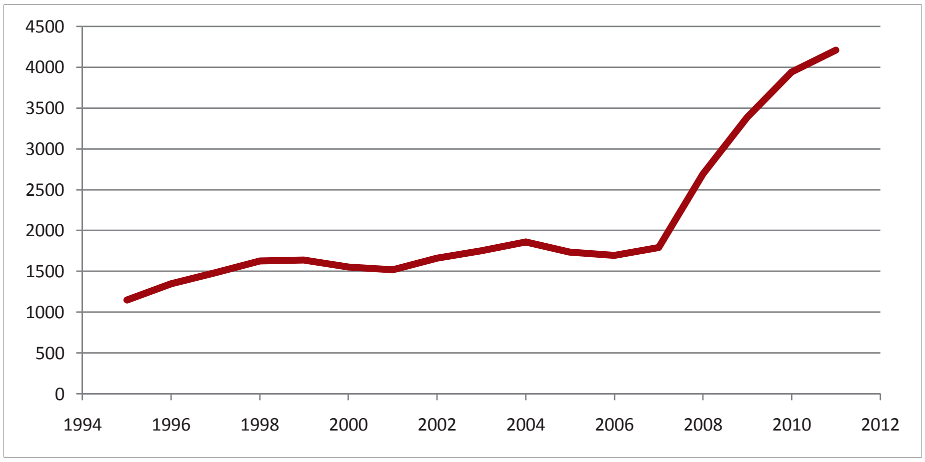

Diagram 1. Dynamics of foreign debt of Georgia for 1996-2011

As shown in the diagram, Georgia's foreign debt has increased sharply since 1996 after the Government of Georgia started taking of debts intensively from the International Monetary Fund and the World Bank. As seen from the table, during past 15 years the country's foreign debt increased approximately four times[1]. Simultaneously, if in 1996 foreign debt amounted to 44% of GDP, by the end of 2010 its amount decreased to approximately 33,8% of GDP[2] that is only 40% of the entire foreign debt.

The diagram also shows sharp growth of foreign debt starting from 2008 that can be explained by the economic and financial policy of the Georgian government, as well as by the consequences of the 2008 August war[3].

In August 2008 the Joint Needs Assessment Document was prepared under the aegis of the World Bank and the UN Development Programme (with the participation of Asian Development Bank, European Bank for Reconstruction and Development, European Investment Bank and the European Commission). The document defined the needs for rendering financial assistance to Georgia. The key goal of the document was to submit a plan of recovery from the consequences of the August hostilities. The document was prepared solely by the international financial institutions and the government. On October 22, 2008 the document was submitted to the donor conference in Brussels, where the

1 www.mof.gov.ge

2 However, according to expert explanations, the debt to export ratio is still grave. Last year Georgia's export amounted to only USD 1,6 billion.

3 The International community responded both political, as well as socio – economic problems of Georgia, after Russian military incursion into Georgia in August 2008 through increased international assistance and cooperation.

international financial institutions and donor countries pledged to allocate USD 4.5 billion (grant/credit) to support Georgia's financing needs for post-conflict recovery. The table below gives the distribution of financial aid allocated by the international financial institutions after 2008 by sectors.

Sector	Credit Mln USD	Grant Mln USD
Road infrastructure	761	
Municipal infrastructure (water, landfills)	357.5	13.98
Railway	138	12,4
Energy infrastructure	465	176
Agriculture		13.3
Environment protection		6,9
Total	1721.7	223

Table 1. The financial aid allocated after 2008 by sectors

2. Social, Environmental and Sustainable Development-Related Aspects of Infrastructural Projects

A great part of financial aid allocated to Georgia was earmarked for the implementation of infrastructure (road and energy) projects. According to the government and the donors, similar projects should promote the economic development and growth, as well as the employment and settlement of social problems. The table below gives the list of infrastructure projects implemented in Georgia during 2008-2011 with the support of international financial institutions.

Donor[4]	**Project name**	**Project cost**	
		Credit (mln USD)	Grant
World Bank	Vaziani-Gombori-Telavi Highway Project	30	
	East-West Highway Improvement Project Second disbursement	20	
	East-West Highway Improvement Project Third disbursement	147	
	Rikoti Tunnel Rehabilitation Project	28	
	Municipal Development Facilitation (MDF)	40	
	Local Roads Project	70	
	Regional and Municipal Infrastructure	45	
ADB	Municipal Development Facilitation (MDF)	37	

[4] ADB – Asian Development Bank, EBRD – European Bank for Reconstruction and Development, EIB – European Investment Bank, BP- British Petroleum, JICA – Japanese International Cooperation Agency, KfW – German Reconstruction Bank, MDF – Municipal Development Fund NIF – Neighborhood Investment Facility, SIDA – Swedish International Development Agency, USAID – US Agency for International Development, WB – World Bank.

	Kobuleti Bypass Road Project	119	
	Batumi Bypass Road Project	150	
	Sustainable Urban Transport Investment Program I	85	
	Urban Service Improvement Program I	80	
JICA	Zestaponi-Kutaisi-Samtredia Highway Project	197	
EBRD-EIB	Enguri Rehabilitation Project, Third disbursement	55,2	6,9 - NIF
EBRD	Tbilisi Railway Bypass Project	138	12,42 NIF
EBRD	Rustavi Landfill Project	2,208	BP –3,7
EBRD	Adjara Landfill Project	4,1	SIDA– 7,4
EBRD	Borjomi Water Supply Project	2	2.5
KfW	Batumi Water Project	62,1	2,76
KfW, EBRD, EIB, NIF	Black Sea Transmission Line Project	372,52	45,87
USAID	Energy Infrastructure Development Project	30	124

Table 2. Infrastructure projects implemented in Georgia during 2008-2011 with the support of international financial institutions - distribution by donors

A great part of the projects given in the table are either implemented or remain at the stage of implementation. However, it is already possible to state at this point that they have failed to provide economic development and growth, to catalyze foreign direct investments, to increase employment as well as to promote the settlement of social problems persisting in the country. In some cases these projects have even created the basis for violation of economic and social rights of Georgian citizens. Tbilisi Railway Bypass Project and Vaziani-Gombori-Telavi Road Project can serve as the examples of what kind of environmental, social and economic problems may emerge as a result of inadequate planning of investment projects.

Tbilisi Railway Bypass Project

In May 2010 the European Bank for Reconstruction and Development and the European Investment Bank approved an Euro 100 million credit each for the Georgian Railway Ltd (100% state-owned company) to implement the Tbilisi Railway Bypass Project.

The main goal of the project is to relocate transit of hazardous goods from the densely populated area outside the capital with the purpose of increasing the efficiency and safety of railway operations. According to the project, the reconstruction of abandoned territories will promote the development of the northern part of the capital. Although the general project goal – to increase the efficiency and safety of railway operations – is praiseworthy, the project is rather problematic from both environmental and social points of view.

The project envisages the construction of a new railway line in the densely populated Avchala district, thus posing a threat to the local population because of transiting hazardous freights (oil, oil products). Forceful resettlement was planned and implemented inadequately and incorrectly, as a result of which a part of the population suffered material and economic losses. Minimal distance of the new railway line from the Tbilisi Sea (900m) poses a threat to supplying water to the capital. Even in case of spilling half a tank, i.e. 30 thousand liters, about 50% of useful capacity of the reservoir will become useless that will leave the population of three districts of Tbilisi as well as about 20 thousand ha of agricultural lands of the Gardabani district without water.

The railway project does not envisage cleaning of the abandoned territory from hazardous waste; real expenses of cleaning the abandoned territory are not calculated either; thus, it becomes impossible to estimate the total economic cost of the project.

It should be noted that in September 2010 the Georgian government finally rejected the credit subsidized by the European Investment Bank. The management of the Georgian Railway said that in order to complete the Railway Bypass Project the company would use USD 250 million Eurobonds issued on July 22, 2010 (percentage rate 9,875% per coupon).

The project yielded no positive results. It failed to provide at least temporary employment opportunities – the railway is being constructed by the Georgian-Chinese company Khidmsheni and basically the Chinese manpower is used. As a result of poor environmental and social impact assessment and resettlement action plan hundreds of people experienced the involuntary resettlement (both physical and economic) without adequate compensation [5], that worsen their economic situation .

Vaziani-Gombori-Telavi Road Project

Vaziani-Gombori-Telavi Road Project, which was much highlighted by the Georgian Government, is yet another example of inadequate planning of infrastructure projects implemented with donor assistance.

According to the initial project submitted by the Motor Roads Department of Georgia, instead of rehabilitation of a 66 kilometer road, it should have been widened (the width of the motor road corridor was 20 meters, while the road bed – 10.5 meters). The project envisaged the construction of four new bridges with a total length of 348 meters. The project cost was USD 60 million.

Road widening would necessitate forceful resettlement of several families living near the roadside. At the same time, the project-proposed compensations were extremely scarce and unfair. Furthermore, road widening would also trigger the destruction of a part of forests and other ecosystems, as well as agricultural plots. The proposed project envisaged replacement of the asphalted road by concrete cover that would necessitate extraction of a great amount of inert materials from the river beds.

Furthermore, because of the difficult relief (the road passes through the Gombori Pass at a height of 1620 meters) and because of the fact that the road is running through the villages of Ujarma, Paldo, Otaraant Kari, Sasadilo, Gombori, Kobadze and Tetrtsklebi, the perspective of using the road as a highway for transiting various freights was rather doubtful. It should also be noted that the project documents did not provide the feasibility study about the necessity of road widening.

Vaziani-Gombori-Telavi Motor Road passes through geologically very difficult Gombori Pass, which falls under extremely high risk of geological disasters. Because of difficulty and depth of landslides, surface stabilization is actually impossible there. Thus, the wide road constructed through using expensive technologies would be damaged shortly after its construction because of landslides. In the opinion of civil society, it would be expedient to rehabilitate the road by using the simplest technologies to ensure that annual repairs, which would be unavoidable, cost inexpensive.

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[5] Green Alternative filed compliant to the EBRD's Project Compliant Mechanism and demanded investigation of the compliance of project standards with the Bank's performance standards. It also helped the project-affected communities to submit two complaints two bank. All three complaints are under consideration. EBRD carried out project internal audit to verify wheter the project is in line with the Bank's environmental and social standards. It should be noted that the Bank postponed allocation of the first disbursement to the Georgian Railway company.

The World Bank shared the opinions expressed by non-governmental organizations and financed the project worth USD 30 million envisaging the rehabilitation of the existing road and implementation of road safety measures on both Vaziani-Gombori-Telavi and Tbilisi-Gurjaani-Telavi motor roads.

Landslide on a problematic section of Vaziani-Gombori-Telavi road in 2011 showed once again how important it is to plan similar infrastructure projects adequately and to avoid exaggerated expectations.

Energy Projects

As far as the energy sector is concerned, the major efforts were directed to the development of energy infrastructure. Development of energy infrastructure is important for further development of the country and the construction of the Black Sea Transmission Line is a good example of long-term energetically profitable projects. However, neither the government, nor international financial institutions financed and supported large-scale energy efficiency projects (at both legislative and practical levels), the implementation and rate of return of which require comparatively short time and which are economically effective, since they are oriented to resource saving.

The Georgian Government and international financial institutions support the construction of new big hydro power plants (HPPs). Besides the fact that similar projects deepen social and environmental problems, giving due consideration to the current tax environment of Georgia, the effectiveness of their implementation for the state budget is extremely doubtful.

For example, the European Bank for Reconstruction and Development and the International Financial Corporation allocated a USD 115 million credit for the construction of a 87 megawatt Paravani HPP. The credit has not been allocated under the state guarantee, though money was allocated in frames of a pledge given by donors at the Brussels conference. The credit was given to Urban-Energy Georgia, a daughter company of Turkish Anadolu Group. Since the project is being implemented under the Build-Own-Operate scheme, the project revenue – USD 36.6 million – will be the property of the company and only the state taxes will be directed to the state budget [6]. According to the project, during winter the HPP should supply electricity to the Georgian market; however, it should be taken into consideration that during winter the Paravani River frequently freezes that makes the possibility of supplying electricity rather doubtful.

It should also be noted that water abstraction and discharges are exempted from any taxes in Georgia; it means that use of natural resources is free of charge and respectively, it occurs irrationally.

From environmental point of view, throwing of 90% of the Paravani River into the tunnel is rather problematic, since it will have a negative influence on the river biodiversity. At the same time, exploitation of Paravani HPP will pose a threat of flooding to the village of Khertvisi. In the process of construction of Paravani HPP-related transmission lines, the local population already lost access to rural pastures. According to the construction company, 60% of the hired employees will be local, though they will mainly perform unqualified work. According to the company, the Turkish manpower will be hired as technicians and engineers.

[6] Revenue tax at 12% will be transferred to the state budget; property tax at 1% - to the local budget.

3. Real Economy and Foreign Debt

The country's economic problems and foreign debt are closely interlinked. Without economic and social development it will be impossible to pay off foreign debts.

According to the Georgian statistics office, Geostat, 16% of Georgia's population is officially unemployed [7], while 55% of the employed population is working in the sphere of agriculture [8]. Simultaneously, according to the World Bank survey, 60% of poor population lives in rural areas[8]9. 1,7 million persons have been registered in the base of socially vulnerable people of the Social Service Agency that constitutes approximately 40% of the population [10].

It is essential to invest in real economy to overcome these problems. Foreign direct investments (FDI) significantly decreased during 2008-2011 that can be explained by the August war. Following the 2008 August war, in order to maintain the liquidity of the banking sector, a great part of international assistance (European Bank for Reconstruction and Development, International Finance Corporation) was placed in commercial banks. However, because of the existing business environment, commercial banks failed to invest these sums in real economy. In 2010 EBRD President Thomas Mirow said that Georgia suffers "lack of healthy companies" thus explaining low credit activity of commercial banks.

This problem is more properly described in the World Bank report:

"While there was widespread recognition of the improvement in the business environment in recent years, in terms of taxes, red-tape, corruption and so on, one area where investors continue to find fault with the government is in tax administration. Across sectors, there is a widespread perception that the tax authorities are overly aggressive in levying taxes and penalties on those companies that are doing their best to comply; and they are overly slow in processing appeals or reimbursing VAT [11]."

Although 60% of rural population stays below poverty line, out of the assistance pledged at the Brussels conference, only USD 13 million was earmarked for agricultural sphere. It should be noted that the situation is extremely difficult in agricultural sphere: from 2002 to 2009 the cultivated land area decreased by 43%; wheat production decreased from 199 000 tons to 80 000 tons. In 2010 the government spent less than 1% of the state budget on agrarian sector that is only GEL 53 million. Respectively, food supplies in the country mostly depend on imported products. This, in turn, has much aggravated poverty and inflationary processes in the country.
Theoretically, the mission of international financial institutions is to provide the economic, social and sustainable development of the country. At the same time, all international financial institutions recognize Millennium Development Goals [12]. In practice, as it seems, international financial institutions, as well as the Georgian Government, believe that the market will itself regulate everything and will provide the economic and social development of the country.

Just this is where the root of the problem is hidden – the Government does not have a long-term, consistent model of coherent economic development of the country. Such model should cover real problems – unemployment, poverty, negative trade balance and reflect all aspects of the country's economic development. It should not be tied to the expectations that the development of any one sector (tourism,

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[7] www.Geostat.ge

[8] They are categorized as self-employed.

[9] World Bank, Poverty Assessment, 2009

[10] In November 2010 President Saakashvili acknowledged that according to the governmental data, "30 percents of Tbilisites are completely or partially unemployed." He described this parameter as "catastrophic." The recent survey of the Caucasus Research Resource Centers offers much grave picture – only 27 percents of Tbilisites believe that they work at a full or partial capacity.

[11] World Bank Investment Climate Advisory Services, "Georgia Manufacturing Sector Competitiveness Assessment," May 2009.

[12] Millennium Development Goals

energy or other) will provide the sustainable development of the country.
Respectively, the international financial institutions should assist the Georgian Government in preparing such plan [13], on the one hand, and should provide the adequacy and efficiency of financing allocated by them in respect of settlement of problems existing in the country, on the other.

As the economists explain, "although, Georgia's foreign debt is not so big from theoretical point of view, the rates of its growth create the basis for concern. Ultimately, Georgia faces a serious challenge; despite self-restriction imposed by the Georgian Constitution, according to which the state debt should not exceed 60% of GDP, during last years the rate of growth of Georgia's debt exceeds the rate of GDP growth that should lead the authorities to the decision of "tightening their belts" and even freezing the debts. It is also important that Georgia minimizes budgetary deficit as one of the major factors of accumulating foreign debts as well as launches gradual redemption of emitted Eurobonds [14]." In expert opinions, the government should focus on Eurobonds emitted by the Georgian Railway as well as on serving the debts taken by the Railway.

Furthermore, it would be better if the Georgian Government, along with international financial institutions and donor countries, starts searching of alternative ways to pay off foreign debt and/or service payment. For this purpose, it is possible to use various mechanisms, such as, for example, debt-for-nature swap [15] or debt-for-development swap [16].

13 The so called poverty reduction strategies developed by the World Bank and the International Monetary Fund are the examples of such plans.

14 State Foreign Debt of Georgia, Nodar Khaduri, July 2011

15 Debt-for-nature swap

16 Debt-for-development swap

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