

# Georgia Human Development Report 2008

The Reforms and Beyond



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Published for  
UNDP Georgia

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# Forewords

The UNDP National Human Development Report comes at an important time in Georgia's relentless pursuit of enhanced economic development for all. The beginning of this administration's second term is an ideal time for reflection on what we have achieved and what we still need to do. As a long-term supporter of Georgian reforms, UNDP is ideally placed to engage with us in this reflection, combining insider knowledge and outsider objectivity.

Any discussion about how to proceed should also include a wide range of opinions, local and international, from inside the government and from wider society. The National Human Development Report has helped incorporate these voices to offer a broad-ranging and independent assessment that should be invaluable in framing the policy discussions.

The title of the Report is indicative. It is not just a testimony to the remarkable reforms that have taken place in Georgia over the last four and a half years. Even more important, it looks at the reform process in a long-term perspective, beyond an account of what has been done. It is also a timely reminder of our shortcomings and the work we still have to do, of the inevitable gaps and the possible ways of addressing them.

In reflecting on the past, the Report is a testimony to our many successes. Since the Rose Revolution the Government finances have been secured through a consistently supply-side approach resulting in low, flat taxes which we strive to reduce further and restrictions on doing business have been removed. As a result, the Government has been able to repair roads, irrigation, electricity and water supply, to improve the infrastructure of education and healthcare and to attract investment that has grown the economy and created jobs. The people are freed from the blight of corruption. They can rely on the police to protect their security and deal with Governments without paying bribes.

However, as we enter the second phase of the reforms we need to be forward-looking. The Report reminds us that the objective of these reforms has always been Human Development in the fullest sense. We do not only seek to produce a wealthy society. We want our society to be democratic and participatory, educated, healthy and secure. The first round of reforms have taken us on the path towards these goals and provided the general framework for future improvements, which can only be brought about if we continue with our unwavering commitment to further enhance the economic liberties in Georgia and its openness to foreign investment.

The first task of the new Government is to ensure that every part of Georgian society feels the full benefits of what we have achieved and has the opportunity to realize his or her full potential. We have already initiated targeted social assistance, higher pensions as well as a basic package of universal healthcare provisions. This has offered protections for the most vulnerable and is alleviating extreme poverty. While we will expand these programs in the next few years, broadening of the opportunities created by the reforms needs to go further than social assistance.

The Human Development Report, therefore, offers useful insights as we reflect on where to go from here. Since the Rose Revolution, Georgia has benefitted enormously from its close collaboration with the international community. The Human Development Report is an extension of that collaboration. We hope it will encourage an inclusive policy debate on how we build on current successes to create a just, prosperous and secure future for everyone in the country.



Vladimer Gurgendize  
Prime Minister

No one who has lived in Georgia since 2003 can fail to notice the scale of the reforms introduced since the Rose Revolution. Every part of the country has been affected and, four and a half years later, the changes have been impressive. The legal, institutional and physical infrastructure of the country as well as the environment for doing business have been transformed.

This National Human Development Report looks at the way the reforms have affected ordinary Georgians and pays particular attention to their impact on economically vulnerable groups. Much has been written about the positive impact of the reforms in Georgia on the business climate and macroeconomic indicators. While these are important advances, economic growth alone does not necessarily lead to human development. To achieve this wider goal, growth needs to be equitably distributed and sustainable, and it needs to be used for creating opportunities for participation and greater security for all.

The Government of Georgia has already recognized that more needs to be done in order for the reforms to improve the lives of all sectors of the population. Access to healthcare, and increased job opportunities in particular, continue to be the major issues of concern. In addition to the promotion of macro-economic growth and attempts to improve the efficiency with which social services are provided, the Government has tried to tackle these problems by increasing social payments, and has put in place targeted social assistance programmes.

Recognising that still more can be done, this report was conceived with a view to assist the Government in developing policy focusing on the human dimension. The report results from a series of discussions held with the Government, civil society groups, international and local NGOs, and a wide range of local experts. We therefore believe that the report's conclusions are inclusive, balanced and forward-looking.

Georgia has come a long way in a short time. The first phase of the reforms showed that the Georgian people have both vision and determination. By encouraging debate on the human dimensions of the reforms, we hope to assist Georgian society in addressing the challenges to human development both by improving areas which require further attention, as well as building upon the successes already made.

The date of publication of this report is timely. Parliamentary elections in May 2008 marked the end of the latest election cycle and the beginning of a new Government and Parliament. With the country moving to the second phase of the reforms, we believe it is the right time to reflect on the achievements and challenges of the first phase, and to fine-tune the direction of new and emerging reforms. These opportunities are rare and UNDP is well placed to be a part of the process.



Robert D. Watkins  
Resident Representative  
United Nations Development Programme

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# Executive summary

Expansion of opportunities and choices is the key to human development. Wealth is, of course, an important factor in providing these opportunities, but it is by no means the only one. Human development also encompasses political freedoms, education, health, and security. Personal freedom and individual choice are essential for having options. Poor health can limit one's physical opportunities. Education expands the scope of what one can achieve. Security and sustainability are necessary to protect the results of one's choices.

Looking at the Georgian reforms from this perspective is particularly important given the depth and scope of recent changes. Many of the strides taken by the Georgian people in the last four and a half years have been remarkable. Growth of GDP is in double digits, foreign direct investment has increased dramatically, day-to-day corruption, which was once endemic, is now rare. The electricity supply, which was extremely limited and unreliable across the country in 2003, has been vastly improved.

At the same time, reforms in tax law, customs law, employment law and licensing have made it vastly easier to start and run a business legally. The increase in tax receipts, privatization, and foreign investment have allowed the government to increase spending on key social services like healthcare, education, policing, and national defence, while at the same time increasing pensions fourfold and offering some targeted social assistance to those living in extreme poverty. From a human development perspective, these impressive achievements are part of a broader objective: to improve the lives of the Georgian people, not simply in monetary terms but in terms of their opportunities and choices.

Concerns still remain about the way these reforms have impacted on the everyday lives of most of the population. One concern driving the protests in November 2007 was certainly the persistence of poverty and unemployment in the country. The protests demonstrated the clear frustration felt by many people in Georgia that, in spite of the reforms, they lack the

opportunities to take control of their lives and improve their circumstances.

The report examines the extent to which post-Revolution reforms have impacted on human development opportunities. Specifically, the report looks at the way the reforms have affected the efficiency of the economy; the equity with which people are treated and resources are utilised; the sustainability of the political, economic and social environment; the physical and economic security of the population; and their level of empowerment to take control of their lives and make choices.

It is not intended as a simple piece of critical analysis. There is little point in simply looking backward, either to congratulate or reprimand. This report tries to look forward and will be a success if it can help Georgian society fine-tune the reform process in order to further develop its human focus.

The report examines the reforms to combat corruption, to reform the legal system, to restructure the economy, to improve social payments, to provide education, to ensure a healthy population and to protect the environment. To cover such a wide range of reforms in one document is certainly ambitious. Any chapter or sub-chapter of this report could easily justify its own hundred-page document. However, the Government, by its own estimation, is entering into a new phase of reforms; as a result, a comprehensive overview that focuses on a broad understanding of human development is both timely and useful.

Concerns still remain about the way these reforms have impacted on the everyday lives of most of the population.

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Almost every element of the Government's reforms were infused with an anti-corruption agenda.

That said, covering so many issues requires the authors of this report to be open about the limitations that space imposes. For a start, the report cannot hope to be comprehensive. Planning this report obviously required the authors to prioritise subjects, in consultation with a wide range of stakeholders. In so doing, many important issues will, inevitably, have been missed.

It is also important to be clear what this report is not. It is not intended to provide an overall analysis of Georgian development between 2004 and 2008 or to offer a comprehensive strategy for the next phase of reform. Each of the areas covered by the report will combine a review and a few suggestive insights, but for any area a far more detailed analysis is necessary before comprehensive conclusions can be drawn.

The very magnitude of the report goes beyond the capacity of a single author or team of authors. That is why the report involved a broad and intensive consultative process with Government and civil society. It is the intention of the report to express a wide range of views, not simply to serve the ends of objectivity. Writing the report was also an opportunity for identifying and developing areas of consensus between different stakeholders. This is both an end in itself and should ensure that the report's conclusions have every opportunity to affect change.

### **Rule of law: anti-corruption, legal and judicial Reforms**

It is almost impossible to exaggerate the scale of the corruption problem the Government faced in 2003. Georgia ranked 124th out of 133 countries surveyed on corruption in Transparency International's Corruption Perception Index. Tax collection rates and payment rates for state-run utilities were staggeringly low, debilitating public finances. The police and judiciary were viewed by the population as a more likely source of criminality than a protection from it. Educational qualifications were bought as often as they were earned.

Almost every element of the Government's reforms were infused with an anti-corruption agenda. The first and most visible step was the wholesale replacement of large sections of existing state institutions. To remove the old-guard

Government, officials were fired or required to reapply for their old jobs; to reduce incentives for corruption, salaries were raised. Outside of central Government other institutions were also the focus of attention. Judicial salaries were raised and a range of mechanisms was used to encourage previous judges to resign. In education, a national exam was introduced to ensure that university applicants were selected according to merit.

The Government's success in removing day-to-day corruption has been astonishing and would have seemed impossible five years ago. The World Bank and Transparency International have both highlighted the success of the reforms but, perhaps most importantly, numerous polls suggest that most Georgians no longer experience corruption directly.

These reforms are an impressive success by the standards of efficiency, equity and security. In terms of efficiency, the removal of corruption has made running a legitimate business cheaper and more predictable. In terms of equity, the removal of preferential treatment for those with position and money makes society more equitable. In terms of security, confidence in the police and judiciary to pursue criminals, rather than their own self-interest, has made everyone more secure.

That said, concerns persist over the extra-legal influence of executive power, particularly in the judiciary. The Government has responded to some of these concerns, in particular removing the President from the High Council of Justice in December 2006 and therefore removing his ability to directly appoint judges. It is too soon to say if these reforms will increase judicial independence or the perception of it, but without doubt, the overwhelming effect of the anti-corruption reforms has been positive for most Georgian citizens.

### **Economic reforms – The macro perspective**

When the present Government came to power in 2004, state finances were in crisis and key publicly-owned companies were losing money and failing to provide the services upon which society depended. The meager USD 6.50 per month minimum state pension was not being paid and key portions of the public sector were

paid so poorly that they were forced to depend upon extortion for their survival. The country's basic infrastructure was in a state of collapse, electricity and water supply were unreliable across the country and non-existent in some places, roads were ruined and irrigation systems could not provide water for crops.

This situation impacted on all of the key dimensions of human development. An economy and infrastructure so badly dilapidated cannot produce anything efficiently. A Government that cannot collect taxes cannot help relieve social inequity or provide social goods like education and healthcare, which are necessary for empowerment and security. A weak and dependent economy is also extremely insecure at a personal and national level.

To simultaneously kick-start the economy and resolve the crisis in social services, the Government adopted a set of extremely liberal economic policies. It lowered taxes and import duties and simplified government bureaucracy to create an attractive business environment, particularly for foreign investors. This has increased tax receipts from GEL 1.2 billion (USD 558 million) in 2003 to GEL 4.4 billion (USD 2.6 billion). Combined with dramatic increases in revenue from privatizations, the central Government has increased its spending from GEL 897 million (USD 417 million) in 2003 to GEL 5.2 billion (USD 3.1 billion) in 2007.<sup>1</sup>

Reforms in customs and trade have also dramatically cut bureaucracy and unilaterally reduced the import tariffs on most goods, while at the same time the Government has been pushing hard to increase Georgia's involvement in international trade regimes. Most notably, the government secured preferential access for Georgian goods to EU markets under an expanded General Scheme of Preferences (GSP+) and recently secured a free trade agreement with Turkey. It has also sought to encourage a range of free trade-related industries with a free economic zone in Poti and plans to make Georgia a regional financial hub.

These reforms have been extremely well received, particularly by international organisations and a number of different indices have documented the improvement. Most famously, Georgia moved from a position of 112th in 2006 to 18th in 2008 in the World Bank's Ease of Doing Business Ranking. Georgia's credit

rating has also improved. There has also been an improved up-take in privatizations and dramatic increases in foreign direct investment. Net FDI, which was USD 331 million (8% of GDP) in 2003 reached a peak of USD 1.6 billion in 2007 (15% of GDP) in 2007.

This has helped to dramatically improve banking, telecommunications and electricity supply and has created a housing boom in Tbilisi. Privatizations have allowed the Government to increase public spending above the level of tax receipts without jeopardizing public finances. At the same time, privatized businesses have helped maintain Georgia's exports. Several of Georgia's largest and fastest growing exports are produced by privatized firms.

These reforms have almost certainly improved the efficiency of the economy and they have developed efficiency in key sectors like energy production. However, those efficiency gains have not, as yet, translated into a significant increase in employment or reduction in poverty.

On the other hand, this first wave of reforms was not intended to, and could not have been expected to, provide a 'quick fix' for Georgia's human development problems. Their major purpose was to establish an economic basis upon which future benefits could be built. This has largely been successful. The priority now, as acknowledged by the Government, is to ensure a human focus and make sure that the economic success of the first-stage reforms translates into better development opportunities for all.

Bearing this in mind, it is worth considering some of the structural hurdles to expanding human development through these reforms. The structure of the tax system may have a negative impact on equity. Taxes on expenditure are the most prominent part of the Government's tax revenue and these taxes tend to have a disproportionate impact on low-income families who spend a greater portion of their income. Also, while this dramatic increase in revenue has allowed the Government to increase spending across the board, pensions and national defence sectors have benefited the most while the education and healthcare sectors have not seen such dramatic or persistent increases. In trade, involvement in different trade regimes may have helped to mitigate the effects of the closure of Russian market for selected Georgian products. However, new markets have not,

Privatizations have allowed the Government to increase public spending above the level of tax receipts without jeopardizing public finances.

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A lack of transparency and poor communication about the privatization process have allowed some mistrust of the Government to remain.

so far, translated into dramatic improvements for Georgia's biggest employer, the agricultural sector.

This combination of reforms has also not helped to lower prices. Investments have fuelled inflation by injecting more cash into the economy and prices for the services of recently-privatized utilities have often gone up. While these prices may have been necessary in the long term to ensure the sustainability of the businesses, they have also been felt most sharply by the poor.

A lack of transparency and poor communication about the privatization process have allowed some mistrust of the Government to remain. Competitive bidding is not enough to guarantee trust in the privatization process when the investors are not known, criteria of selection are unclear and initial deals are often subject to later renegotiation. Therefore, while there is little doubt that privatized firms have performed better, and may offer better services and employment opportunities in the future, the method of privatization has detracted from this success.

### The household perspective

All of the chapters consider the implications of the reforms from the position of the average Georgian. That said, average household incomes and income inequality deserve particular attention. When the Government came to power in 2004, poverty, along with unemployment, was acknowledged to be one of the most pressing problems.

However, though there may be disagreements over the level of poverty in Georgia, there is general consensus that neither poverty nor extreme poverty have been significantly reduced. The discrepancy between strong GDP growth and stagnating poverty estimates suggest that economic reforms have still not impacted on the lives of enough of Georgia's society. Going beyond the strong GDP figures and translating them into higher general levels of prosperity is, the Government recognizes, a key priority for the next phase of the reforms.

The Government's main policy for poverty alleviation has been its attempts to stimulate growth, but increasing social payments has also been a priority and a central plank of the

2008 budget. Social assistance payments have increased from GEL 100 million (USD 47 million) in 2003 to GEL 778 million (USD 465 million) in 2007, with a projected budget of GEL 1.1 billion (USD 723 million) in 2008.<sup>2</sup>

It is difficult to understand how poverty could have remained constant in the face of these increases. The Government is convinced that these facts are so incompatible that they have called into doubt the Integrated Household Survey, produced by the Department of Statistics, and the basis of poverty calculations. This in itself highlights the need for developing better information-gathering and analytical capacity inside the Government if evidence-driven social policy is to move forward.

There are four possible explanations why poverty may have remained high despite the Government's efforts to alleviate it. First, socially vulnerable groups may be disproportionately affected by external shocks. In this way, events such as the closure of the Russian market to selected Georgian products and flooding in rural areas in April 2005 may have hit hardest those groups with the least capacity to recover.

Second, the macroeconomic improvements have had little impact on agriculture, which employs over half of the population. Agriculture's share in GDP has fallen from 19.3 percent to 9.7 percent between 2003 and 2007 and agricultural production has declined by approximately five percent in real terms over the same period.

Third, the vast majority of social payments are not well-targeted at those who need it most. While social assistance that targets low-income families (as opposed to pensions that targets the elderly) was introduced in 2006, the value of the payments has not been increased to match inflation. In addition, total income-targeted payments remain relatively low compared to total pension payments. In 2008, the total cash payments made to the extremely poor, at about GEL 80 million (USD 52.6 million), is only about one eighth the amount of the Government will distribute in the form of pensions. This is not a very effective way of targeting social assistance if the objective is poverty reduction, since pensioners are fairly evenly distributed among both rich and poor households.

Fourth, a combination of inflation and taxes could have reduced the consumption pos-

sibilities of the poor even as they were receiving assistance. Though officially, inflation has only just passed ten percent this year, there are indications that food prices may have risen far faster than prices on other goods, and food is the main expenditure of the poor. The effect may be further exacerbated by the fact that VAT collection rates have gone up significantly. These new taxes would present themselves to the consumer as an increase in prices.

Overall the Government has put in place the necessary structures for alleviating extreme poverty but more work needs to be done to understand why poverty has persisted in spite of the reforms.

## Education

The early 1990s saw the beginning of a deep crisis in the Georgian educational system. Financing of education decreased from seven percent of GDP in 1991 to one percent in 1994. This reduced teacher and lecturer salaries and led to a deterioration of basic infrastructure. At the same time, the system was unable to provide students with the knowledge and skill sets necessary for human development in a market economy or in a democratic political system.

The crisis in the educational system damaged the social development of the population at the same time as it undermined the country's opportunities for economic development. Both secondary and higher education have undergone dramatic change in the level and structure of their finances, administration, curricula and accreditation. School funding at both the secondary and university level is now assigned based on number of students, so the popular institutions are rewarded.

The overall reorganisation has attempted to localise decision-making and control while at the same time setting national standards and providing national quality control. Management of secondary schools is now overseen by an elected Board of Trustees, and a Representative Council is the new responsible body in universities. This has given far more powers to local communities, parents, teachers, lecturers and students to make decisions about how to run their schools and universities.

At the same time central oversight mechanisms have started to offer some quality con-

trol. University accreditation closed ineffective universities and dramatically reduced their number. Secondary school accreditation will be introduced in 2009 and should provide similar basic quality control.

The newly-established National Curriculum and Assessment Centre are trying to standardise certain requirements of secondary education by developing national educational curricula. Minimum salaries for teachers and university lecturers have been increased and professional development opportunities for secondary school teachers widened.

The most well-known success in education was the introduction of Unified National Examinations (UNE), through which university students are now selected and assigned funding on an entirely meritocratic basis. In the space of one year, this removed corruption from the university recruitment process altogether, changing the structure of incentives for secondary school students, increasing confidence in the system and ensuring brighter students at university.

The effects of all of these changes are overwhelmingly positive. Education is clearly crucial for the efficiency of society. It can alleviate inequity by offering opportunities to the poor and it is vital for participation and empowerment. The reforms are helping the educational system to more successfully achieve all of these goals. These could be more effectively and efficiently achieved if the Government spent more money on education since, at less than 3 percent of GDP, Georgia spends less on education than most CIS countries. Within the existing financial restraints, the main issue is equity. Allocating funding to students entirely on the basis of ability (test scores) naturally favours those who need the financing least, since wealthier students, who go to better schools and who can afford private tuition, tend to score highest. This problem is exacerbated for students from ethnic minorities, for whom Georgian is a second language.

## Healthcare

The healthcare system inherited from the Soviet Union, though inefficient, provided universal coverage of all types of health services for the entire population. After gaining inde-

The crisis in the educational system damaged the social development of the population at the same time as it undermined the country's opportunities for economic development.

## Executive summary

The expansion of primary health-care and the development of modern family practices have been widely applauded and have improved the efficiency and equity of the system.

pendence, meaningful universal healthcare became financially impossible to maintain. By 2003 almost all healthcare was funded through out-of-pocket payments. In addition to low financing, the healthcare system was over-staffed with under-skilled medical professionals who used outdated practices and tended to over-medicate their patients

Health expenditure increased significantly, in absolute terms by about 130 percent, between 2003 and 2007. The reforms have focused on four main elements: the expansion of primary health care, the expansion of health assistance targeted to socially vulnerable people, the development of insurance as a mechanism of healthcare finance management and the privatization of public healthcare facilities.

Healthcare reform also has wide-reaching consequences for human development. Not only are healthier people more productive, but preventative care is a more efficient resolution of medical problems. Healthcare is also crucial for equity and security, since fear of social and economic impoverishment that poor health can bring is a major source of uncertainty about the future.

The expansion of primary healthcare and the development of modern family practices have been widely applauded and have improved the efficiency and equity of the system. In principle, targeted assistance to the most vulnerable has also been well received. From the human development perspective, the biggest concerns relate to insurance and privatization. Health insurance may be problematic for alleviating inequity in Georgia because insurers are not used to dealing with very poor patients and vice-versa. There are doubts that individuals are receiving the full coverage to which they are entitled, and it is unclear if insurance companies will be able to afford to cover everyone they are supposed to.

It also seems unlikely that health insurance will cover the majority of people in the medium term. The medium-term goal for healthcare should clearly be the increase of publicly-funded cover so that all of the most vulnerable have basic protection.

The other main concern expressed is with hospital privatization. The principle of privatization is not generally rejected, but there is widespread apprehension about the likely long-term consequences of allowing pharmaceutical

companies to own both hospitals and (probably soon) primary healthcare when oversight mechanisms remain weak. There is a risk that this might not just generate super-monopolies in the healthcare sector, but it might also create conflicts of interest. Properly regulated, this problem might be offset, but the regulation mechanisms do not currently exist.

## Environment

Post-Soviet collapse had contradictory influences on the Georgian environment. Diminishing industrial capacity lead to reduced water and air pollution, particularly in the cities, but deteriorating economic conditions contributed to dilapidated infrastructure and, together with a lack of law enforcement, created new pressures on Georgia's natural resources. Some legal reforms were initiated in the early 1990s but they were largely ineffective, serving as a source of corruption and offering little in the way of management over state assets.

In human development terms, environmental legislation principally targets the sustainability of an economy by trying to protect it from short-term degradation. It aims to protect equity by ensuring that natural resources are distributed equitably and that everyone lives in a clean environment. However, the same legislation often creates hurdles for businesses. Since environmental legislation was largely seen as an ineffective set of rules for protecting resources and people, the priority of the reform was to remove the cumbersome restrictions that affected a range of Georgian businesses. The number of categories of projects legally subject to environmental impact assessments and the level of evaluation/consultation necessary before the project could move forward was diminished.

Two key sectors that the new Government targeted for reorganization were water and forestry. Reforms to the forests have largely been concentrated on the potential for leasing forests through long-term concessions. The concessions, it is argued, could provide incentives for forest management, improve policing and make use of one of Georgia's great resources. However, environmentalists have been concerned that, after 15 years of illegal logging for lumber and fuel, the forests may be vulnerable. In general terms, sustainable use of natural resources is vital for human development. How-



ever, Georgia's forests are also important because they serve a crucial role in preventing erosion, flooding and landslides.

Long-term leases are, therefore, a contentious idea. Without conducting initial assessments of the forests in order to select appropriate plots for lease and to provide a baseline for evaluating the activities of the leasing company, it is not clear that forest leasing and use will be sustainable. Since these forests also help protect the land from erosion, flooding and landslides, leasing before environmental assessments are conducted could create security problems for rural communities. Concerns also remain about local access, since these resources have been used by local people and excluding them could have inequitable results.

In 2003, there was a crisis in Georgia's supply of potable water. First, there was a

problem of access. About 30 percent of the population did not have access to piped water and cities outside of Tbilisi had running water for very short periods during the day. Second, bacteriological contamination was causing a public health hazard. Both problems resulted from collapsed infrastructure, under-pricing and over-consumption.

In response, the Government has significantly renovated water supply systems, starting in Tbilisi, and has increased pricing to cover a greater proportion of the costs of production. This has clearly created some concerns, particularly as water metering introduces the possibility that those who cannot pay may be disconnected, but the Government has made efforts to mitigate these effects with targeted social assistance. Availability of potable water in rural areas, where people have not seen a significant change, is still a concern.

In human development terms, environmental legislation principally targets the sustainability of an economy by trying to protect it from short-term degradation.

## Recommendations

- Anti-corruption and the judiciary – During the first phase of the reform the Government selectively targeted different groups, both inside and outside the Government. In the next phase, efforts should be made to limit executive influence so that anti-corruption measures operate through institutionalised mechanisms outside the direct control of the Government. This will ensure that the great successes of the anti-corruption process are sustainable in the long-term.
- Macroeconomic reforms – In order to ensure that the burden of taxation does not fall disproportionately on the most vulnerable populations, the Government should target future tax cuts at low-income groups. Alternatively, the Government could introduce a minimum income tax threshold.
- Social Assistance – Now that the Government has an effective mechanism for targeting poor households, future increases in social payments should either aim at broadening the number of poor people covered or, at the very least, ensure that targeted social assistance payments keep up with inflation.
- Education – The Government should aim to raise spending on education as a percentage of GDP. Within the current spending parameters, the Government could achieve more equitable results if it set aside a larger proportion of university funding for those students on the socially vulnerable register.
- Healthcare – For privatization of hospitals and primary healthcare to be effective, the government needs to ensure that sales contracts contain clearly defined responsibilities. In addition, it should ensure that a powerful oversight mechanism is in place to guarantee compliance.
- Environment – For the sustainable use of forest resources, an analysis of forest sensitivity needs to be undertaken, at the very least highlighting the geographic areas that are most important to preventing erosion, flooding and landslides. These areas should be excluded from any future privatizations or leasing deals.

# Introduction

When Georgia declared independence on a cool spring morning in April 1990, few people could have imagined the calamities that the country had in store. In the following four years it experienced war in the regions of South Ossetia and Abkhazia, as well as a bloody coup d'état that brought fighting to the streets of Tbilisi. At the same time, Georgia's industrial and agricultural base, which had been successful within the Soviet context, had no structures for maintaining itself outside of that environment and no idea how to refashion itself for a global market economy. War and de-industrialization combined to create complete economic collapse.

These two body blows had knock-on effects that made economic and social recovery even more difficult. Faced with few opportunities, some of the most educated and productive members of Georgian society simply left the country. Georgia experienced massive emigration in the 1990s, while the two wars created an influx of internally displaced people whom the state had to support. Since many people were forced back onto small land holdings to survive, the Georgian agricultural sector remained unconsolidated and inefficient. Abandoned industrial and agricultural infrastructure was dismantled and sold for scrap metal which, until recently, was Georgia's number one export

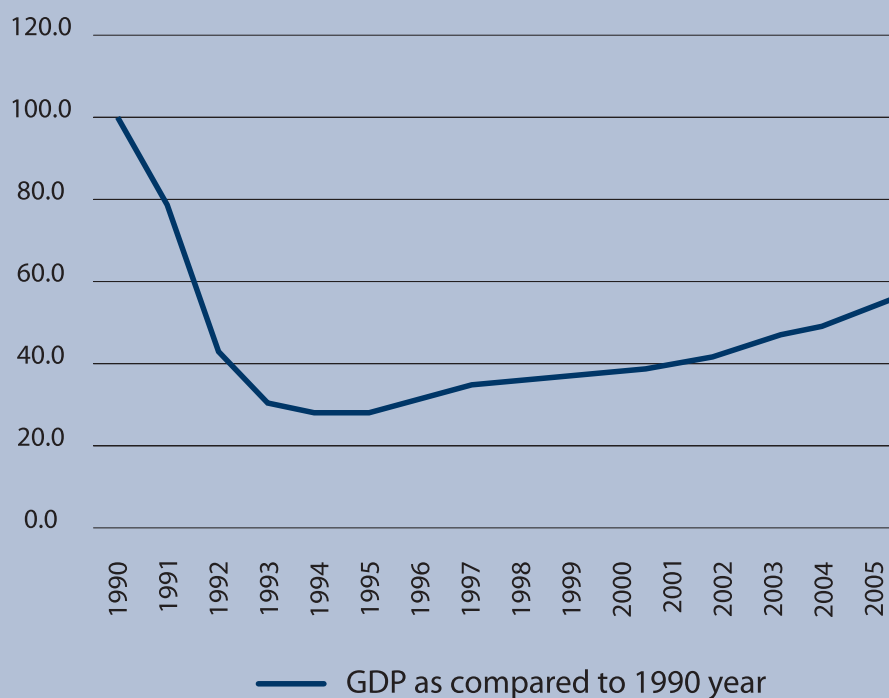
A brief review of real GDP since 1990 gives us an idea of the scale of the problem that Georgia has faced, if only in economic terms.

On top of all of this, the grey economy and a history of clientelism made it enormously difficult to normalize the economy. Under the Soviet system, unofficial economic and political networks provided vital lubrication for a fatally flawed economic and political model. Without the restrictions of the Party and the Soviet state machinery these networks were able to flourish, giving the well-positioned few enormous opportunities to steal the assets of the country.

By the mid-1990s a group of reformers had started to emerge inside Shevardnadze's Government. Partially through the efforts of this new group, the Shevardnadze Government set

about overhauling the civil, criminal and tax codes and started an Anti-Corruption Bureau. These reforms were quickly embraced by the EU, which signed the Partnership and Coop-

**Figure 1** GDP index (1990 base year)



Source: State Department of Statistics (January 2003)<sup>3</sup>

## Introduction

The stolen elections of 2003 were a catalyst for change that was clearly needed and desperately wanted.

eration Agreement with Georgia in 1996 and made Georgia the first South Caucasian member of the Council of Europe in 1999. Georgia joined the World Trade Organization in 2000.

Over the same time negotiations to secure the route of the Baku-Tbilisi-Ceyhan (BTC) pipeline were concluded, making Georgia a major conduit for non-Russian oil. The BTC founding document was signed in 2002, cementing the country's strategic importance to the West.

These legal and institutional reforms had little effect because the Government lacked the political will to enforce them. That President Shevardnadze was unwilling or incapable of carrying out true reforms is unsurprising. Lacking a natural constituency, President Shevardnadze was able to maintain his position as President by skilfully balancing different Georgian interest groups. He provided relative peace and stability in the post-war period, however.

*Stability had been bought at the price of buying the loyalty of certain powerful figures from former communist nomenklatura and the 'shadow economic elite', whose continued influence would sap the ability of the new state to reform itself.. By the end of 2001, the economy was once again at a standstill, corruption had become ubiquitous and the political elite had earned the contempt of almost every member of society.<sup>4</sup>*

In this context, the new laws and international involvement simply provided more mechanisms for extortion and resources to steal. EU standards established barriers that could be selectively applied to businesses and donor money was often channelled into the bank accounts of precisely those people who were meant to carry out the reform.

## The situation in Georgia in 2003 and the aspirations of the new Government

The circumstances that set the scene for the Rose Revolution were therefore political, economic and social. In 2003 the situation was dire. The Shevardnadze Government was unable to provide basic social services because the few taxes that were collected and not stolen by state officials were spent on the basic costs of Government. Pensions and social benefits were not paid; basic utilities like water and electricity were unreliable at best; healthcare quality was poor and even basic care was not provided by the state; and basic infrastructure like roads and irrigation were either poorly repaired or destroyed entirely.

Poverty remained high. In 2003, the UNDP undertook a poverty mapping exercise that concluded,

*the available sources of data show that poverty in Georgia is high and that it has remained high for a long time. The poverty headcounts have been oscillating between the low 40s and the high 50s, with an average of 50.6% for the period 1996-2002.<sup>5</sup>*

The stolen elections of 2003 were a catalyst for change that was clearly needed and desperately wanted. However, the Revolution was not simply about the removal of a corrupt regime. The opposition movement that propelled Mikheil Sakaashvili to power was also built on a belief that rapid change was possible.

To talk of priorities in this agenda potentially misunderstands the task that the Georgian Government sought to undertake. The 'priorities' of the Georgian Government were laid out in a document presented to a Brussels donor conference in June 2004. This document highlighted five key areas: governance (with a particular focus on anti-corruption), rehabilitation of the energy sector, protection of the vulnerable (including education and health), promotion of private sector development and promotion of regional development. In essence, the document professed an aspiration to make sweeping changes in every major sector.<sup>6</sup>

# Chapter 1: Rule of law

It is almost impossible to exaggerate the scale of the corruption problem the Government faced when it came to power. In 2003, Georgia ranked 124th out of 133 countries surveyed on corruption<sup>7</sup>. Tax collection rates and payment rates for key utilities were staggeringly low, debilitating public finances. The police were viewed by the population as a more likely source of criminality than a protection from it. Educational qualifications were bought as often as they were earned.

When it became independent from the Soviet Union in 1991, Georgia inherited a Soviet-style system of Government that was corrupt, over-staffed and inefficient. State employees from the police to doctors, from teachers to tax inspectors, supplemented their meagre salaries with bribes and gratuities. Civil servants succeeded through nepotism, favouritism, and clan politics. Bribes were common and services were poor.

The legal system had a similar problem. Under the old system bribery of judges was common-place and justice in the courtroom had devolved to a form of bargaining, where lawyers served as monetary mediators between the judge and the adversarial parties.

Neither of the previous administrations made any serious efforts to tackle this problem. While Shevardnadze's Government joined the Group of States against Corruption (GRECO) in 1999, his administration lacked the political will to enforce the law or carry out international recommendations. Ironically, the Anti-Corruption Bureau he set up was widely seen as a mechanism for gathering information against state officials in order to ensure their patronage.<sup>8</sup>

In this way, it was not just the corruption of falsified elections that encouraged the Rose Revolution, but dissatisfaction with a corrupt society more generally. This generalized dissatisfaction reflected the many ways that corruption impacted people's lives. From a human development point of view, corruption is destructive because it produces inequity, inef-

iciency and insecurity. It produces inequity because corrupt societies serve the rich or the well connected. It reduces efficiency because bribes constitute an additional cost for a business but, more importantly, because they make assessing returns on future ventures practically impossible. From a security point of view, a corrupt society offers no one clear protections so every other area of development is continually threatened.

The new Government, therefore, made anti-corruption one of their key priorities. President Saakashvili, in his inaugural address, made the priority clear, as he argued then,

*we have to root out corruption. As far as I am concerned, every corrupt official is a traitor who betrays the national interest. We will eradicate corruption and revamp the system that gave birth to the vicious circle of corruption now burdening us.*<sup>9</sup>

## Anti-Corruption reforms

### Legal framework

The legal framework for Georgia's anti-corruption legislation is a patchwork of laws and subordinate acts including the General Administrative Code of Georgia, laws on Public Procurement, on Conflict of Interest and Corruption in Public Service, on Licensing and Permits for Entrepreneurial Activities, on Legalization of Illegal Income and many others.<sup>10</sup> In accordance with these anti-corruption

From a human development point of view, corruption is destructive because it produces inequity, inefficiency and insecurity.

## Chapter 1: Rule of law

Since 2005 a range of different laws for combating corruption have come into effect.

measures, in its first year the Government also formed a patchwork of responses to particular problems but lacked an overall strategy.

In 2004-2005 Georgia signed a partnership agreement with the G8 to fight corruption and promote transparency. The Shevardnadze Government had already committed the Georgian Government to follow the recommendations of the Council of Europe's Group of States Against Corruption (GRECO) and the Organization for Economic Co-operation and Development's (OECD)'s Anti-Corruption Network for Transition Economies. All of these organizations considered the development of a national anti-corruption strategy a priority.

In January 2005, a working group organized under the National Security Council was tasked with developing a general anti-corruption strategy. The group consisted of representatives of various state bodies and NGOs.<sup>11</sup> The anti-corruption strategy prepared by the working group and approved by the President in June 2005 covered such issues as: enhancement of transparency in the public administration; finance of political parties, support to the creation of a competitive business environment; reform of the judiciary and law enforcement bodies; improvement of business legislation and involvement of the community in anti-corruption activities.<sup>12</sup>

Following the strategy document, the Government proceeded to develop an anti-corruption action plan that was adopted by Presidential decree in March 2006. This plan did not involve the same working group and was developed, from November 2005, under the State Minister for Reforms Coordination, who took full responsibility for anti-corruption reform from that time.<sup>13</sup>

Since 2005 a range of different laws for combating corruption have come into effect. A process for confiscating unproved property was initiated in June 2006, provisions on active and passive bribery have been aligned with international standards, and changes have been made to the Criminal Code to criminalize the promise of offering a bribe.<sup>14</sup> Exactly who will be responsible for coordinating reforms into the future remain unclear, since the State Ministry of Reforms Coordination was abolished at the end of 2007. However, anti-corruption policy remains a priority of the Government

and, in January 2008, the Parliament of Georgia ratified the European Council Criminal Law Convention on Corruption.

### Reforms of Government institutions

As mentioned earlier, bloated bureaucracy and administrative complexity were seen as both a symptom and a cause of corruption. Cutting down staffing and Government bureaucracy was, therefore, a means of both improving the business environment and tackling corruption. The Government started by radically reducing the size of executive Government. The number of ministries was reduced from 28 to 13. Eighteen state departments were abolished and a large number of staff were either fired outright or required to re-apply for their old jobs in smaller departments. According to the Public Service Bureau, the total number of public officials (120,000 in 2003) was cut in half by 2005.<sup>15</sup> At the same time, the majority of Licenses and Permits were abolished. From 909 original licenses and permits only 109 licenses and 50 permits now exist, mainly relating to health and safety issues.<sup>16</sup>

In addition to generally overhauling the structure of the Government as whole, the Government focused on those departments and ministries considered most corrupt. These included the police, judiciary, public and civil registries, tax, customs and the higher education system. In order to remove the need for government employees to elicit bribes, salaries were significantly increased. In education, a national examination system was brought in, students were recruited into university on a merit-based system and offered Government support based exclusively on the results of this exam.

The police reforms in particular were one of the first, and most effectively, targeted. Most of the old police force were fired and a smaller police service was recruited to replace them. At the same time, salaries were increased dramatically, in some cases as much as ten-fold, the police were provided with new equipment and new uniforms, and some of the instant 'checks' on citizens (like instant checks on the road-worthiness of vehicles), which were a common source of extortion, were suspended.

## Reforms to the judiciary and legal System

### Initial changes to the judiciary

Understanding that one of the main reasons for corruption was poor remuneration, from 2006 the Government significantly raised judicial salaries, making judges among the highest paid employees in the public service.<sup>17</sup> Monthly salaries of judges have increased to GEL 1,650 (USD 1086) in regional courts, to GEL 2,100 (USD 1382) in the courts of appeal and between GEL 3,100 to GEL 4,100 (USD 2040 to 2700) in the Supreme Court.<sup>18</sup>

The budget of the judiciary has increased substantially, from GEL 14.4 million (USD 8 million) in 2005 to GEL 33.2 million (USD 18.7 million) in 2006 to GEL 35.9 million (USD 21.5 million) in 2007, allowing the upgrade of material and technical resources.<sup>19</sup>

Although, the new Government was able to increase the salaries for judges, there was no simple way to change all of the judicial personnel or facilitate a 'clean break' in the fashion of the traffic police reform. However, the new Government did use a number of mechanisms to ensure the replacement of the old cadre of judges.

First, the reorganization of the court system allowed some of the judges (outside of the Supreme Court) to be effectively suspended. Under the new law, some of them were transferred to a 'reserve list' where they no longer practised unless appointed to a new court. On the list, they retained position and salary. 26 judges were dismissed as a result of disciplinary proceedings on the basis of gross violation of the law.<sup>20</sup> Since 2004, ten judges have been detained for taking bribes and 15 judges have been brought to criminal court.<sup>21</sup>

With the Supreme Court judges, the government used a combination of financial incentives and threat tactics. In June 2005, a new law was passed that guaranteed pensions equal to their current salary for the Supreme Court judges who would voluntarily resign before December 31, 2005. 21 out of 37 Supreme Court judges resigned, guaranteeing their income. Five of the judges that refused to resign were subject to disciplinary proceedings in 2005 and removed from office. By the end of 2006, most of the Supreme Court Judges had left or

been removed and the Supreme Court, which had 37 members in 2003, now has 18, ten old judges and eight new ones.<sup>22</sup>

### Selection and training of the Judges

In parallel to the 'retirement' of old judges, the government also sought to recruit new judges. Seventy four judges were appointed in 2005, 44 judges were appointed in 2006 and 24 judges in 2007. New candidates were recruited through a merit-based competition, which consisted of an examination of judicial knowledge and a personal interview. Information on the competition as well as on the results were published in the media and on the web site of the High Council of Justice. The selected candidates were nominated by the High Council of Justice and appointed by the President. Following the constitutional amendments of December 2006, the function to appoint judges has been fully transferred from the President to the HCJ.<sup>23</sup>

From October 2007, a new system of selection and appointment became effective under the High School of Justice. Under the system, candidates who pass the judicial examination qualify to undergo a fourteen-month programme of theoretical and practical training provided by the High School of Justice. After completing the course, judges are nominated to the HCJ for appointment. The High School of Justice conducts periodic retraining of sitting judges to develop and advance their qualifications.<sup>24</sup>

### Early concerns and Government reactions

By 2005, despite the success of the reforms in eliminating monetary corruption, many organizations still expressed concern about the competence of the judiciary and their independence. The World Bank's evaluation of the common court reform, which had been extremely positive in 2004, declined significantly in 2005.<sup>25</sup> The American Bar Association in 2005 stated,

*One of the most serious issues facing the Georgian judiciary is improper influence from the executive branch and the procuracy, particularly in criminal cases, despite constitutional*

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## Chapter 1: Rule of law

One of the most serious issues facing the Georgian judiciary is improper influence from the executive branch and the procuracy, particularly in criminal cases, despite constitutional and other guarantees of judicial independence.

*and other guarantees of judicial independence. Such influence is said to have increased since 2003. Some respondents asserted that no court in Georgia had the reputation for being independent*<sup>26</sup>

Concerns about the anti-corruption reforms in the judiciary were also reflected in public opinion. The Georgian Young Lawyers Association observes that, while ‘society assessed more or less positively the judicial reforms implemented in 2004...for 2005, public opinion has changed drastically [towards the negative].’<sup>27</sup>

At the centre of this concern was the fact that the reform process gave the Government plenty of avenues for exerting, or appearing to exert, pressure on existing judges. It was possible to fire judges for ‘gross violation of law’ or for ‘legal misinterpretation’ and some claimed that these categories were so imprecisely defined as to allow their arbitrary application.<sup>28</sup> The ability to simply leave judges on ‘waiting lists’ as the court system was reorganized provided a similar level of discretion. As a result of this, a 2005 evaluation by the American Bar Association concluded that the Georgian judiciary lacked judicial safeguards and could not be considered independent.<sup>29</sup>

A range of amendments to the legal framework were made in response to these concerns. Alterations were made to the HCJ in order to reduce executive influence. In October 2005, judges became the majority of the HCJ and the prosecutor general was removed as a member.<sup>30</sup> In June 2006, the Minister of Justice was also removed from membership of the HCJ.<sup>31</sup> Finally, in December 2006, constitutional amendments transferred the authority to appoint or dismiss judges from the President of Georgia to the High Council of Justice and removed the President from the position as its Chairman. As a result, the HCJ ceased to be a consultative body to the President and became a full part of the judiciary.<sup>32</sup>

Important steps were also taken to address the concerns about the disciplinary process. In July 2007, there was an attempt to clarify the phrase ‘gross violation of law’<sup>33</sup> so as to make its application less discretionary and the category ‘misinterpretation of the law’ is no longer a sole basis for disciplinary proceedings.<sup>34</sup> The process of appealing decisions made against the judiciary was also simplified so that criticisms

of judges are themselves subject to a more reasonable due process. In 2007, the Parliament of Georgia adopted the Law on Communication with Judges. The law prohibits any form of communication with a judge when a case is pending or during a trial if that communication has the intent of undermining the independence of the trial.

### Reforms to the court system

Alongside the efforts to advance the competence and impartiality of the judges, a main priority of the reforms that started in 2005 was institutional reorganization.<sup>35</sup> The court system was considered inefficient. The Regional Courts, District Courts of Appeal and Supreme Court had no clear sequential order.<sup>36</sup> The District Court and a Supreme Court both had jurisdiction to hear appeals from the Regional Courts. The system was also under-staffed and over-burdened. Courts suffered from a lack of specialized judges, a large caseload and a high number of pending cases that often took several years to hear. On top of this, the courts were often ignored. Seventy percent of the civil and administrative judgments went un-enforced by the Ministry of Justice.<sup>37</sup>

In November 2005, amendments to the law on common courts transferred the jurisdiction over the first hearing of particular cases (so-called ‘first instance’ cases) from the former District Courts and the Supreme Court to the Regional Courts. The amendments also established a new sequential order that started with Regional Courts, went on to Appeals Courts (which replaced the District Courts) and then finally to the Supreme Court. To achieve more efficiency, the regional courts are being consolidated.<sup>38</sup> Simultaneously, a system of Magistrate Judges was introduced for small cases in the administrative-territorial units not covered by the Regional Courts.<sup>39</sup>

It is hoped that this division of responsibility will not only make the legal process more transparent, but will also speed it up with different courts specializing in particular functions. As the result of these reforms, the current number of Common Courts has been reduced to 44 Magistrate Courts, 21 District Courts, two Appeal Courts and one Supreme Court<sup>40</sup>

In 2004-2005, within the framework of criminal law reform, the institution of plea-bar-



gaining was introduced to reduce caseloads and investigations. The courts have also increased their use of non-custodial sentencing. For nine months in 2006, the percentage of cases resolved through plea bargaining was 19.7 percent. In 2007 it increased to 50.2 percent. The percentage of non-custodial sentences handed down as a result of convictions also increased from 36 percent in 2006 to 47.3 percent in 2007 and the frequency of non-custodial measures used during pre-trial investigations increased from 40.8 percent in 2006 to 55.3 percent in 2007.<sup>41</sup>

### Public communication by the judiciary

In order to increase the public's trust in and transparency of judicial proceedings, the constitutional changes of 2004 re-introduced the institution of the jury trial to Georgia. The system is expected to become operational in 2009. It is hoped that involving the public in the trial process in this way will help to revitalize the image of the Georgian judiciary and reduce the problem of public distrust in the administration of justice.<sup>42</sup>

In order to partially address the concern of public trust and transparency, the institution of the Speaker Judge was introduced in January 2006. Speaker judges disseminate information on court activities and report court decisions to the public, thus serving as an important link between the judiciary, the media and the general public. In August 2007, Amendments to the Law of Common Courts banned video and photography in the courtrooms. While the law has generally helped judges maintain order in the court room, it has also been criticized for limiting media access and augmenting public skepticism about the transparency and impartiality of the judicial process.<sup>43</sup>

### Human development impact of anti-corruption

In human development terms, the anti-corruption reforms produced efficiency, equity and security gains. In terms of equity, every-day corruption and bribery was a massive source of inequity since the rich and powerful were exempt. From this point of view, there is little

doubt that the reforms have successfully produced a more equitable society.

Recent polls clearly demonstrate that small scale bribe-taking is practically non-existent at the moment. In a national poll, sampled from the entire population, the Caucasus Research Resource Centers found that in 2007 only one percent of respondents said they had given a bribe in the last 12 months. This compares to eight percent for Armenia and 20 percent for Azerbaijan in the same survey.<sup>44</sup> A 2007 International Republican Institute Poll also showed only one percent of the population directly experiencing corruption.<sup>45</sup>

This conclusion is supported in a number of different surveys. In Transparency International's Corruption Perception Index, Georgia now scores 3.4 out of ten rather than its 2003 score of 1.8. This makes Georgia 79th out of 179 rather than 124th out of 133.<sup>46</sup>

The impact of the reforms, in terms of the efficiency of society have also been judged to be a great success by organizations that focus on business operation. The 2005 World Bank report on corruption, which takes a business viewpoint, concluded that out of the 27 countries it surveyed, the most dramatic improvements came from Georgia and the Slovak Republic.<sup>47</sup> They further comment that, 'there appears to be a broad consensus that corruption has declined markedly dramatically over the past three years in Georgia'.<sup>48</sup> In the same report, corruption in business deals was reported to have diminished five times, putting Georgia at the level of Germany or Portugal.

The general level of bribery required to operate a business, or the 'bribe tax', calculated by the EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS) as a percentage of annual revenue, dropped by five and a half times between 2002 and 2005, bringing the level to approximately the same as Greece or Germany.

In terms of security, the anti-corruption story is also good. The insecurity created by corruption is related to the rule of law. Laws that are universally applied, and which are adjudicated by an independent judiciary, provide protection from criminal behaviour and so help to offer both economic and personal security. There seems to be little doubt that this security has increased. The police service, who were generally considered a source of criminality rather

Alterations were made to the HCJ in order to reduce executive influence.

## Chapter 1: Rule of law

It is hoped that this division of responsibility will not only make the legal process more transparent, but will also speed it up with different courts specializing in particular functions.

than a protection from it, are now trusted. In a report done by Tbilisi based polling company BCG in 2006, 85 percent of Tbilisi residents polled thought that the police were law-abiding. Perhaps even more impressive, 65 percent said they thought that the police were either 'fairly effective' or 'very effective'<sup>49</sup> This number would almost certainly compare favourably to attitudes in the West.

### Remaining concerns: tensions between executive flexibility and executive power

One of the apparent contradictions in the post-Revolution environment is that while day-to-day corruption is not personally experienced by the population, public opinion polls do not show corresponding faith that corruption has been removed from society generally. Transparency International's index, while showing improvement, still shows that corruption is considered a problem in Georgian society. While people acknowledge that low-level bribery is diminished, they are suspicious that political manipulation and extortion remains at the highest level of Government and business.

There seems to be more to these continuing concerns than simply the pessimism of the general public. In a Georgian context, corruption always operated at two levels. The first and most

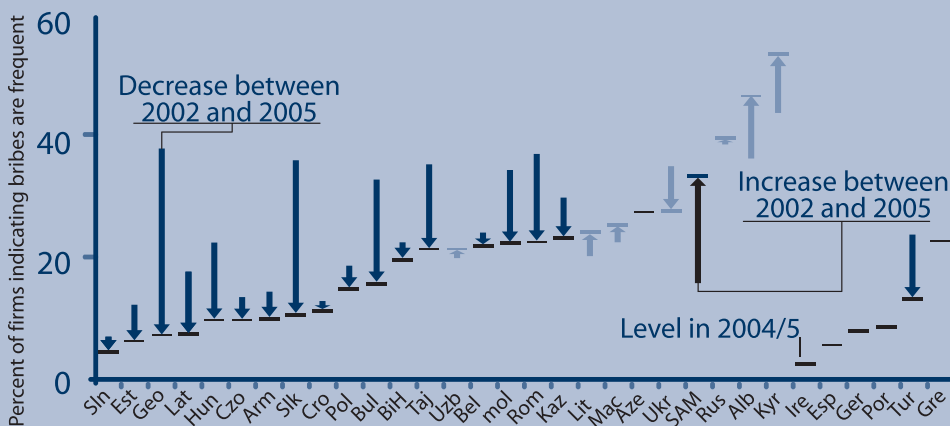
obvious was the day-to-day bribe elicited by the low-ranking official, policeman or judge. Second was the use of power that occurred at the highest level, where the Government would use extra-legal mechanisms to pursue its agenda.

In removing the first kind of corruption and vigorously pursuing rapid reforms, the Government has often ignored concerns over the use of its own power. As a Transparency International, Georgia review of the reforms in the judiciary comments,

*A major obstacle to reform of the judiciary, however, was identified in the contradictory objectives of the reform strategy itself: on one hand, the government strives to achieve quick results and its political distrust of many judges leads to interference in court decisions; on the other hand, it plans long-term reforms that will establish the courts as an independent branch of authority<sup>50</sup>*

This contradiction is apparent in a range of areas and will be discussed in different places throughout this report. In the judiciary, it is clear that bribe-taking has fallen. According to GRECO and the Anti-Corruption Network for Transition Economies (ACN/OECD), the Criminal Code of Georgia substantially complies (in terms of anti-corruption) to the best international practice<sup>51</sup> However, skepticism

**Figure 1.1** Bribery frequency, by country, 2002 and 2005



Source: The World Bank (2006), Anti-Corruption in Transition-3: Who is Succeeding and Why?, (<http://siteresources.worldbank.org/INTECA/Resources/ACT3.pdf>), p16.

in the independence of the judiciary persists. In September 2007 an International Republican Institute poll showed the Judiciary to be the least-trusted state institution. Polls by Transparency International (2007) and the Caucasus Research Resource Centers draw the same conclusion.<sup>52</sup>

Again, this view is supported by more than simply public perception. In their 2007 Global Corruption Report, Transparency International points out that while the Georgian judiciary enjoys high ‘de jure’ independence, in practice, because of executive interference, the judiciary’s de facto independence is much lower. As the Transparency International report continues,

*the community still considers that the judiciary is corrupted. According to the widespread opinion the nature of the corruption in the judiciary has changed. Though the judges do not take bribes, they are under the pressure of the executive power.<sup>53</sup>*

As outlined above, the more recent reforms were specifically designed to respond to these concerns. The legal reforms to the HCJ and changes to rules on judicial prosecution have been welcomed, most recently by the European Commission, as a step forward.<sup>54</sup> However, while extremely important, there is a feeling

that they came too late. The perception remains that judges are heavily influenced by the wishes of the executive. One reason for this is that some judges are reported to be ‘fearful and concerned about their future’<sup>55</sup> In spite of the reforms, there also remains a concern that arbitrary prosecutions or intimidation of the judges will be used as a means of applying pressure<sup>56</sup>

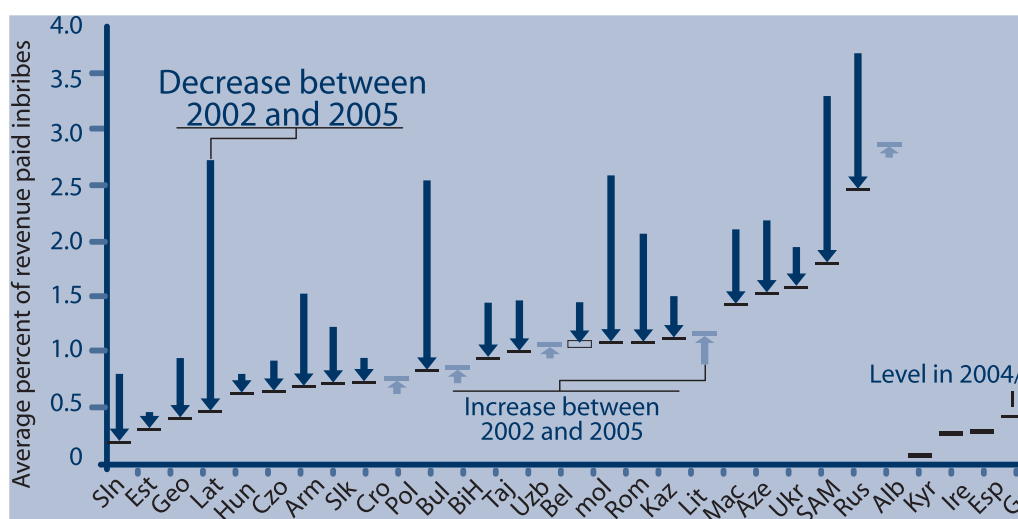
Another problem is that judicial reform has not been responsive to public concerns about executive power. Several reports by the Public Defender’s Office have offered harsh criticism of the court’s weakness in overcoming political pressure, of the absence of clearly-defined selection criteria for judges and of selective prosecution of judges in 2007.<sup>57</sup>

However, parliamentary and official response to the Public Defender’s criticism was limited to the statement that the report had been ‘heard by the Parliament’. This was probably a missed opportunity and only served to fuel speculation that the report, particularly relating to executive influence, had merit.

This is an unfortunate missed opportunity. Recognizing the importance of public perception about the reforms has demonstrated some great successes in building public trust. For example, despite wide international approval, when the university entrance exam was introduced some concerns persisted about the trans-

In removing the first kind of corruption and vigorously pursuing rapid reforms, the Government has often ignored concerns over the use of its own power.

Figure 1.2 Bribe tax by country, 2002 and 2005



Source: The World Bank (2006), Anti-Corruption in Transition-3: Who is Succeeding and Why?, <http://siteresources.worldbank.org/INTECA/Resources/ACT3.pdf>, p11.

## Chapter 1: Rule of law

Recognizing the importance of public perception about the reforms has demonstrated some great successes in building public trust.

parency of the marking process. In response, the National Assessment and Examination Centre took the brave step of making all marked exam scripts available for review by students online. This made it practically impossible for people to maintain suspicions of questionable practices.<sup>58</sup>

Part of the problem here is that the mechanisms appropriate for making initial reforms may not be appropriate in the longer term. While it was necessary to use harsh tactics for reforming the institutions of Government in the first few years after the Rose Revolution, continuing to exert direct executive pressure can undermine the judiciary's independence and efficiency in the long-term. As the World Bank Report explains,

*Many of these changes have been accomplished by a relatively small group of young and very determined reformers. Over the next few years, the government needs to translate these impressive gains into lasting institutional change. This will require decisive reforms to strengthen the rule of law... Committed leadership is important, but transparent, accountable, and well-functioning institutions are the key to good governance over the long term.*<sup>59</sup>

It is hard to assess the impact of these concerns about executive power in terms of human development. The concerns may make people feel insecure. The Government claims that there is little basis for these concerns and points out that in administrative cases (where the Government is prosecuting a citizen, for example, for non-payment of taxes) the Georgian courts have been increasingly prepared to decide against the Government. However, public perception persists that in financially large or politically sensitive cases the Government remains unlikely to lose.

## Chapter 2: Economic reforms – the macro perspective

When the Government came to power in 2004, state finances were in crisis and the key publicly-owned companies were losing money and failing to provide the most basic services (water, electricity and gas). The meagre GEL 14 (USD 6.50) monthly state pensions was not being paid and key portions of the public sector were paid so poorly that they were being forced to depend upon extortion for their survival. The country's basic infrastructure was in a state of collapse, electricity and water supply were unreliable across the country and non-existent in some places, roads were ruined and irrigation systems could not provide water for crops.

Tax collection rates were extremely low. Tax revenue was only 13.9 percent of GDP in 2003, roughly half the proportion of GDP it is now, even though the official tax level was significantly higher.<sup>60</sup> The lack of tax revenue made the provision of basic social services impossible.

The continuation of unofficial and administrative restrictions on trade also had three significant effects. First and most obviously, the time taken to process paperwork, and high official or unofficial tariffs, discouraged imports and therefore reduced competition. Second, since most of this money went into the pocket of border guards and smugglers there was little benefit to public finances. Finally, higher import prices impacted on any import-dependent sector and decreased the returns for rail and transit services.

In other areas of the economy, President Shevardnadze's reforms had also been impressive on paper but hollow in practice. Government put the legislation in place for reforms to key industries. For example, the Law on Electricity and Natural Gas, passed in 1997, set the legal and institutional framework for effective management and oversight of a privatized energy network, fully conforming to international standards.<sup>61</sup> This was one of the reasons why the American electricity provider AES was willing to buy the Tbilisi electricity distribution

company Telasi. However, again, there was no willingness to enforce the law when this meant confronting powerful Georgian entrenched interests. AES-Telasi went bankrupt and reform of the sector never extended beyond Tbilisi. Power supply remained inconsistent in the capital and extremely rare in other parts of the country.

Poor tax collection, the inability to provide basic social services or pay pensions, poor electricity supply and poor growth were all connected and all helped to produce inefficiency, inequity and low levels of social participation, health and security. The situation was extremely problematic in human development terms. By the 2003 revolution, government failures at all levels had become more than a social and economic problem. Solving the problem was a political necessity.

### Fiscal policy

#### Tax reform

Government reforms in tax since the Rose Revolution have been aimed at three related goals. First, reducing corruption in the tax service and tax evasion in society was intended to increase Government receipts. Second, in order to stimulate business development, there was

Tax collection rates were extremely low. Tax revenue was only 13.9 percent of GDP in 2003, roughly half the proportion of GDP it is now, even though the official tax level was significantly higher.

## Chapter 2: Economic reforms – the macro perspective

Companies can now register in three days and a sole trader can register in one day.

an aim to reduce Government bureaucracy and simplify tax payment. Third, the overall level of taxes was reduced. The Government has been remarkably successful in all three areas, reducing tax rates while dramatically increasing Government tax revenue. This has allowed it to significantly increase spending on basic social services (to be discussed later).

The Government's first step was to reduce the size of the Ministry of Finance itself. In order to pursue non-payment, it declared an amnesty on unpaid taxes prior to January 1, 2004, allowing GEL 100 million (USD 52 million)<sup>62</sup> of assets to be legally registered. At the same time they began actively pursuing non-payment of taxes after that date. The tax system was also simplified. The first major reforms in 2005 reduced the number of taxes from 22 to eight; on January 1, 2008 the number was further reduced to six. The tax rates were also reduced at the same time, as can be seen from the table below.

The new 2005 tax code also sought to simplify business registration and tax payment. Business registration, which previously had to take place in a court (with the associated delays) was taken over by the Department of Taxation and the number of documents needed was reduced. Companies can now register in three days and a sole trader can register in one day.

One of the most visible signs of the Georgian Governments' success in legalizing the economy is its increase in tax revenue. Government tax revenue has risen from GEL 1.2 billion (USD 558 million) in 2003 to GEL 4.4 billion (USD 2.6 billion)<sup>63</sup> in 2007<sup>64</sup>, a 172 percent increase in absolute terms. The fact that this was possible in such a short period of time, and in the face of declining tax rates in almost

all areas, indicates the extent to which the previously grey economy has been legalized. There has also been a shift in the composition of the tax burden. Progressive income tax has been abolished and there has been a noticeable shift to VAT as the major source of Government tax revenue, as the chart below indicates.

This dependence on VAT will increase in 2008, as the tax amendments brought into effect at the beginning of the year decreased corporate tax and, by combining income and social tax, effectively reduced the tax on income.

### Spending priorities

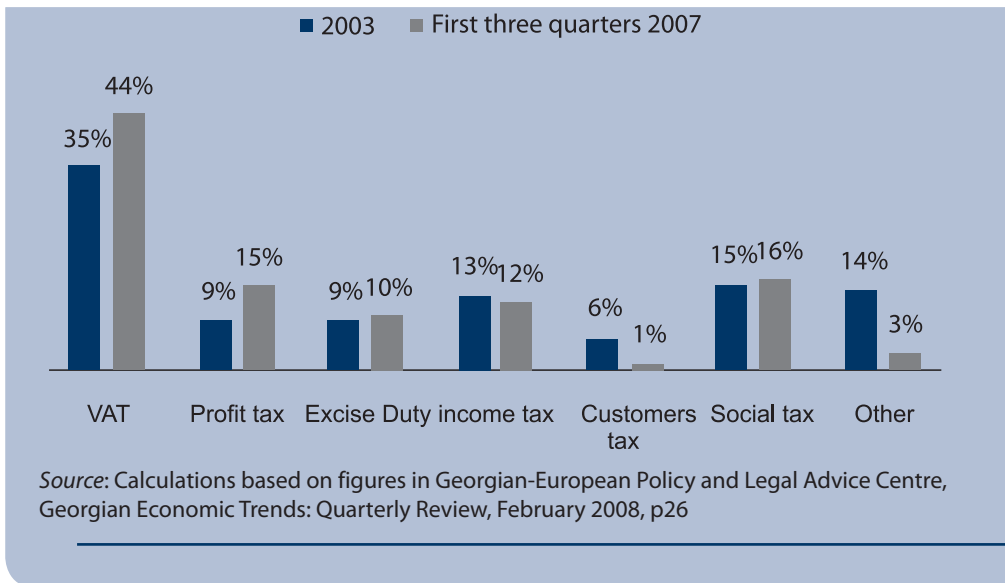
The Georgian Government was able to dramatically increase expenditure in almost all areas after the Rose Revolution, not just because of increased tax income, but also because of income resulting from privatisations. As a result, total central Government spending rose from GEL 897 million (USD 417 million) in 2003 to GEL 5.2 billion (USD 3.1 billion) in 2007.<sup>65</sup>

It is worth noting a couple of changes to the priorities of Government spending between 2003 and 2007. In 2003 social spending was the largest line item on the budget. Social spending dramatically increased in 2004 and was still the largest item in 2005. In 2006, while absolute spending on social security rose, defence became a slightly bigger item of the budget, absorbing 18 percent of total spending, with social security at 16 percent.

In 2007, the proportion of the total budget planned for defence was set to go down and at GEL 397 million (USD 238 million), would have made up ten percent of the total spending for that year. However, as the year progressed,

**Figure 2.1** Main Taxes and Tax Rates in Georgia

	before (percent)	2005 (percent)	2005-2007 (percent)	2008 (percent)
Income Tax	12-20		12	25
Social Tax	27-33		20	abolished
Profit Tax	20		20	15
VAT	20		18	18
Customs Duty	0-30		0.5, 12	0.5, 12

**Figure 2.2** Composition of Tax Revenue (2003 and 2007)

While spending on education and health have gone up significantly since 2003, the increases have not been so dramatic.

budgetary receipts were significantly higher than anticipated and the bulk of that windfall was allocated to the defence budget. Final year Government spending was almost three times higher than planned, at GEL 1.1 billion (USD 659 million), or 29 percent of the total final expenditure.<sup>66</sup>

While spending on education and health have gone up significantly since 2003, the increases have not been so dramatic. Educational spending has gone up from about 2.1 to about 2.8 percent of GDP (not including school rebuilding) and health spending has increased from 1.3 to 1.8 percent of GDP. In the 2008 budget health spending is going up by about 5% in real terms while education spending is going down by about 6%, compared with 2007.

The Government has promised to revise this focus and has given the 2008 budget a 'social emphasis'.<sup>67</sup> Most of the proposed increase will go towards pensions and a job creation programme.

### Trade liberalization policy

The Georgian Government implemented four different kinds of trade reforms: it reorganized and reduced the size of the customs control institutions, simplified the administrative re-

quirements of customs clearance, unilaterally lowered import duties and sought to extend Georgia's involvement in international trade regimes.

The custom system reforms were initially formulated in the Customs System Development Strategy that came into effect in August 2004. This system reduced the number of customs staff by almost half.<sup>68</sup> In April of 2007, the institutions of tax and customs were further reorganized when the tax department, customs department and financial police were combined into a new State Revenue Service under the Ministry of Finance. The first part of this reform was targeted at reducing corruption, but the second component was done to make the new organization more administratively efficient and to facilitate information sharing.

The second set of reforms, aimed at simplifying customs procedures, was again undertaken with the dual goals of anti-corruption and efficiency in mind. Procedures for importing goods are now vastly simplified compared to 2003, as discussed below, and improvements are on-going. As late as 2007, the European Commission's assessment of the European Neighbourhood Policy noted that there had been good developments over the year in the customs declaration system and on coordination of technical regulations.<sup>69</sup>

Third, there have been considerable unilat-

## Chapter 2: Economic reforms – the macro perspective

Already a member of the WTO and the Council of Europe, Georgia joined the European Neighbourhood Programme (ENP) in 2004.

eral reductions in the level of tariffs surpassing any requirement of the WTO. Under 2006 amendments to the customs system, import tariffs were dramatically reduced so that, according to the Government ‘Georgia’s tariff rates are among the lowest worldwide, with custom duties for up to 90 percent of goods at zero percent rate and the rest at five percent or 12 percent.’<sup>70</sup> Minimum volumes for imports below which no taxes are paid have also been raised recently on a range of goods, improving the situation for small importers.

Finally, Georgia has attempted to extend and intensify its involvement in international trade regimes. Already a member of the WTO and the Council of Europe, Georgia joined the European Neighbourhood Programme (ENP) in 2004. These organisations offer advice and support to the Georgian Government for normalisation of customs standards, particularly on phyto-sanitary controls and customs procedures.

In addition, the ENP has facilitated greater access of Georgian goods to the EU market. Within the WTO, it is possible for developed countries to offer a Generalised System of Preferences (GSP) to less-developed countries that allows developing-country goods preferential access to developed country markets. Georgia has GSP arrangements with the US, Japan, Canada, Norway and Switzerland and enjoys a GSP+ status (which includes a wider range of goods) with the European Union. Georgia had

also enjoyed GSP+ status with Turkey since January 2006. There are also continual efforts to further deepen these relationships. Georgia signed a free trade agreement with Turkey in 2007 (which is not yet in effect) and aspires to a free trade agreement with the EU.

On top of this, Georgia is attempting to stimulate its role as a transit- and export-oriented country in a range of different ways. In April 2008, Ras Al-Khaimah (RAK) investment fund from the United Arab Emirates purchased a 51 percent stake in Poti Port for the next 49 years, after winning the government tender to operate the port and an adjacent 400 hectare site as a Free Economic Zone. The capacity of Poti port is planned to increase in coming years from its current level of 8.5 million tons of cargo to 35-40 million tons. The Government believes that this will produce USD 200 million in investment in the next three years and create 20,000 jobs.<sup>71</sup>

### Outcomes of the reforms as reflected in international indices

The Government’s aggressive reforms have moved the country forward dramatically on a number of indices intended to demonstrate the ease of doing business. The biggest rank im-

**Figure 2.3** Georgia’s Rankings by Different indices.<sup>74</sup>

Index	Institution	2007/8 Rank	2006 Rank	2005 Rank
Ease of Doing Business Index (2008)	The World Bank	18	37	112
Economic Freedom Index (2007)	Heritage Foundation	32	52	89
Economic Freedom of the World Index (2007)	Fraser Institute	44	60	64
Global Competitiveness Index (2008)	World Economic Forum	90	86	N/A



provement achieved was on the World Bank's Ease of Doing Business Index<sup>73</sup>, where Georgia moved from 112th place in the 2006 Index to 18th place in 2008. Rank changes in different indices are listed below.

It is worth taking some time to consider the ways in which these indices have assessed different components of the Georgian economic environment. Below is the breakdown of the World Bank report.

As we can see, the reduction of regulations, particularly on employing labour, are seen as one of the great successes of the Government. This is supported by The Heritage Foundation, *Economic Freedom Index*, which ranks Georgia very highly in terms of labour freedom (99.9 percent), fiscal freedom (90.7 percent), business freedom (85 percent) and freedom from Government (81.3 percent).<sup>75</sup> The Fraser Institute, *Economic Freedoms of the World Index* also gives high ratings to market regulations and government.<sup>76</sup>

The reforms have also affected Georgia's international credit ratings. In July 2007, the global credit rating agency Fitch assigned a 'BB-' rating to Georgia with 'a stable outlook'.<sup>77</sup> Standard and Poor's rating in 2007 is that the Georgian economy has a 'positive outlook'.<sup>78</sup>

The Georgian Government has been most successful in indices that prioritise legislative over practical reforms. The World Economic Forum's *Global Competitiveness Index* considers both dimensions and is interesting because of the contrast it reveals. Again, consistent with the other reports, Georgia scores well on 'burden of Government regulations' (14<sup>th</sup> in the world), but badly in other aspects of institutional efficiency, such as 'transparency of Government' (96) and the 'operation of the legal system' (more below). Similarly, when assessing business operation, while the 'time required to start a business' is ranked highly (21) the 'level of competition' (115) and 'customer orientation' (98) do very badly.<sup>79</sup>

Similarly, on the operation of the tax system, the differences across the indices tell an interesting story. The Heritage Foundation and the Fraser Institute rank Georgia fairly well in terms of the tax system, but their assessment is almost entirely an assessment of tax *levels*.<sup>80</sup> The World Bank and the World Economic Forum rank the tax system poorly because they argue that, practically speaking, getting taxes paid is

still an enormously time consuming process. Both groups still think it has improved.

There is common agreement across most indices that the legal system and the independence of the judiciary are low. According to the Heritage Foundation (which gives property rights a rating of just 35 percent), 'Judicial corruption is a problem... Both foreigners and Georgians continue to doubt the judicial system's ability to protect private property and contracts. Enforcement of the law protecting intellectual property rights is weak'.<sup>81</sup>

Similarly, according to the Fraser Institute, Georgia ranked 103<sup>rd</sup> in the world on 'legal structure and security of property rights' (2005 data).<sup>82</sup> The World Economic Forum ranks 'the legal system' and 'protection of property rights' both at 117<sup>th</sup> and judicial independence at 112<sup>th</sup> worldwide (2007 data).<sup>83</sup>

## Investments

The Government has sought to attract investment in the Georgian economy for a range of reasons. From a human development point of view, the Government's priority has been efficiency since increased investment should increase productivity. This is particularly important where the business in question is a key input for other sectors, like electricity. However, from the start, it should be clear that efficiency here is only a partial end in itself. With efficiency, it is hoped, there will be jobs, lower prices and greater opportunities for society as a whole. This section will consider foreign direct investment, privatisation and, as an illuminating case-study, the electricity sector.

### Foreign direct investment

The Government has adopted a twin-approach to attracting FDI. First, it has engaged in the strategy of economic liberalization already discussed in previous sections, reducing the administrative requirements for starting a business, lowering taxes and improving the import/export environment. Second, it has focused on particular industries that it believes could both benefit from investment and attract it. This has often been done alongside certain targeted privatisations.

Figure 2.4

Georgia's Individual 'Ease of...' Rankings with the World Bank

Category	2007 Rank	Category	2007 Rank
Employing workers	4	Enforcing Contracts	42
Starting a business	10	Getting Credit	48
Dealing with Licenses	11	Trading across borders	64
Registering Property	11	Paying taxes	102
Protecting Investors	33	Closing a business	105

Source: World Bank (2008) 'Explore Economies: Georgia', *Doing Business*, (<http://www.doingbusiness.org/ExploreEconomies/?economyid=74>).

The Government has been very successful in attracting foreign direct investment. Net FDI, which was USD 331 million (eight percent of GDP) in 2003, reached USD 1.6 billion in 2007 (15 percent of GDP). Given that the vast majority of FDI in 2003 related to BP and the BTC pipeline, which by 2007 is not a significant factor in the FDI, these figures are even more impressive. Even as BP's investment diminished, overall investment has continued to grow.

It is also worth noting that these investments are fairly well diversified in origin. In 2002-2006, the largest investor was the UK (largely because of BP investments), followed by the US, Turkey, Azerbaijan, Russia and Kazakhstan.<sup>84</sup> Since 2006, the group has widened further still, with large investments coming from the Czech Republic, Ukraine and the United Arab Emirates.

### Privatisation

The range and profile of the businesses available for privatisation in 2003 was considerable. Approximately 1,800 enterprises of various sizes were designated for privatisation. The size and nature of privatisation deals have changed over time. As the graph below illustrates, while the number of privatizations has gone down dramatically, the size of the privatisations has moved in the other direction.

For this reason, the European Bank of Reconstruction and Development (EBRD) un-

surprisingly shows a significant improvement in the privatisation of large businesses, from 3.3 out of five in 2003 to four out of five in 2007.<sup>85</sup>

### Electricity sector reforms

In June 2006, the parliament of Georgia approved the 'Main Directions of the State Policy in the Energy Sector of Georgia'. This stated that,

*The main task of the long term policy in the power sector of Georgia is full and gradual satisfaction of the demand on electricity resources on the basis of its own hydro resources: first with the help of import, then by its substitution with thermal generation.*<sup>86</sup>

The strategy of focusing on hydro-electric energy production was aimed at utilizing Georgia's abundant river resources to ensure continuous electricity supply, reduce dependence on foreign and unreliable supplies and avoid significant Government emergency expenditure. It was also hoped that this could all be done without significant increases in price.

There were two key elements of the electricity system that needed to be reorganized: distribution companies and electricity producers. The starting point of this problem was collection. Without well-managed collection, there were no funds for electricity distributors to pay producers, and so there would be no mo-

tivation for investment in maintenance of the distribution system, existing energy production or development of new capacity. While the American electricity company AES had taken the bulk of the responsibility for the reform of distribution management in Tbilisi when it bought Telasi, in the regions there were a number of companies and no investors expressed an interest in their privatization.

In an attempt to restructure energy supply and distribution throughout the country, the Government unified the various distributors into one company. The combined United Energy Distribution Company serves every region of Georgia (outside of Tbilisi) except Kakheti. The Government also enacted legislation that allows individual contracts with suppliers and the right to cut off communal meters for non-payment. As a result, the Government was able to dramatically increase collection rates, from 20 percent in 2003 to 95 percent in 2007, when the company was sold to Energo Pro in the largest privatisation deal in the sector.

The second goal of energy reform was to increase efficiency in the existing hydro plants and to build new electricity production capacity. The state financed the renovation and repair of hydro-electric power stations across the country, most significantly repairing the Inguri hydro dam, which today provides 40 percent of Georgia's electricity needs.<sup>87</sup> State owned plants were sold (with the exception of the Inguri dam) and power plants with a capacity of less than 10 megawatts were deregulated. At the same time, the Georgian Natural Energy Regulatory Commission (GNERC) guaranteed that these smaller energy producers would receive a minimum rate for their electricity so that they could justify investment with guaranteed cash flow. As a result, a large number of new power projects have been submitted to local commercial banks.

## **Human development impact**

### **Fiscal policy**

From the human development perspective, fiscal policy affects the Georgian population in two ways: as both tax-payers and consumers of social services. It has obvious consequences in efficiency, equity, sustainability and, to a lesser

extent, security.

From the point of view of tax payers, three issues are relevant: tax level, distribution and collection method. First, since total tax income has gone up dramatically, overall tax payments by the population have obviously gone up, even though the tax rates have decreased. Second, in terms of distribution, there are clear indications that, since 2003, the Georgian tax system has collected more taxes from the poor as a proportion of their income and as such is less equitable. An income tax system that charged higher rates to higher incomes was replaced with a flat-rate income tax. In addition, the shift towards VAT as the Government's main source of tax income (around 44 percent for 2007 and rising in 2008) is disproportionately borne by lower-income households, who consume a higher proportion of their income (while rich people save and invest more). This is particularly true in Georgia, where food (except raw fruits and vegetables) is also taxed.<sup>88</sup>

The impact on poor households is partially offset by a number of tax exemptions. Farmers earning less than GEL 100,000 (USD 65,800) are exempt. This should result in exemptions for half the population. However, income tax was only 22 percent of overall tax revenue in 2007 and, as the Government plans to lower it still further, the mitigating effect of this exemption will lessen.

The fact that VAT exemption is also offered to businesses earning less than GEL 100,000 (USD 65,800) *seems* to also lessen the impact on lower income households, but if the business is buying from a larger wholesaler who will have paid VAT already, then this will be passed on to the end consumer (this is why it is called 'value-added' tax).<sup>89</sup> This effectively results in an increase in price for the consumer.

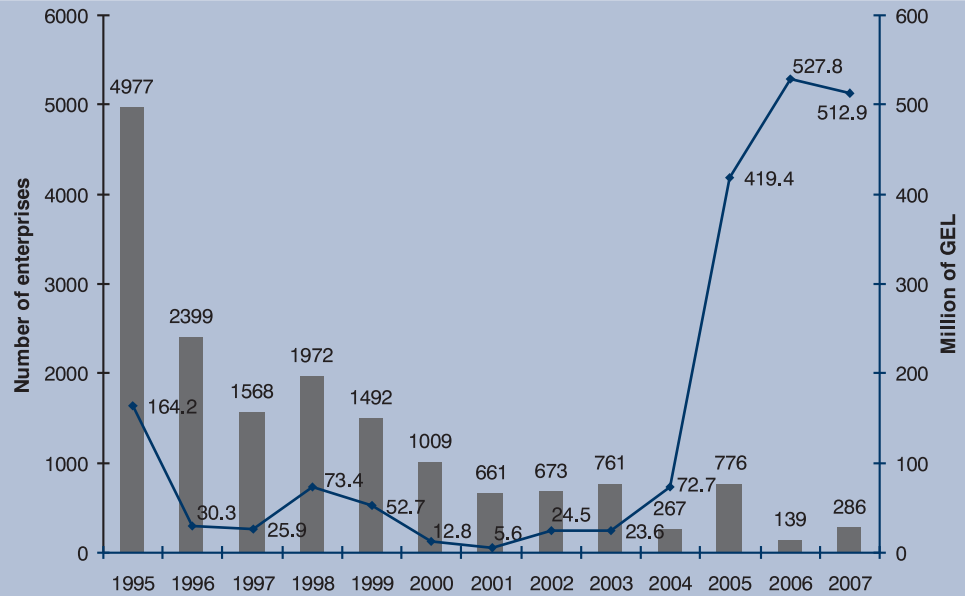
Finally, the way taxes have been collected, and the rules associated with them, have created considerable concern. This is based on two main issues. First, in order to ensure complete payment of taxes, all retail outlets were required to have cash registers and to keep records of sales using them. This was an expense to retailers, since the Government-sanctioned cash register cost GEL 300 (USD 168). It was also backed by the threat of large fines and caused protests when it was first initiated.<sup>90</sup> Second, the way in which the tax police pursued non-payment was seen as excessively harsh, lacking due process

With efficiency, it is hoped, there will be jobs, lower prices and greater opportunities for society as a whole.

There were two key elements of the electricity system that needed to be reorganized: distribution companies and electricity producers.

Figure 2.5

Number of privatised units and income from privatisation in Georgia, 1995-2007



Source: Department for Statistics, Ministry of Economic Development

and biased in favour of the Government.

This can create issues of economic security since, if people feel they are being arbitrarily targeted, they may not feel that any economic improvements they find in their lives are secure. This is a hard question to judge since it is difficult to distinguish between those who simply complain when they are legitimately asked to pay taxes for the first time and those who feel they are unfairly targeted. Contrary to public perception, increased equity in adjudication of complaints seems to be suggested by the increase in court cases that citizens are winning against the Government.

The human development impact of the Government's spending priorities is also difficult to assess, but for different reasons. While the human development perspective would seem to prioritise spending on areas like health and education that directly target efficiency, equity and empowerment, all Government spending can have an impact on some area of human development and it is ultimately the choice of a democratically-elected Government how they choose to distribute public finance. In this way, defence spending can be a legitimate response to security concerns. Since Georgia obviously faces a particularly difficult

set of security circumstances this may justify higher defence spending.

Nonetheless, by international standards, defence spending in Georgia is extremely high as a proportion of GDP while spending on health and education is fairly low. Georgia's defence spending in 2007 was roughly ten percent of GDP, putting Georgia second in the world in terms of military spending.<sup>91</sup> This may be a short term phenomenon. Georgia's *Strategic Defence Review* makes it clear that the objective of current reform is to modernize an out-of-date force and that spending on the military will decrease as a proportion of GDP over the next eight years, to a stable 2.3 percent level.<sup>92</sup> However, there is little indication that defence spending is heading in that direction at this time.

Similarly, the 2008 budget is intended to be more socially oriented. However, the definition of 'social' in the 2008 budget is fairly narrow. While pensions and social assistance benefits will go up, expenditure on healthcare will only go up slightly and spending on education will actually go down slightly in real terms. Also, while military spending will go down from its 2007 high, it will still be six percent of GDP.

## Trade policy

In addition to combating corruption, which we have already discussed, the most obvious impact of the unilateral improvements in access to the Georgian market was to make business, and particularly importing, easier. This has been a success. According to the *World Bank Ease of Doing Business Report*, by 2007 it was 20 percent cheaper to export and almost 30 percent cheaper to import a cargo container of goods into/out of Georgia than the regional average. A large part of this difference was the result of administrative simplification.<sup>93</sup> For this reason, international business people routinely consider Georgia one of the easier places to do business in the region. For example, the American Chamber of Commerce states that between 2004-2007, Georgia improved its customs regime dramatically and, as a result, it is now easier to import into Georgia than into Armenia or Azerbaijan.<sup>94</sup>

Increased prosperity in certain sections of society, combined with fewer restrictions on imports, has had the additional effect of dramatically increasing the volume of imports. Since this has not been matched by a corresponding growth in exports, Georgia's trade balance on goods and services has increased from a deficit of USD 578 million to 1.8 billion between 2003 and 2006 (with projections of 2.2 billion for 2007). This has largely been financed, up until now, by capital inflows (mostly foreign direct investment and remittances), but it certainly creates issues of sustainability in the long-term.<sup>95</sup>

The most obvious human development impact of these changes is that one would hope competition with the local market should lower prices and increase the consumption possibilities of average Georgian consumers. However, up until now if we look at the main import categories, we can see that they are unlikely to have resulted in dramatic downward pressure on prices for goods that affect the majority of the population.

The highest growth area for imports, in absolute terms, is hydrocarbon-related products (oil, gas and related products). These have grown from USD 148 million in 2003 to USD 656 million in 2006, probably *because* of increases in prices.<sup>96</sup> The next biggest increase in imports has been motorcars, principally originating from the US and Germany (from USD 47 million in

2003 to USD 295 million in 2006).

Seen even more narrowly, for prices to impact on equity they would have to lower prices on the main consumption items, particularly food. However, tariffs on agricultural products have not gone down as much as in other areas so import-led downward-pressure on food prices are unlikely. This may change in the future. Georgia's new Free Trade Agreement with Turkey will significantly open Georgian markets to Turkish agricultural imports, while at the same time allowing tariff-free exports of Georgian wine to Turkey. This has the potential to create downward pressure on Georgian food prices, though it will also increase competition for Georgian farmers.<sup>97</sup>

If assessing the impact of trade-related reforms on imports and prices is difficult, it is even harder to assess their likely impact on local productivity or the export market since most of the benefits of the reforms are indirect. The one area of these reforms which would hopefully have the most noticeable impact are the free trade zone with Turkey (that, as mentioned, has already been agreed) and a deepening free trade relationship with the EU (which is a goal of the Georgian Government). The human development impact of these benefits depends on exactly what goods are covered.

It is commonly accepted that in Georgia encouraging agricultural production would be the most reliable way of impacting on poverty since agriculture is by far the biggest employer and agricultural productivity is lower than almost any other sector. In the case of EU, trying to assess the impact of trade regimes on Georgian agriculture involves three issues. First, will the trade regimes include access to the (traditionally protected) agricultural markets and particularly, wine? Second, would Georgian produce find a market in these places if they were open? Third, what will the reciprocal access of foreign exporters mean for local producers?

A recent UNDP report evaluated the likely impact of a Free Trade Area with the EU and concluded that the economic benefits would probably be marginal, with a likely 0.1 percent yearly increase in agricultural output, 0.13 percent in manufacturing and 0.05 percent in services. This was largely because most of the goods that would be covered by an FTA are already covered by GSP+. However, the report still believed that an FTA could further Georgia's

From the human development perspective, fiscal policy affects the Georgian population in two ways: as both tax-payers and consumers of social services.

## Chapter 2: Economic reforms – the macro perspective

Nonetheless, by international standards, defence spending in Georgia is extremely high as a proportion of GDP while spending on health and education is fairly low.

long-term objectives by deepening its connections with the West, thereby creating long-term economic and security benefits.<sup>98</sup>

Looking at the specifics of the most recent agreements may give clues as to areas of benefit. As mentioned, the free trade agreement with Turkey should benefit Georgian wine exporters and Georgian consumers, but it will carry certain costs for Georgian farmers. That said, the benefits of any trade agreement are limited by the degree to which local businesses understand and can utilise them.

Whether the goods are suitable for western export markets is another issue. Productivity in the Georgian agricultural is low and stagnating:

*Georgian farmers do not engage in the kind of commercial planning and contracted relationships necessary to supply export markets. Even in Moscow [a less Westernized market space] there are only 5 or 6 major retailers, and they want suppliers who can provide reliable products year round – and they are pretty vicious in pricing. Georgia is just not able to provide them with the quality and consistency of product they demand.<sup>99</sup>*

This may be an overly pessimistic view. There are clearly some areas of the Georgian agricultural sector which already have demonstrated export potential. In spite of the closure of the Russian market for selected Georgian products, which has made Georgia's principle export market more or less completely inaccessible, Georgia still exported USD 36.7 million of fruit, USD 10.2 million of wine and USD 19.2 million of spirits in 2007.<sup>100</sup>

More interestingly, fruit, which has preferential access to the EU market, has seen considerable recovery since Russia closed its market to many Georgian products in 2005. Fruit that was exporting at a level of USD 44 million in the fourth quarter of 2005 was exporting at USD 36.7 million in the fourth quarter of 2007 (or 83 percent of its previous level in absolute terms). Around one half of total exports in fruit appear to be going to Europe.<sup>101</sup> Wine, however, which does not have access to Europe under GSP+, at USD 10.2 million for the same quarter was less than 40 percent its 2005 level in absolute terms.<sup>102</sup>

Though this will need considerably more intensive research before firm conclusions can be drawn, it does seem as though widening and deepening the involvement of Georgia in foreign trade regimes might hold out opportunities for Georgian exporters, produce jobs, improve incomes and lower prices. Unfortunately, as with so many of the Government's macroeconomic changes, it is hard to assess the level of benefit, since it will take considerable time for the Georgian economy to recognize and take advantage of these opportunities.

### Assessments of the business environment

The generally good assessments of the reforms have therefore focused on the Government's ability to remove restrictions and, in so doing, increase the efficiency of Georgian business. They have, however, led to one general concern, in human development terms, that some of the limitations on business activity might have served a useful purpose. This report will discuss the environment later, but another consistent issue has been labour. Making business easier in Georgia has involved removing labour protections. The recent ENP assessment of Georgia is unusually straightforward in suggesting that this might have gone too far: 'the labour code contradicts both EU standards and the European Social Charter that the country ratified in July 2005'.<sup>103</sup>

The Governments reaction to this issue is to disagree with this assessment. It also highlights the ineffectiveness of previous legislation. It argues that, since labour protections never really worked in Georgia, removing these restrictions to business carries no cost in terms of equity. The very fact that this issue has not gained significant traction locally may suggest that the Government is right. As a Transparency International, Georgia report suggests, the easing of labour legislation in Georgia is widely accepted among local groups:

the new labour code, with its flexible stipulations regarding employer-employee relations, was regarded as one of the most progressive steps towards economic development by opposition and civil society representatives.<sup>104</sup>

### Investment

The reasons for attracting foreign direct investment and for encouraging investment in companies through privatisation are remarkably similar. Both foreign direct investment and privatisation involve the investment of capital and expertise in a company and should, therefore, increase the efficiency with which it uses resources.<sup>105</sup> Both forms of investment have initial economic benefits. Privatisation makes funds available for the Government budget and foreign investment makes foreign currency available to cover trade deficits.

It is also hoped that private investment, particularly FDI, will introduce new expertise and money into a business. This should have direct benefits for the business and its employees/customers, since higher productivity should translate into more jobs, higher wages, better service and/or lower prices, and can be equally important in training local people and supporting secondary businesses.

The two crucial issues that decide the im-

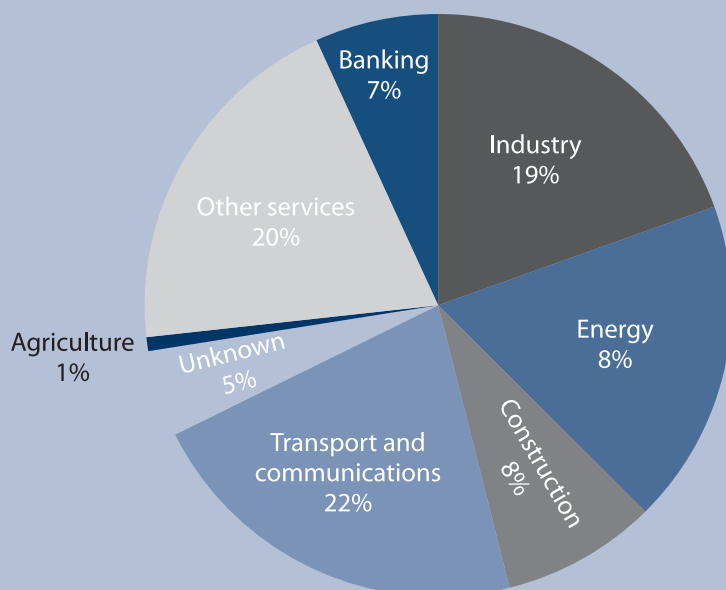
act of foreign direct Investment from a human development point of view are productivity/employment and pricing. Productivity and employment, for the most part, relate to efficiency while pricing usually relates to equity and sustainability. If a public asset is bought by a private company and productivity goes up, we would expect it to employ more people (or pay current employees better) or to lower prices in order to sell more goods. That said, the degree to which FDI and privatisation can be depended upon to resolve the country's economic woes heavily depends on the sectors in which investment occurs. Below is the sector breakdown of FDI for 2007.

It is hard to make any generalizations about the likelihood for long-term employment or the broader impact of these figures. However, one thing stands out: agriculture, which is by far the largest employer, only attracted 1 percent of the investment for 2007.

For privatization if one simply thinks in terms of efficiency, then Georgia's main privati-

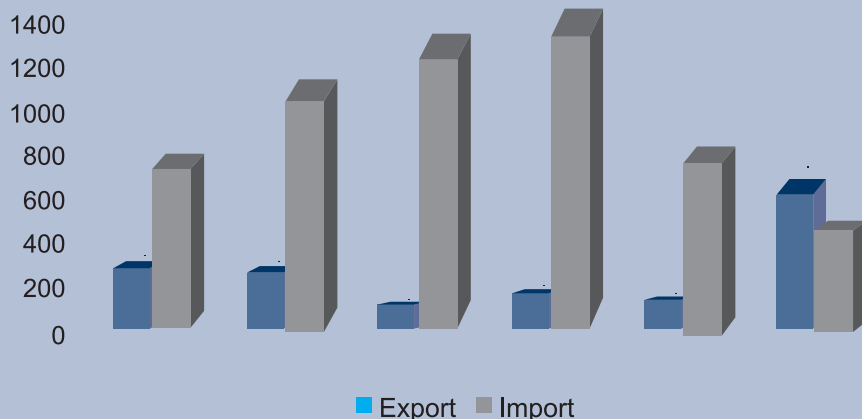
It is commonly accepted that in Georgia encouraging agricultural production would be the most reliable way of impacting on poverty since agriculture is by far the biggest employer and agricultural productivity is lower than almost any other sector.

**Figure 2.6** FDI by Sector 2007 (Total USD 2 billion)<sup>109</sup>



Source: Provided on request by State Department for Statistics (June 2008). This is the first year that the SDS has gathered sectoral information on FDI.

Figure 2.7 Export and Import of Electricity in Georgia from 2002 to 2007



Source: Ministry of Energy of Georgia (2008).

As mentioned, the free trade agreement with Turkey should benefit Georgian wine exporters and Georgian consumers, but it will carry certain costs for Georgian farmers.

sations seems to have been successful so far and are definitely contributing to national productivity, particularly with respect to the balance of trade. The categories ‘ferroalloy’ (manganese) and ‘copper ore and concentrates’ are Georgia’s two biggest exports; ‘unprocessed or semi-processed gold’ and cement are also the fourth and fifth biggest. All four are produced by privatized companies and all of them have seen dramatic increases in exports since 2004.<sup>106</sup>

Since privatisation involves Government assets, and while it is important to look at the proceeds that the Government managed to collect, it is also necessary to assess whether the Government received, and was seen to have received, a fair price. If privatized assets were under-valued this creates issues of equity, since the sale involved a transfer into private hands. In terms of judging the sale price, likely reliability of the purchasing company and the state authorities who conducted the sale, transparency is key. On the scale of transparency, auctions are the most transparent type of sale because evaluation criteria are clear and simple. Direct sales are probably the most suspicious since, without a field of competitors to establish a market price, how is one to judge value? Given the history of corruption in previous administrations, many people will simply *assume* that a direct sale involves corruption of some kind. Unfortunately, even if the bid is an open competition, it takes considerable efforts to ensure transparency.

Four requirements seem to be a minimum to ensure transparency in the privatisation process. First, it has to be clear exactly who is bidding. Of course, in the modern world this may be difficult, since it is possible for investors to disguise money-laundering or insider-dealing as legitimate-looking businesses. However, it seems sensible that, as a minimum, the names and backgrounds of those who direct or manage any potential privatisation (over a certain size) need to be a matter of public record.

Second, the criteria for selecting a particular bidder should also be clearly laid out in advance. This might be difficult, since developing the criteria (for example, understanding the type and value of investment needed) may be beyond the expertise of civil servants. But where necessary, they should bring in experts to clarify the terms.

Third, the details of all bids should be made a matter of public record. Finally, any post-bid negotiations should take place with every possible effort to ensure that the initial bidders are treated in good faith. If the initial bid needs to be significantly revised for some reason, then the initial bidders should be given an opportunity to modify their tender.

The number of actual deals that are sold by direct sale or by ‘competitive direct sales’ is fairly low compared to the number that are sold at auction. However, these less transparent sales processes are often used for some of the most significant and more complicated sales. This is unsurprising since one would expect the Government to want greater flexibility in the sale of strategic assets. However, when these sales often seem to appear and disappear without explanation, when the criteria for evaluating bids is not clear and when the financial value of the bid seems to be renegotiated even after the bidding contest has been completed, it is easy to see how speculation and rumour might arise.

### The electricity sector

The efficiency of the energy sector is crucial. However, the privatisation of energy also brings up questions of equity, as prices can be hardest felt by the poor. It is very hard to argue with the basic successes of energy reform and privatisation in efficiency terms. Reliability and coverage of supply have been dramatically increased



**Figure 2.8** Changes in Prices and Billing (before and after June 2006 including VAT)<sup>50</sup>

Tbilisi						
Pricing 'steps'	Prices		average (GEL)	payment	Increase (%)	
	May-06	Jun-06	May-06	Jun-06	Price	Bill
100kwh		13.5	6	7	13	17
101-300kwh	11.97	16	20	26	34	30
over 300kwh		17.6	60	85	47	42
In the regions						
	Prices		average (GEL) <sup>1</sup>	payment	Increase (%)	
	May-06	Jun-06	May-06	Jun-06	Price	Bill
100kwh		13	3.9	6.5	63	67
101-300kwh	7.965	16.5	11.9	23.5	107	97
over 300kwh		17.5	146.7	234.6	120	60

Source: USAID (August 2006), EE Office Energy Series: Electricity Tariff Increases

so that there is now, more or less, continual power supply across the country. Companies in the utility sector are now able to cover their operating costs and invest in the capital repairs necessary to make the system sustainable.

Moreover, deregulation of the production sector has encouraged small hydro-production and so Georgia is becoming an increasing exporter of electricity. This is a dramatic reversal from the point where 'The financial losses of the electricity sector totalled between USD 250 million and USD 400 million annually, which was equivalent to 7.5 – 15 percent of gross domestic product in 1995 – 98'.<sup>107</sup>

As the new hydro-electric dams that are currently being built by private investors and the dams that EnergoPro have promised to build, come online, this situation is likely to get become even more favourable to Georgia.<sup>108</sup>

A number of the reforms that have brought about this change have not been so broadly welcomed. For example, outside of Tbilisi, individual metering for electricity has been rare and so legislation passed by the new Government made it possible for the electricity distributor to cut off electricity based on communal meters. In this way, it is the responsibility of one customer to collect payment for an entire group. Non-payment of that bill in full will re-

sult in the disconnection of the entire group. However, what has caused most upset has been the increase in prices in June 2006. The effect of that increase is outlined below.

As the table shows, in order to mitigate the effects of the price increases on individual families a 'stepped' pricing system was introduced. Since poorer families usually consume less, this system charges a lower unit price to those consuming less. However, even with this, the price of electricity increased by 13 percent in Tbilisi and 63 percent in the regions.

In both equity and security terms the benefits of widespread, reliable electricity definitely seem to outweigh the equity problems created by increased costs, at least at this point. While increases in costs may have impacted some of the most vulnerable families, the increase in opportunities that continual power-supply provides is massive. Without electricity, it is necessary to organize life around daylight hours (candles are expensive). Increasing this scope of opportunity should not be underestimated.

In general, therefore, one can say that the macroeconomic reforms have improved the efficiency of the economy and the sustainability of public finances and vital utilities. Some equity concerns persist but these will be discussed in more detail in the next section.

However, one thing stands out: agriculture, which is by far the largest employer, only attracted 1 percent of the investment for 2007.



# Chapter 3: Economic reforms – the household perspective

Average incomes continue to be lower than they were in 1991. When the Government came to power in 2004, poverty was acknowledged to be a major problem and, along with unemployment, was one of the most pressing issues that faced the Government and the people. What little social assistance that did exist was directed at particular categories like pensioners, the disabled or orphans. Historically, there has been no attempt to offer means-tested social assistance in Georgia, and no mechanism for identifying the socially vulnerable.

In 1996, a series of quarterly studies were initiated by the State Department of Statistics with the intention of building instruments for better understanding the economic situation in the country, though this by itself could not have offered a mechanism for targeting the vulnerable. By 2003, targeting would have been irrelevant anyway, since the disastrous situation in public finance made it all but impossible to pay for existing programmes of social assistance, let alone to initiate new ones.

Even under President Shevardnadze, pensions and social assistance took up the largest part of the state budget. Pensions were offered on a range, depending upon one's pension category (veterans, for example, got more than the basic pension), but the minimum pension was GEL 14 in 2003, and all the categories often went unpaid.

In human development terms, high levels of economic poverty are not just bad because of the inequity it reflects. Economic poverty fundamentally retards basic human freedoms, since the ability to participate in society is more or less impossible if one is extremely poor. Widespread economic poverty also impacts on efficiency since the poor have few resources with which to be able to improve their situation and, therefore, to contribute to the growth of an economy.

Economic poverty fundamentally retards basic human freedoms, since the ability to participate in society is more or less impossible if one is extremely poor.

## Incomes and income distribution in Georgia in 2004

One of the notable successes of the Georgian economy has been the strong growth in GDP per capita, from 5.9 percent in 2004 to around ten percent for 2005 and 2006 and 12 percent for 2007.<sup>111</sup> Increases in average nominal wages has been equally impressive, showing eight percent real growth for 2003, 22 percent for 2005, 18 percent for 2006 and 10 percent for 2007.<sup>112</sup> However, these income figures relate to those in full-time employment and are probably not representative of the entire population.

Income distribution is difficult to establish. Official figures show a slight drop in the GINI coefficient, suggesting a slight reduction in the level of inequality, but this does not seem to be consistent with most people's day-to-day experience: a relatively small section of Georgian society seems to have become dramatically richer in the last few years, while the majority has not seen vast income improvements.

Polling also suggests that people do not *feel* that their lives have improved economically. The International Republican Institute conducted six polls since 2004 and only once in that time did more people say their financial situation had improved, rather than worsened, in the preceding three months. In September

2007, eight percent said their situation had improved while 46 percent said that it had worsened.<sup>113</sup> Similarly, the Caucasus Research Resource Centers *Data Initiative*, which polls a representative sample of 3,300 people nationwide, said only 18 percent reported their financial position to have improved between 2005 and 2006.<sup>114</sup>

### Poverty estimates

Understanding and estimating poverty is one of the hardest tasks of any human development assessment in Georgia. In 2003, Government figures show that 54 percent of families were living in poverty. This went down to 52 percent in 2004.<sup>115</sup> A comparable figure has not been released since 2005.

There are good reasons to believe that this estimation of poverty in Georgia may be too high. The poverty figures are calculated using the State Department of Statistics' Integrated Household Survey and this is considered by many to be an unreliable survey. In addition,

the basket of goods the SDS historically used for calculating poverty had more high-value food-stuffs (like meat) than poor families typically consume. It also counted poverty in terms of percentage of households, not in terms of people; this tends to overestimate poverty, since small households are generally poorer.

As an alternative indicator, initial estimates published by the IMF (using World Bank figures) suggests that absolute poverty has increased marginally, from 27 percent in 2004 to 31 percent in 2007.<sup>116</sup> Slightly higher than this, about 1.5 million people, or slightly over one third of the population, classify themselves poor by registering in the database of socially vulnerable families.<sup>117</sup>

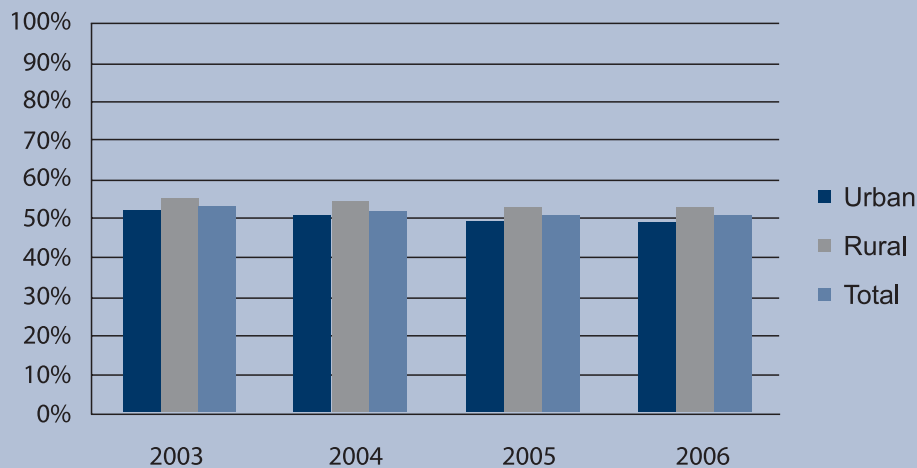
Finally, by the UNDP's two dollars a day estimate, 25 percent of the population lives in poverty. This crude figure allows comparison with other countries in the region.

While there is no consensus about the absolute level of poverty in Georgia, there seems to be a general agreement that there has been little change in either poverty or extreme poverty over the last four years. In addition to the IMF assessment, the European Commission's assess-

**Figure 3.1** Population living below USD 2 a day (percent)<sup>118</sup> and GINI index<sup>119</sup>: cross national comparison

Country	Population living below two dollars a day (percent)	GINI index (date of estimation)
Georgia	25.3	40.4
Armenia	31.1	33.8
Azerbaijan	33.4	36.5
Bulgaria	6.1	29.2
Estonia	7.5	35.8
Latvia	4.7	37.7
Slovakia	2.9	25.8
Kazakhstan	16	33.9
Kyrgyzstan	21.4	30.3
Lithuania	7.8	36.0
Moldova	20.8	33.2
Russia	12.1	39.9
Tajikistan	42.8	32.6
Ukraine	4.9	28.1

Sources: UNDP (2008), Human Development Report 2007/2008, available at <http://hdrstats.undp.org/indicators/147.html> and <http://hdrstats.undp.org/indicators/24.html>.

**Figure 3.2** Percentage of Per Capita Expenditure on food

Based on consumption patterns from the Department of Statistics (March 2007).

ment for 2007 reports that, ‘no progress can be reported as regards poverty reduction and social welfare’.<sup>120</sup>

This is further supported by the household expenditure patterns. Expenditure on food as a proportion of income is a classic indicator of poverty, because as income goes up, percentage of income spent on food goes down. In Georgia, since 2003, household expenditure on food has remained fairly constant, at 50 percent of income.

### Poverty determinants

If we accept that poverty in Georgia has not changed dramatically over the last five years, then this fact clearly demands some explanation, particularly given the increase in a range of major macroeconomic indicators, such as per capita GDP. Putting to one side income redistribution and targeted social assistance (which will be discussed below), there are essentially three different arguments that might explain the persistence of poverty in Georgia.

The first version focuses on external shocks. The World Bank argues that the slight increase in poverty after 2004 is explained by uncontrollable events. A range of external factors could have impacted on the income possibilities of

the very poor in Georgia in recent years, but the two most obvious are the closure of the Russian market for selected Georgian products in 2005 and significant flooding that happened in Georgia in the spring of the same year.

The second and third arguments are structural and largely depend upon one’s economic philosophy. The second argument notes that, during its first term, the Government’s reorganization of the economy was largely focused on normalization of the economy and improvement of the business climate. This done, the economically liberal position argues, we would not expect these changes to filter down to the very poor in the short-term, but the changes have set the groundwork for future improvements. Using a version of these first two arguments, the World Bank suggests that,

*the unusually severe floods and the impact of external shocks in 2005 took a toll on the rural areas, where about 60 percent of the poor reside, and on the economy. The negative impact of this shock and the deep economic restructuring of the economy contributed to a rise in overall poverty to 32.9 percent in 2005.*<sup>121</sup>

However, as they continue,

### Chapter 3: Economic reforms – the household perspective

In fact, the share of agriculture in GDP has fallen from 19.3 percent to 9.7 percent from 2003-2007 and, in real terms, production has declined by approximately five percent over the same period.

*As reforms are being implemented, business opportunities are expanding, foreign direct investment... is expanding... the Government has increased social spending and introduced the targeted assistance program for the extreme poor. As a result, the trend towards the gradual alleviation of poverty is becoming more resilient to shocks.*<sup>121</sup>

The third argument is that the liberal, free-market orientation of the reforms as themselves part of the problem and poorly suited to poverty alleviation since they expose an unprepared population to the vagaries of the market. It is certainly beyond the scope of this report to adjudicate this dispute. The sections that follow will discuss three possible reasons why the benefits enjoyed by the economy as a whole have not been enjoyed by the very poorest in society so far. However, these are only intended to be suggestive and cannot explain whether the poverty trends will continue.

#### Decreasing output in agriculture

One of the most obvious reasons why the growth and the expansion of social programmes has not really affected poverty and unemployment is that, despite considerable effort, agriculture has not developed. In fact, the share of agriculture in GDP has fallen from 19.3 percent to 9.7 percent from 2003-2007 and, in real terms, production has declined by approximately five percent over the same period. This is not necessarily a negative process if it reflects transition to more productive sectors of the economy.

However, according to official statistics, agriculture employed 55 percent of the population in 2006.<sup>122</sup> This probably makes it Georgia's most important sector from a human development point of view, and its diminishing share in GDP suggests, at the very least, that society is becoming more inequitable. Perhaps more importantly, the value added per employee in agriculture is practically the lowest in the economy and has not improved since 2003.<sup>123</sup> As a result, the European Commission Delegation to Georgia reports,

*Limited progress was achieved on implementing the commitments on agriculture in the ENP Action Plan. A working group in*

*charge of the development of an agricultural strategy was established in June 2007, and a tender for the preparation of a medium-term strategy in agriculture was launched in November 2007, with the support of the World Bank. A first draft is expected by May 2008.*<sup>125</sup>

It is impossible to know exactly how agriculture has been affected by the reforms because the closure of the Russian market for Georgian agricultural products in 2005 has certainly made life difficult for some of the most lucrative agricultural sectors, particularly wine. If one simply looks at exports, most agricultural goods are producing significantly below 2005 levels. What's more, the overall recovery in exports since the closure of the Russian market has been largely driven by growth in exports of mining and mineral processing.<sup>126</sup>

Restrictions on access to the Russian market have almost certainly been hardest on small producers. While larger exporters may be able to re-orient themselves to different export markets, it seems unlikely that small producers will be able to adapt in the same way in the short-term.

Opinions differ on the likelihood of promoting growth or alleviating poverty by targeting agricultural productivity. Considerable money and time has already been spent trying to improve the productivity of the agricultural sector, both by the Government and the international community. Improving infrastructure, particularly in the form of roads and irrigation, has been a major target of aid and development money as well as Government resources. For example, the Millennium Challenge Corporation has disbursed almost USD 100 million for road rehabilitation. At the same time, there have been efforts to improve the availability of inputs and capital such as machinery, seed and fertilizer, to encourage cooperation of agribusiness in purchasing and capital use and to provide advice and expertise on modern farming methods and more marketable crops. However, the benefits of these efforts have so far been minimal on overall productivity.

At the same time, aggressively encouraging the structural changes necessary to dramatically improve agricultural productivity could have negative impacts on poverty. Probably the biggest hurdle to agricultural productiv-

ity is the small size of land plots. These plots, while fairly unproductive and insecure, at least provide a subsistence income for a huge proportion of Georgia's population. Encouraging the consolidation of these plots, while positive from an efficiency point of view, could increase the vulnerability of individuals who are poorly placed to find alternative employment.<sup>127</sup>

### Unemployment

Another reason for persistent poverty, and a problem in itself, is the continuing high levels of unemployment. Official statistics have unemployment rising from 11.5 percent in 2004 to 13.3 percent in 2007.<sup>128</sup> However, the number of people who classify themselves as 'unemployed' is usually closer to 30 percent.<sup>129</sup> The reason for this discrepancy is that while official statistics (and international standards) consider subsistence agriculture 'employment', many of the people who work in such positions do not.<sup>130</sup>

Unemployment is also variable across the country. As the above discrepancy suggests, it may not be a good idea to use official unemployment figures as the basis for targeting assistance to the unemployed, since official figures routinely show unemployment as higher in the cities. Clearly the most widespread unproductive 'employment' remains in the countryside.

### Inflation

Another possible reason for persistent poverty could be inflation. If inflation is sufficiently high, it could wipe out the increased buying power achieved through higher wages and social benefits. Official statistics show consumer prices increasing by 4.8 percent in 2003, 5.7 percent in 2004, 8.2 percent in 2005, 9.2 percent in 2006 and 9.2 percent in 2007, and a conservative estimate suggesting 12 percent for 2008. This is the equivalent to an annual inflation of eight percent from 2004-2007.<sup>131</sup>

This is certainly not enough to wipe out the value of a GEL 50 monthly income for very poor households (the targeted social assistance to discuss below) or a GEL 56 increase in pensions compared to 2003. However, the overall consumer price index (CPI) may not be representative of the increase in prices routinely

**Figure 3.3** Average Food Prices in Georgia (Tetri per kilo)

Food prices	2004	2007	Equivalent Annual Increase (percent) 2004-2007
Bread	97	126	9
Potatoes	58	79	11
Haricot Beans	169	333	25
Wheat flour	114	140	7
Maize flour	91	199	30
Beef	553	717	9
Pork	547	713	9
Chicken	489	603	7
sunflower oil	257	420	18
Cheese	502	705	12
Milk	147	158	2
Eggs	226	252	4
Sugar	104	137	10

Source: State Department of Statistics, (January 2008), *Food Security Situation: Trend in Figures*, Government of Georgia, Tbilisi, p15; and own calculations, Ministry of Economic Development

experienced by the poor. Even official measurements of increases in food prices are higher than the CPI.

As one can see, the price of certain basic foodstuffs has gone up far faster than inflation. In addition, VAT will be experienced as inflation by the consumer. While this will not apply to basic unprocessed food, it may explain why inflation may appear higher than official figures.<sup>132</sup> That said, there is a sense in the general population that prices have gone up even more quickly than these corrections would suggest. When CARE International conducted a straw poll of Tbilisi residents and asked them to list the prices of essential goods, first, as they remember them in 2004 and then as they are now, the growth in prices translated into an annual inflation rate that ranged from 11 percent for bread to 27 percent for cheese. These are both higher figures than estimated in the chart above.<sup>133</sup>

The first possible explanation for this discrepancy is that the official inflation figures are incorrect. The second explanation is that, in an environment where prices change dramatically on a regular basis (bread prices, for example, went up by 33 percent between 2006 and 2007

## Chapter 3: Economic reforms – the household perspective

Another reason for persistent poverty, and a problem in itself, is the continuing high levels of unemployment.

according to the State Department of Statistics),<sup>134</sup> people are likely to perceive that inflation is higher than it actually is because they remember the big price increases and forget the years when prices remained stable.

### Reforms in social assistance

The post-Revolution reforms in Georgia have focused on pursuing economic growth rather than social redistribution as the policy for long-term income improvement and poverty alleviation. This policy was pursued out of a mixture of practical necessity and economic philosophy. Clearly, when a third or more of the population is poor (according to some standard), redistribution will always be fairly limited in its ability to change the situation. At the same time, efforts to redistribute wealth drastically with, for example, higher taxes on businesses and the wealthy, could stifle the very growth that is needed to achieve long-term improvements. Most of what was discussed in the previous section reflected economic reform and business orientation strategy. This section will look at the policies that provide pensions, social assistance and other income redistribution.

The line item for 'social safety' has historically (with the recent exception of defence spending) been the largest in the state budget. This includes pensions and pension supplements for particular groups, child benefits, disability benefits and, more recently, targeted social assistance. Central Government spending on social safety was GEL 101 million (USD 47 million) in 2003, or 11 percent of overall expenditure.

In 2004, the most pressing demand on social assistance was simply to clear outstanding arrears from the previous administration and to increase the levels for those already covered. Fulfilling those objectives took the budget for social protection to 20 percent of overall spending by 2005. Total spending on social assistance continued to increase in 2006 and 2007, though its importance as a proportion of the state budget fell as budgetary receipts grew and were allocated to other budget lines. In 2007, the budget for social assistance was GEL 778 million (USD 466 million) or 15 percent of the overall budget. However, the more 'social' budget of 2008 is projected to increase spend-

ing on social assistance to GEL 1.1 billion (USD 724 million) or 23 percent of the overall budget.<sup>135</sup> Planned increases in pensions could push that figure much higher.

### Pensions

The single biggest driving force for these increases has been the desire to increase pensions. In April 2008 there were 839,000 pensioners in Georgia.<sup>136</sup> The total budget for pensions in 2007 was around GEL 500 million (USD 299 million). When the Government came to power, its first goal was to pay arrears. This was achieved fairly early. After that, the goal has been to regularly increase the minimum pension level. The pension system was initially simplified with the introduction of a single flat rate pension, payable to all at the age of retirement.

Between 2003 and 2006, pensions have increased from GEL 14 (USD 6.5) to GEL 70 (USD 46.1) per month in April 2008. The current Government has set as an objective that pensions will be equivalent of USD 100 (GEL 150) by 2009.

### Targeted social assistance programmes

Social aid programmes in Georgia have traditionally targeted certain categories of the population such as pensioners, veterans, the disabled and orphans. These were rigid categories that could not be easily expanded and they were not needs-driven, so they did not differentiate, for example, between large and small households or between poor and wealthy pensioners. Since a significant part of the poorest could not be assigned to any category, these provisions were extremely badly targeted from a poverty reduction or equity point of view.

Since 2005, the Government has developed the infrastructure necessary to means-test families in order to provide targeted social assistance. The Social Services Agency (SSA) put together a database of socially vulnerable families that includes 470,000 households or 1.5 million people (about a third of the population). In order to be included on this database, each family has to apply to the SSA. A Government assessor then visits the family to record a range



of poverty ‘indicators’ which are used to assign each family a score of neediness.<sup>137</sup>

In April 2008, 135,000 families (360,000 people) received cash social assistance in this way. This is about 12 percent of families or eight percent of the population.<sup>138</sup> The benefit received currently totals a maximum of GEL 30 for the first family member and GEL 12 for each family member thereafter. So, for example, a family of three would receive 30+12+12 or GEL 54 (USD 35.50) per month. In addition, a wider group from the same list (approximately 700,000 at the time of writing) receive coupons that should provide them with largely free access to medical treatment.

Some people are currently receiving social transfers under both the category based and targeted systems. For instance, among the 360,000 beneficiaries of social assistance, about 110,000 are pension recipients as well.

### Human development: The impact of social transfers

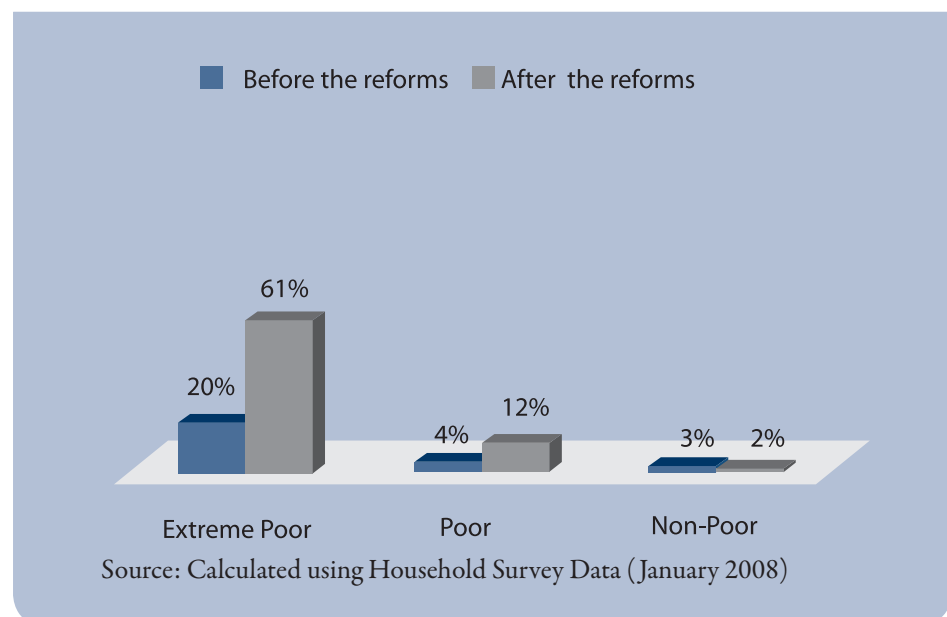
Social transfer payments are the most direct way in which Governments redistribute wealth. They should, therefore, make a society more equitable and reduce insecurity by providing a ‘safety net’ that protects from unexpected changes in circumstance. This redistribution has many goals, but probably the two most important are to combat social inequity and to alleviate poverty. Social assistance has made great strides in more effectively targeting the poor. If we compare the degree to which poor groups were targeted before and after the reforms, the most significant impact is that a far larger proportion of the families living in extreme poverty are receiving social assistance than before.

However, in equity terms it is unclear if the current Government priorities are the most effective way of alleviating social inequity. The largest subheading of the budget for social assistance continues to be pension payments. For 2008, simply providing the minimum GEL 70 for all 839,000 pensioners will cost GEL 705 million (USD 464 million). In comparison, the targeted social assistance programme, which is on average offering approximately GEL 50 (USD 32.9) per family to 135,000 families, will cost around GEL 81 million (USD 52.6 million) in the same time.<sup>139</sup> If pensions go up this

year as the Government strives to fulfil its USD 100 target, the discrepancy between these two figures is likely to increase. At USD 100 per pensioner, the budget for pensions alone would be over GEL 1.5 billion (USD 1 billion), or about a third of the total Government budget. If the increase in pensions of GEL 750 million (USD 493 million) were spent on healthcare, it could provide everyone in the country with free health insurance (assuming current premiums) or dramatically increase the value and coverage of targeted social assistance.

In 2007, the budget for social assistance was GEL 778 million (USD 466 million) or 15 percent of the overall budget.

Figure 3.4 Percentage of the population to receive social assistance





# Chapter 4: Education

With a strong literary tradition that dates back to the beginning of the last millennium and historically well-respected higher educational institutions, academic achievement is socially prized in Georgia.<sup>140</sup> The early 1990s, however, saw the beginning of a deep crisis in the Georgian educational system. Financing of education decreased from seven percent of GDP in 1991 to one percent in 1994.<sup>141</sup> In 2003, it was 2.1 percent. This reduced teacher and lecturer salaries and led to a wide deterioration of basic infrastructure. According to the Georgian Ministry of Education, by 1999, 70 percent of schools in cities and 84 percent of schools in rural areas needed significant repair or complete reconstruction. Approximately USD 200-250 million in investments was required to restore them.<sup>142</sup> Failing to secure that restoration, the situation in 2003 was even worse.

At the same time teaching and learning methods, as well as existing curricula, were outdated, favouring memorization and rote learning over the development of critical thinking. The system as a whole was unable to produce individuals with the knowledge and skill sets necessary for human development in a market economy or a democratic political system. This was further exacerbated by ineffective planning and management of the educational sector and the absence of a clearly-defined state educational policy.

Corruption was also rife. It was particularly prevalent in the university application process, where acceptance on merit was rare. Students gained their places in university because of a family contact or a gratuity. Having paid for admission, it is hardly surprising that they rarely expected to gain their degrees by merit either.

The crisis in the educational system negatively affected numerous other aspects of the development of Georgian society. Education is a criterion of social development because critical citizens are more able to make reasoned choices about their own lives and to shape the political and social landscape they inhabit. A weak and corrupt educational system is also profoundly socially inefficient. A poorly trained workforce played a significant role in the stagnation of the Georgian economy. But perhaps worst of all, students were conditioned

to expect corruption and to work with it before their careers had even begun.

## The reforms

Although the secondary and higher education sectors in Georgia are regulated by different laws, both sectors faced similar problems, were driven by a similar reform agenda and demonstrated some of the same strengths and weaknesses. The overall reorganisation has attempted to localise decision-making and control while at the same time setting national standards and providing national quality control.

The Law on Higher Education, adopted in December 2004, and the Law on General Education, adopted in April 2005, serve as the legal basis for educational reform. Both documents aim at the establishment of European standards of education in Georgia, offering new models of financing, management and quality control. Parallel to the legislation, state financing of the education sector has been continually increasing since 2003 (Figure 4.1).

As we can see, expenditure, though almost three times higher than its 2003 level, has remained a relatively stable proportion of GDP. Consolidated figures do not exist for 2008, but the state budget line for education will see a reduction of about six percent in real terms.<sup>143</sup>

Education is a criterion of social development because critical citizens are more able to make reasoned choices about their own lives and to shape the political and social landscape they inhabit.

Figure 4.1

## Consolidated State Budget for Education

Year:	2003	2004	2005	2006	2007
GEL million	164	286	289	414	458
USD million	76	149	160	232	274
percent of GDP	2.1	2.9	2.5	3	2.8

Source: Georgian-European Policy and Legal Advice Centre (February 2008), Georgian Economic Trends: Quarterly Review. Tbilisi, Georgia, p27. Final quarter for 2007 provided directly by GEPLAC.

### Secondary education

Secondary education<sup>144</sup> has seen a slight increase as a proportion of the education budget in the last two years, moving from GEL 187 million (USD 105 million), or 45 percent in 2006, to a forecast 245 million (USD 161 million), or 50 percent of the total budget, in 2008.<sup>145</sup> This figure does not include a number of additional programmes. The National Programme for School Building Rehabilitation will spend GEL 500 million (USD 329 million) on school rehabilitation by 2011. Also, the Deer Leap project aims at complete computerization and provision of internet access in all secondary state schools of Georgia, bringing student/computer ratios to 20:1 and training 70 percent of teachers how to use computers.

In addition, the structure of state financing has also been reformed and now operates according to a 'money follows the student' model. A schools' budget is directly dependent on the number of students it serves, and whenever a student changes school, the financing goes with them. Within this framework, secondary schools enjoy considerable autonomy in managing their annual budgets and can therefore set their own priorities, within certain legislative constraints.

Secondary education has also undergone root and branch reform of management structures, curricula development and quality control.<sup>146</sup> The effort to democratize and localize school decision making has been led by the creation of Boards of Trustees (BoT) composed of elected teachers, parents and one student who

are the main decision makers in all major aspects of school life, including the selection of the Principal and oversight of the management and finances.

Curricula are developed by the newly-established National Curriculum and Assessment Center. All public and private schools are obliged to meet national curriculum goals and criteria, though 25 percent of the curriculum is still free to the school's discretion. The state will, however, measure school achievement and will, if needed, participate in improving the quality of learning.

Quality assurance and control are implemented by the Ministry of Education and Science, which will begin evaluating compliance of the learning process and outcomes with the national curricula through a school accreditation process in 2009.<sup>147</sup> The state will only recognize a certificate on secondary education that is issued by an accredited school. In preparation for this, the number of schools has been reduced by 885 in order to concentrate resources. This makes particular sense given that student numbers are set to decline in the coming decades.

The Government has also sought to provide teachers with better resources and training. In 2005, the minimum monthly wage for a teacher was increased to GEL 115 (USD 63.50) and since then it has been increased to GEL 200 (USD 132) in the state schools, although the Board of Trustees can choose to raise salaries even higher.

The reform also envisages enhancement of

teachers' qualifications through Teachers' Professional Development Centers. Certification of teachers by the Ministry of Education and Science (MoES), was originally planned to start in 2009, though at this time the start date is unclear. There are other significant aspects of the reforms. The government aims to reduce the size of classes to 25, to make the system more inclusive for disabled children and to offer additional funds to schools in ethnic minority areas.

### Higher education

The new Law on Higher Education was also comprehensive. Like secondary school legislation, it also introduced new financing and governance principles, an objective system of enrolment, new rules for admitting academic personnel, and a credit system (ECTS) at all three stages of higher education (BA, MA and PhD).

Before the reforms started, corruption during the university admission process was one of the most widespread in Georgia.<sup>148</sup> Since 2005, admission of students to higher educational institutions has been entirely based on the results of Unified National Examinations (UNE).<sup>149</sup> The administration of these exams and the whole admission process was completely removed from the universities and was assigned to the National Examination Centre which was created especially for this purpose.

The examination process is incredibly transparent. Since 2006, all applicants' exam sheets have been scanned and posted on the Centre's website. It is also extremely meritocratic. Both student placement and funding are allocated entirely on performance in this exam.

The new system of financing universities is based on the same 'money follows the student' principle that exists in schools. For each student, a fixed fee is paid every year to the institution. State funds are allocated to cover all or part of the tuition for students who perform well in the UNE.

The supreme decision-making bodies of the universities, the Academic and Representative Councils, are elected by all professors on the basis of direct and equal elections. One third of the members of the Representative Council are students. The University Strategic Plan,

curricula, principles of selection of academic personnel and other academic and administrative issues are made openly by the elected representatives. Like the Board of Trustees, this is intended to help democratize university life.

University accreditation was also instituted. The National Accreditation Centre evaluates university resources (during Institutional Accreditation) and its programmes (during Programme Accreditation). Both types of accreditation are obligatory for all education establishments since 'the state recognizes only diplomas issued by accredited higher education institutions'.<sup>150</sup> If a university does not pass the accreditation twice, it may be abolished.<sup>151</sup>

As a result of institutional accreditation, by 2007 the number of Higher Educational institutions recognised by the state had decreased almost five times from the 2004 level, and only 52 accredited universities are left in Georgia.<sup>152</sup> Universities that did not pass the accreditation were allowed to continue admitting students, but new students would not receive recognised diplomas. In the accredited universities, institutional accreditation also determined the maximum number of students per university programme.

A large proportion of the university faculty were required to re-apply for their old positions and as a result many lecturers either lost their positions entirely or were re-appointed at lower positions and under more flexible contracts. Selection for university academic positions occurs through open competitions, which are held once every few years. No professor can be elected for a lifetime. On the institutional level, highly qualified academic staff are necessary for successful programme accreditation. State funded research grant programmes<sup>153</sup> have been developed in order to promote professors' involvement in high-standard research projects.

The new system of higher education, which is part of the Bologna process, aims at integrating the Georgian higher education system into the European Higher Education Area and gives students the freedom to choose not only subjects but also Major and Minor academic programmes for their BA curriculum.<sup>154</sup> By the time the reforms are fully implemented, students will be able to form their own, individual, educational programme according to their academic interests. Provided that they have the

The examination process is incredibly transparent.

## Chapter 4: Education

Survey results suggest that public attitudes toward the education reforms are largely positive and continuing to improve.

right to choose courses, they can refuse to be taught by under-qualified professors.

### Human development impact

Survey results suggest that public attitudes toward the education reforms are largely positive and continuing to improve. In April 2005, when asked directly about their attitude to the reforms, 46 percent of respondents in Tbilisi, Gori and Kutaisi regions of Georgia supported the reforms; by November 2005 reform was supported by 59 percent. The number climbed to 65 percent in 2007.<sup>155</sup>

According to Transparency International, Georgian educational reforms get more unqualified positive support from the opposition, as well as local and international NGOs, than reforms in any other area. As they report in a recent paper, 'Education reform was the single policy issue recognised by nearly all the interviewees as a success of the current government'.<sup>156</sup> That said, the educational sector is still weak in some areas. As a World Bank report points out,

*intake into the final primary grade is estimated at only 86 per cent, which leads the World Bank to put it [Georgia's educational system] into a category of only three countries (along with Tajikistan and Moldova) that are 'unlikely' to achieve MDG2, universal primary education.*<sup>157</sup>

In addition, at the current time there is no real way of assessing the quality of teaching at secondary schools. The Organization for Economic Cooperation and Development (OECD) runs a programme for international student assessment that provides standardised testing to 15 year old students as a means of judging relative attainment in different educational fields. Azerbaijan is currently a member of this system but Georgia is not. Therefore, while there is no doubt that dramatic steps have been taken, there is clearly some way to go. How far education has progressed is hard to judge without better methods of measurement.

### Management structures in education

In secondary education, the attempt to democratise the educational system has met with mixed results. In spite of numerous trainings by international organizations and the Ministry of Education and Science (MoES), some members of the Board of Trustees have failed to demonstrate an ability to act as effective and independent decision makers for the school.<sup>158</sup> This issue becomes even more pressing where finances are involved.

Similar concerns exist about university governance and management. While the aspiration to ensure broad participation in the universities' governing structure is admirable, the Law provides neither mechanisms of accountability for members of Representative and Academic Councils nor mechanisms to ensure their independence in decision making.

On the other hand, some schools have responded very well to the opportunities presented by self-governance. The World Bank states that,

*[Some schools] are relishing their new-found autonomy as Legal Entities of Public Law (LEPLs). For instance, one such school visited in Tbilisi has changed from two shifts to a single shift, with the same number of teachers, and, with an increase in the number of students from 1,200 to 1,700, has been able to raise teachers' salaries by 60 per cent.*<sup>159</sup>

From the human development perspective, efficiency is of course an issue, but empowering the schools and universities, to the extent that this is possible, is an end in itself.

### Financing

One of the most commonly expressed concerns with the current state of the educational system is that even though levels of funding have increased dramatically in absolute terms, funding is still low, even compared to other CIS countries, at below three percent of GDP<sup>160, 161</sup>. As a World Bank assessment summarises,

*[the] proportion of GDP devoted to public expenditure on education in Georgia may be underestimated, but it is undoubtedly among the lowest in the region and the coun-*

try's schools certainly suffer from budget deprivation.<sup>162</sup>

This also creates major equity problems. As the same document continues,

*Underfunding from public sources has been reflected in an increase in private expenditure on education, which accounted for around 3 per cent of households' cash consumption expenditure in 2005.... As might be expected, and to the detriment of equity, richer families spend far more on education than do poorer families: the top 10 per cent accounted for 43 per cent of total private expenditure on education in 2005, compared with the 0.2 per cent share of the bottom 10 per cent.*<sup>163</sup>

In addition, the need for private tuition is commonly accepted. According to a large 2007 survey, 57 percent of the respondents in Georgia thought that private tuition was essential to success in the job market.<sup>164</sup>

In light of internationally low levels of funding, the shift to a totally meritocratic funding system in both schools and universities may also create issues of equity. While deciding entry entirely on the basis of test scores is the easiest way of avoiding corruption, the system is commonly acknowledged to advantage already-privileged groups.

### Recruitment, retention and training of teachers and lecturers

The recruitment, training and retention of staff also continue to create very serious concerns. Particularly at regional higher education institutions, the selection process for new staff has remained very formal and few additional resources have been allocated to lecturers' salaries. Consequently, changes in procedures did not result in the selection of new and better qualified academic staff. The accreditation system, already initiated in universities and starting in schools in 2009, should help to provide some oversight and monitoring. At the very least, it will help to provide incentives for improvements in teaching standards and methodology.

For both lecturers and teachers, the main problem continues to be salary. The minimum

wage for teachers is low. Teachers routinely need to take on additional work or, in the worst case, to solicit payments from students, in order to survive. The situation for university lecturers is somewhat different. In Tbilisi, a university professor at a state university can earn more than GEL 1,000 (USD 658 million) per month, but there is no consistency across institutions. In the regions, a full professor makes closer to GEL 300 (USD 197) per month, which is hardly a motivation to pursue an academic career.

This may also impact on quality of teachers and lecturers. While the Government is trying to introduce training, curriculum development and accreditation, it is difficult to recruit good and dedicated teachers and improve the general level of teaching when salaries remain low.

An associated problem is that the very success of certain parts of the economy makes it hard to persuade some of the brightest students to consider academic careers. There is a real shortage of those with the right mix of educational background and language skills in the economy and, as a result, that group has seen their earning potential increase dramatically, not just in finance and information technology but in the non-profit sector. At the same time, the continuing youth of the current Government offers opportunities for responsibility and advancement that are found in few other countries. Competition from these alternative options will make it difficult to persuade the best students to commit exclusively to academia in the near future and the system will almost certainly need to be flexible to potential academics who want to maintain a mix of professional responsibilities.

### University entrance exams

The entrance exams are, along with the traffic police reforms, commonly cited as one of the clear successes of the Georgian Government's anti-corruption strategy. The Transparency International, Georgia (TI) assessment of the first Unified National Examinations in 2005 is unusually unqualified in its praise:

*The NAEC [National Assessment and Examination Centre] and the Ministry of Education were found to have invested significant effort into informing university en-*

In secondary education, the attempt to democratise the educational system has met with mixed results.

## Chapter 4: Education

For both lecturers and teachers, the main problem continues to be salary.

*trants, parents, teachers and exam administrators about the new examination process. The examinations were well organised and transparent, and the appeal process was meticulously planned and objective.*<sup>165</sup>

Not only does the report say that the examinations were free and fair, but the information campaign about them and the public consultations created an impressive degree of confidence in the process. TI surveyed 973 students, 764 parents and 340 administrators countrywide and concludes that a large majority of respondents (80% of students, 79% of parents and 96% of administrators) felt confident that the new process would eliminate corruption in university admissions.<sup>166</sup> It is not surprising that the Georgian Government has routinely highlighted this as one of their big successes. Improving university entrance has made the whole educational system more equitable and empowering. By restructuring incentives toward the right learning outcomes, it is hoped that in the longer term this will also have an impact on the efficiency of society as a whole.

The overall impact of the reforms on higher education is less clear. According to a 2006 Survey, 54 percent of students of a regional university report that in the process of their education they did not notice any changes caused by the reforms in higher education, while 39 percent reported that they could see changes. In the course of their interviews they predominantly associated educational reforms with the Unified National Examinations.<sup>167</sup> The same survey also suggested that, while corruption may be non-existent for university entrance, it still exists within the university. According to a 2008 survey, 60 percent of student respondents said that it was 'easy' or 'very easy' to get the grade you want with a bribe. This is better than the 82 percent who gave the same answer in 2006, but it clearly suggests that corruption reform in the educational sector has some way to go.<sup>168</sup>

One concern about the Unified National Exam is the representation of the poor and of ethnic minorities who pass the exams and receive state funding. While a meritocratic system is vastly more equitable than a corrupt one, a system that only allocates resources based on exam performance may not be the best way of ensuring broad social inclusion. The poor are automatically disadvantaged because they

cannot afford preparatory private tuition and because they do not attend the best secondary schools.

Non-ethnic Georgian students suffer from the twin disadvantages of having to go to school and take tests in their non-native language and of being generally poorer. Five hundred 'social grants' are distributed to students in addition to the meritocratic-based system, but these are divided between students from mountainous areas, conflict regions, Armenian and Azeri ethnic groups and internally displaced people.<sup>169</sup> The inequity can be seen in the allocation of awards. 53 percent of students who passed the exam in Tbilisi were awarded some form of state grant in 2005, compared to only 23 percent of students from the ethnic-Armenian region of Samtskhe-Javakheti. These figures almost certainly understate the discrepancy, since they do not take into account the students who did not even try.<sup>170</sup>

Not only does this impact on equity, but failing to make allowances for income differentials in university recruiting may be inefficient in the long-term. University entrance should be a means of targeting academic *potential* rather than simple academic *achievement*. Those who score most highly may have the highest level of achievement, but those who score slightly lower, without the help of private tuition and having come from worse secondary schools, might have better academic potential in the long term.

Reform in education has tried to localise control while centralising standards and oversight mechanism. Corruption, in some parts of the system, have been entirely removed and there are efforts across the schools and universities to bring in better teaching standards. These are all hugely positive achievements in human development terms. General level of funding remains a concern and while the Government hopes that these reforms will generate further improvements in education without significant spending increases from current levels, efficiency improvements probably have limits.

The poor are automatically disadvantaged because they cannot afford preparatory private tuition and because they do not attend the best secondary schools.



# Chapter 5: Healthcare

The healthcare system inherited from the Soviet Union, though inefficient, provided free health services for the entire population. After gaining independence, meaningful universal healthcare became financially impossible to maintain. The Government's health expenditure declined 24 times between 1991 and 1994,<sup>171</sup> so patients had to pay for services that had previously been free. In 1995, the Government finally declared that healthcare could not be 'free' any more,<sup>172</sup> but for almost a decade it failed to provide a subsequent plan or viable alternative for healthcare financing.

The healthcare system suffered from poor administration and technical inefficiencies. The few public finances available prioritized hospital care at the expense of primary care and preventative medicine.<sup>173</sup> The 400 hospital facilities in Georgia had an average of 14 beds each<sup>174</sup> and were neither efficient nor able to provide quality treatment. While the density of doctors was one of the highest in the world with one physician per 197 inhabitants,<sup>175</sup> both the medical personnel and the facilities were largely under-utilized due to poor quality and unaffordable services. In 1999, the occupancy rate for the hospitals was 31 percent, with 1.5 physicians per occupied bed.<sup>176</sup> The number of people receiving first aid emergency services in 1998 declined to 124,000, approximately ten percent of the 1990 figure.<sup>177</sup>

Corruption in the medical sector was also widespread. Even the services that were supposed to be offered free would often be withheld unless a gratuity was paid to the medical staff. It has been estimated that, as a result, in 60 percent of the households in need of major medical treatment, medical expenses led to extreme impoverishment.<sup>178</sup>

All of this resulted in a significant worsening of the population's health. Severe outbreaks of measles and diphtheria occurred in 1994 and tuberculosis turned into a serious threat among the population. Death caused by cardiovascular diseases increased by 35 percent and

the overall age adjusted mortality rate rose by 18 percent.<sup>179</sup> This clearly represented a disaster both in human development and political terms. Poor healthcare was in itself a clear social deficit, but it also exacerbated poverty, made economic development difficult and left large portions of the population tragically insecure.

## Reforms

### Expenditure on healthcare

Despite the alarming indicators, significant reforms of the healthcare sector did not really get started until 2006. A range of reports were written on healthcare reform but none of them translated into action.<sup>180</sup> Before 2006, reforms had been fragmented.<sup>181</sup> In 2003, the Government started primary healthcare reform to improve quality and affordability of the primary health services. In the following year, the Government initiated rehabilitation of the hospital sector. However, neither of these reforms were completed. The hospital sector reform focused on rehabilitating departments of separate hospitals,<sup>182</sup> while the primary healthcare reform lacked integration into the overall system.

In fall 2006, after the rejection of the initial healthcare plan by the Ministry of Health, Labour and Social Protection, the State Minister for Reform Coordination put together a health reform strategy. The new draft focused

The number of people receiving first aid emergency services in 1998 declined to 124,000, approximately ten percent of the 1990 figure.

on reform of financing in primary healthcare and hospital reorganization. It aimed to lessen the technical and administrative burden of the government with the privatisation of healthcare provision and the involvement of private insurance as the main mechanism for organizing healthcare financing.<sup>183</sup>

### Financing

Expenditure on healthcare increased considerably under the new administration. As a percentage of GDP, it was 1.3 percent in 2003 and reached a peak of 1.8 percent in 2006. It has stayed between 1.6 and 1.8 percent of GDP since then.

While consolidated figures of this kind are not available for 2007 and 2008, central Government expenditure increased, in absolute terms by 17% between 2006 and 2007 and between 2007 and 2008. This is the equivalent to a real increase of about 7% and 5% respectively.<sup>184</sup> This is less than inflation in both years. Georgian society as a whole spent GEL 1.1 billion, or ten percent of GDP on healthcare expenses. Public health expenditure is 22 percent of this total. The rest was mostly paid by the population privately.<sup>185</sup>

The Government's plan for healthcare financing, as it currently stands, is expected to evolve through several phases. At the initial stage of the reform, public resources are financing a Universal Package (UP) comprising public health services, special drugs supply, tuberculosis and psychiatric care, primary healthcare

and urgent hospital care for the entire population. Qualifying vulnerable individuals<sup>186</sup> will also receive specialist and hospital care on top of the Universal Package. In the second stage, the UP coverage is expected to decrease and to cover only public health services (for example, vaccinations and prevention of communicable diseases) so that only the socially vulnerable will receive free primary healthcare. The vulnerable population will continue to receive the same benefits as in the first phase and the government may consider subsidizing specific population groups.<sup>187</sup>

In addition, it is hoped that as the health insurance market develops, individuals (through their employers or private contracts) will increasingly take out private health insurance to cover their health costs. In this way,

*Private health insurance is going to be the main source for health-care financing in the country. The government's plan is to contract private insurance companies and grant them public finances as insurance coverage for those living in extreme poverty (around 15% of the population).<sup>188</sup>*

### Development of the primary healthcare system

As noted above, the implementation of the primary healthcare reforms in Georgia first started in 2003, under which some healthcare facilities in the regions of Imereti, Adjara and Kakheti were rebuilt and renovated.<sup>189</sup> In 2007, the

**Figure 5.1**

**Government expenditure on health as a percent of GDP**

	2003	2004	2005	2006
General Government Expenditure on health (GEL million)	108	129	195	250
GGE Health (USD million)	50	67	108	140
As percent of GDP	1.3	1.3	1.7	1.8

Source: World Health Organization, *Country Information: Georgia 2003-2006*, (<http://www.who.int/nha/country/geo/en/>) and Government of Georgia Ministry of Health, *National Health Accounts of Georgia 2003-2006* (<http://www.moh.gov.ge/page.php?118>).

Ministry of Labour, Health and Social Protection elaborated the second master plan, which distinguished between urban and rural models of primary healthcare. The second master plan built on the general priorities of the reform to improve access, utilization and the quality of public healthcare.

Conceptually, the most important changes of the reform were shifting the focus from curative to preventative medicine and the introduction of the institution of family doctors. This approach reflects the belief of Ministry of Labour, Health and Social Protection that 'prevention is better than care'.<sup>190</sup> Under the new system, family doctors are expected to be the 'gatekeepers' of the system, treating 80 percent of their patients without referring them to other specialists. This will include the re-training of primary healthcare personnel ('family doctors') by 2010.<sup>191</sup>

In order to increase the efficiency and quality of the medical facilities and care associated with public healthcare, the Government plans to privatize 900 public healthcare facilities in rural areas and all existing ones in cities and regional district centres. Simultaneously, to ensure the accessibility of primary healthcare, the master plan provides for a wide geographic disbursement of public healthcare facilities. The current plan allows for 905 primary healthcare units in rural settlements and up to 200 in urban settlements.<sup>192</sup>

Improving the competence of medical personnel in the primary healthcare units is also an indispensable part of the reform. More than 450 primary healthcare professionals from different regions of the country have already undergone a special programme of professional development.<sup>193</sup>

In terms of financing in the new primary healthcare plan, Involves primary healthcare in universal cover. Medicines (except those provided in healthcare facilities) are not generally paid for by any of the plans, though there are some exceptions. As discussed above, after the expiration of the transition period, the primary healthcare will be removed from the Universal Package and will no longer be financed by the state. As a consequence, the population not covered by the targeted insurance programmes will have to finance the primary healthcare through their own private means.<sup>194</sup> It is not presently clear when this will happen.

### Hospital privatisation plan

Subsequent to the 2004 hospital sector reform, which partially rehabilitated some medical institutions, in January 2007, the Government adopted a new Hospital Development Master Plan. With the exception of the large referral facilities in Tbilisi, the new plan provided for the full privatisation of hospital facilities.<sup>195</sup> At the same time, the Government approved the complete substitution of the existing hospital infrastructure with new ones between 2007 and 2009.<sup>196</sup> Within the same timeframe, 100 new hospitals will be produced, one private hospital per rayon, plus additional hospitals in larger cities.

According to the master plan, the number of beds will be reduced by more than half (from 18,000 to 7,800 beds approximately). As a result, there will be 4,185 beds in Tbilisi and 3,615 beds in the rest of the country. The plan also sets out a referral system organized in three levels: small hospitals, regional hospitals and high-tech hospitals.<sup>197</sup> The 'general' and 'multi profile' hospitals will also be standardized to offer more integrated services. More importantly, to ensure the easy access and optimal location of the facilities, 90 percent of the population should be within 30 minutes of a hospital area.<sup>198</sup>

According to the plan, the investors will build a new modern medical facility and in return they will take ownership of the old facility. The investor will also assume responsibility for managing and maintaining the purchased medical institution for seven years. The private investor is fully responsible for managing all processes during the transition period, including staffing.

At the current time all 15 'lots' (or approximately 500 hospitals, the vast majority of the country's hospitals) have been sold. Only five of these agreements have been finalized and signed at this time; the rest will be finalized very soon.<sup>199</sup>

### Management of the healthcare system

As in many areas of Government reform, the strong emphasis on the market system in the operation and management of the healthcare sector is driven partially by the government's

In addition, it is hoped that as the health insurance market develops, individuals (through their employers or private contracts) will increasingly take out private health insurance to cover their health costs.

## Chapter 5: Healthcare

According to the master plan, the number of beds will be reduced by more than half (from 18,000 to 7,800 beds approximately).

belief in the free market system and partially by the restrictions imposed by limited government resources. To put this in human development terms, it is aiming at increased efficiency within strong budgetary constraints.

The involvement of the private sector operates at different levels. Both 'universal' and 'supplementary' packages of healthcare service are expected to be privately owned and their finance managed by the private health insurance companies. Direct management will, therefore, be organized by the new owners of the facilities.

By the end of the second phase, insurers will manage the allocation of the national budget for the personal health care services to which the entire population is entitled, plus the budget for the package targeted to the vulnerable population.<sup>200</sup> For the remaining specialized out- and in-patient services, the health insurers are expected to develop the market and offer insurance products.<sup>201</sup>

Up until now, the involvement of insurance has been largely focused on secondary healthcare, since primary healthcare is currently universally available. The government is providing vouchers to qualified beneficiaries, who can then choose an insurance company out of the list of licensed companies. Once the private insurance company signs the contract with the beneficiary, the beneficiary is provided with an insurance policy covering a package of medical services, such as doctors consultations, emergency hospital service and certain types of surgeries.<sup>202</sup>

A pilot programme for this insurance voucher system began in the Tbilisi and Imereti regions and rollout to other regions began in March 2008. The budget for the 2007-2008 pilots was GEL 15 million and included 181 thousand beneficiaries.<sup>203</sup> The 'voucherisation' should be completed by the end of the year.

### Human development

Health influences quality of life, productivity, the ability of an individual to engage with society, and the sense of economic and personal security. It is a key measure of equity and is closely connected to economic poverty. The absence of effective healthcare and medical treatment weakens public health and reinforces the per-

sistence of illness. These factors contribute to increased unemployment and impoverishment, leading to the vicious cycle of poverty without the prospects of its alleviation.

Due to the relative late start of the healthcare reforms, their effects cannot yet be measured through health statistics. The attempts to increase access and the targeting of healthcare assistance to particular groups are clearly to be applauded, since they can help to improve the health situation for some of the most vulnerable groups. Improvements in primary healthcare should bring a dramatic increase in access and far more efficient use of resources, since family doctors should resolve minor ailments locally without involving more expensive specialists or hospital facilities. In addition, as has already been discussed, privatisation can be a great source of finance for infrastructure improvements.

Private health insurance and the private hospitals are mechanisms for trying to increase efficiency of provision. If the Government is right, then private insurance and privately run hospitals will be motivated to control costs and implement more effective financial management, gaining better results from the same resources. However, this will require both the providers and consumers to understand their rights and responsibilities.

Currently, most of the population is not particularly well informed about the benefits of the Universal Package service. Those who are insured under the targeted social insurance scheme may find it hard to persuade medical facilities to accept their documentation instead of payment. As a result, medical personnel and hospital administration may have little problem extracting extra-legal payments for services, leading to a situation where 'out-of-pocket payments quickly become unaffordable for most patients'.<sup>204</sup>

Private health insurance companies in Georgia have almost no experience in covering the elderly and socially vulnerable. Free healthcare provision for 700,000 of Georgia's most vulnerable is an admirable goal, but at GEL 11 per month (USD 7.20), the current premium gives a total expenditure of only GEL 92 million (USD 60.5 million) for a year. Since insurance companies claim that their costs are far higher than this, it is hard to see how they will

be able to cover their costs without excluding a lot of patients or offering minimal cover. This is worsened by the fact that the people covered are the most expensive group of society in terms of healthcare resources.<sup>205</sup>

There is also a concern that this system will not be able to cover most of the population. The World Bank estimates that once the second phase is initiated, '40 percent of Georgian citizens who fail to qualify for state support but cannot afford to purchase private insurance will be left without access to even the most basic healthcare services'<sup>206</sup>

This fear is also reflected in the general public's attitude toward the implemented reforms. Almost half of the population surveyed by the Caucasus Research Resource Centres claimed that the most immediate attention regarding the country's healthcare should be paid to the problem of 'availability of medical care, medicines and/or medical insurance'. The second most frequent answer, 'quality of medical care', was only chosen by one quarter of respondents.<sup>207</sup> Thus, price and availability are the main concerns of the population. Many people associate healthcare reform with radical increases in the price of medical services and medicines. It is generally accepted that the price of drugs has gone up dramatically since 2003.

The second concern relates to the privatisation of the healthcare system, particularly primary healthcare. Privatisation may be a good way of gaining new investment quickly, but the companies that bought the hospitals so far have been heavily concentrated in the pharmaceutical and construction sector. This raises concerns two concerns. When the buyer is a pharmaceutical company this can create potential conflict of interest. The conflict could, however, be mitigated with the right kind of Government oversight and controls, although most observers do not think that these are in place yet.<sup>208</sup> Similarly, it seems unlikely that property developers, whose main motivation is attaining well positioned real estate, have either the expertise or the interest in providing high quality healthcare.

Finally, there have been fairly broad suggestions that too much emphasis, at least within the Government reforms, has been placed on the development of new infrastructure and not enough attention has been focused on ensuring the implementation of modern medical prac-

tices. While there has been some effort to re-train doctors, the majority of the focus has been rehabilitating hospitals and primary healthcare units. However, it has been suggested that over-medication of patients and outdated methods might be far more dangerous to patients in Georgia than the absence of modern medical technology.<sup>209</sup>

In general, therefore, there is no way of knowing yet if the healthcare reforms will create the efficiency gains that the Government hopes for. In terms of equity, there has been a dramatic increase in spending in absolute terms and much of this has been targeted at the very poor. The second phase of the reforms, if initiated at this time, would probably leave the majority of the population in a position where they have to pay for their own medical cover. Dramatically widening the range of those covered would almost certainly require a substantial further increase in Government expenditure on healthcare.



## Chapter 6: Environmental reforms

Post-Soviet collapse had contradictory influences on the Georgian environment. Diminishing industrial capacity led to a reduction of water and air pollution, particularly in the cities, but economic desperation and lack of law enforcement created new pressures on Georgia's natural resources.

The first attempt to develop modern environmental governance was made in the early 1990s. The Law on Environmental Protection, adopted in 1996, established a comprehensive legal framework for environmental protection and use of natural resources. General responsibility for this function was held by the Ministry of Environmental Protection and Natural Resources (MEPNR), although the Ministry of Agriculture and the Ministry of Health controlled certain functions. Georgia also joined a range of international conventions including the UN conventions on 'Biodiversity', 'Climate Change to Stop Desertification' and the Aarhus Convention (Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters).

In principle, the environmental requirements that Georgia's new regulatory framework imposed were stringent. They required that any projects with the potential to create environmental problems be classified into one of four categories, with different levels of environmental assessment to be carried out according to the category. Public information and consultation was the responsibility of the MEPNR, and the deliberation process could take up to three months.<sup>210</sup>

In practice, the MEPNR was extremely inefficient, involved little or no participation of the population and was generally considered corrupt, using the time-consuming assessment and permit process as another mechanism for soliciting bribes. In addition, few of the international conventions to which Georgia became

a signatory resulted in concrete steps. For example, as Georgian NGO *Green Alternative* comments, 'ratification of the [Aarhus] convention was not followed by practical steps for the implementation of the requirements set out [in it]'.<sup>211</sup>

As a result, Georgia ran a completely disintegrated and heavily bureaucratic administrative system for issuing licenses and permits.<sup>212</sup> The enforcement of environmental laws and regulations remained largely ineffective as a result of duplication of enforcement functions among different bodies, lack of resources, corruption and general indifference toward environmental issues.<sup>213</sup>

### Environmental governance and protection

The priorities of the MEPNR are clearly stated in the 2006 Annual Report,

All efforts undertaken by the Ministry of Environment Protection and Natural Resource of Georgia during the last year were directed to support as much as possible the development of small and medium size businesses; although dedicated activities to raise environmental awareness of our society continues to be the task of primary importance.<sup>214</sup>

Changes in the governance of environmental legislation after the Rose Revolution were both institutional and legal. Institutionally, a range of state agencies that had taken responsibility for different elements of environmental

As a result, Georgia ran a completely disintegrated and heavily bureaucratic administrative system for issuing licenses and permits.

## Chapter 5: Environmental reforms

The reforms have, however, created concerns because of what the far more limited regulations fail to cover and about the provisions for public information and participation.

protection (like the State Forestry Service and State Department of Protected Areas) were clearly subordinated to the Ministry of Environmental Protection and Natural Resources. Some sub-units were abolished.<sup>215</sup> In the process, responsibility was not only consolidated but centralized, as many of the regional authorities lost the responsibility for managing natural resources in their regions.

The main legislative change was brought in with the 2005 Law on Licenses and Permits. This law had two main impacts. The first was that it dramatically reduced the number of projects that were classified as environmentally sensitive and in need of management and oversight, and it removed the hierarchy of environmental projects so that there was no longer a division of different levels of environmentally sensitive projects. Government projects can be exempt. Second, decision making on issuing a permit has been reduced from a range of one to three months (depending on the seriousness of the likely impact) to no more than 20 days. Levels of required consultation are generally a lot lower.<sup>216</sup>

### Human Development

From a human development perspective, environmental protection legislation is intended to secure efficient and sustainable use of natural resources and to protect local communities from environmental damage which may affect their physical security, health and livelihoods. However, at the same time, overly onerous environmental legislation can come at a cost since it may create hurdles for businesses, reducing their efficiency and impacting on prospects for local employment and economic growth. With the understanding that the old legislation provided few protections but created many hurdles, the Governments' main focus in the reforms was efficiency.

As a result, the reduction of environmental legislation has allowed greater use of environmental resources by businesses and the Government, with less corruption or interference. As the MEPNR states,

The innovative approach, revealed in the adoption of the 'One Window' principle and transparent methods, as well as the implementation of the auction system, resulted in the

issuing of 934 licenses by the Department of Licenses and Permits, which in monetary value translated into a contribution of 81 million GEL into the state budget and the employment of 21 thousand people in small and medium size enterprises by the new license owners.<sup>217</sup>

The reforms have, however, created concerns because of what the far more limited regulations fail to cover and about the provisions for public information and participation. The reduction in the categories of projects that need permits has been a source of concern because it seems to exclude categories with the clear potential to impact the environment. For example, oil and gas extraction and the construction industry are no longer classified as environmentally sensitive and do not need environmental impact assessments. In addition, requirements (at both the ministerial and private level) to provide information to the public and facilitate community participation are seen as too limited. Green Alternative suggests that,

Currently the MEPNR's actions to guarantee transparency and accountability towards the public are mainly manifested in the form of news published on the website of the Ministry, which mainly concerns the already carried out and planned auctions of mining operations and the listing of violations uncovered by the Environmental Inspectorate.<sup>218</sup>

The issue of participation is generally considered even more essential in environmental governance than in other areas, since decisions may be taken centrally but knowledge of likely consequences may be held in local communities, and impact of the decision (in the form of negative environmental consequences) will be felt locally. In this way, the reduction in obligations to inform the public or hold public consultations is a concern. It also increases the likelihood that poor decisions will be made.

The Government's response to most of these concerns is to highlight the ineffectiveness of previous legislation. It is argued that there is little point in having EU standard environmental protection legislation in place since it is unlikely to be applied. Similarly, the Government argues that public participation requirements did not really result in public participation. The balance of these arguments is hard to assess objectively. There is general agreement that the few environmental regulations now in place



are better enforced than under the old system. At the same time it does seem likely that some areas which were left unprotected by the first wave of reforms deserve reconsideration now that we are moving into the second phase.

## Forestry

About 40 percent of Georgia's territory is forested. During the Soviet period Georgia imported most of its wood from Russia, leaving its own forests largely untouched and underdeveloped as an economic resource.<sup>219</sup> After independence, forests remained under state control while other land was privatised but the Government structures that were charged with forest management became progressively more and more thinly stretched. The logging system was managed by the State Forestry Department (SFD) and governed by the 1999 Forest Code of Georgia. However, the SFDs declining budget made it difficult for them to police the system and made the individual employees highly susceptible to bribery. By 2003, a UN report suggested that,

There is no organized State monitoring in Georgia's forests, and neither is Georgia part of international monitoring programmes. Even worse, its forests are under serious threat because the responsible institutions do not have enough money to operate normally.<sup>220</sup>

Georgian forests were cut down for two reasons. First, in the absence of low-priced lumber from Russia, they became a valuable commodity. Timber was harvested both for local use and for export. Second, and more importantly, as the power generation system collapsed, wood became an increasingly important replacement fuel source. As the World Bank suggested in 2002,

There is also a visible trade in illegally-harvested timber in the form of trucks with unrecorded high-quality beech logs crossing the Turkish border, but it accounts for only 6% of total estimated harvested volume. The most immediate threat to Georgian forests is the harvesting of fuel-wood. Declining GDP, rising poverty, and the decline in energy subsidies for fossil fuels has led to greatly increased use of fuel-wood. At present, nearly 60% of the annual forest harvest (or about 720,000 m<sup>3</sup>) is

unrecorded fuel-wood.<sup>221</sup>

Even the legal logging that took place was poorly structured, since short-term contracts between the loggers and the Government offered no incentive for sustainable management or cultivation of the resource.

Because of lack of management, forest resources were used inefficiently and harvested in a way that did more damage than necessary to the surrounding forest. Valuable trees like chestnut, beech and oak were used for fuel rather than as lumber, which is far more profitable. Perhaps more importantly, without management it was unclear what level of commercial logging would be sustainable. Without allowing time for rejuvenation between harvests, logging threatened the survival of the forest.

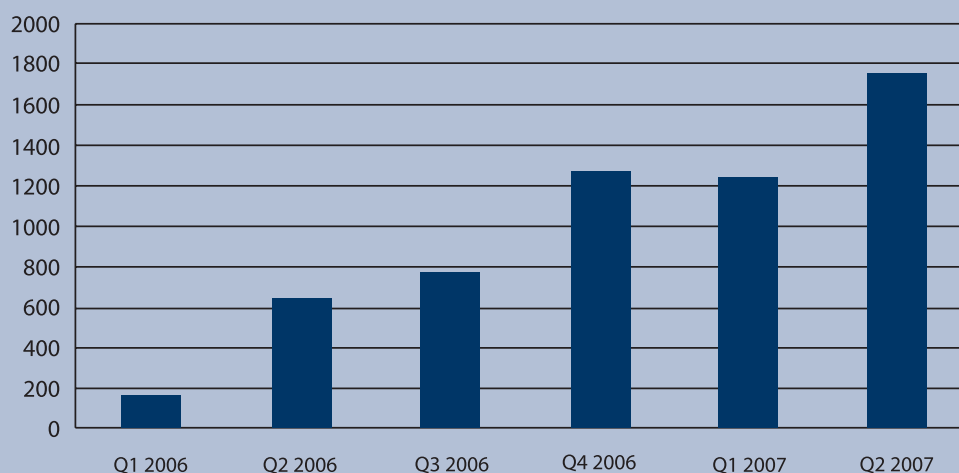
This is particularly problematic because the Georgian forests are vital for protecting connected industries and human security. The Georgian forests are a habitat for Georgian animals and so endangering them endangers Georgian biodiversity<sup>222</sup> which is bad in itself and in the long-term, threatens Georgia's aspiring ecotourism industry. Most importantly, according to the World Bank, half of the forests in Georgia are designated as 'soil protecting and water regulating forest.'<sup>222</sup> The loss of these forests would result in soil erosion, particularly when combined with routine overgrazing, and could increase the chances of flooding or landslides.

## The reforms

The two main changes that have been taking place in forestry are the system of policing and oversight, and the gradual plans to transfer ownership into private hands. The forestry department continues to manage the majority of the forests but is now fully subsumed by the Ministry of Environmental Protection and Natural Resources (MEPNR). The work of the forest rangers is also assisted by the Environmental Inspectorate, which is generally considered to be well-resourced and well-trained.<sup>224</sup>

One immediate effect of the changes in policing has been that illegal logging has been more or less eliminated. This is generally considered to be a good thing, though the determination with which it has been pursued by some of the authorities has created concern about local community access. One obvious demon-

One immediate effect of the changes in policing has been that illegal logging has been more or less eliminated.

**Figure 6.1** Number of Environmental violations

Source: Provided to UNDP (2007) by the Inspectorate of Environmental Protection, Ministry of Environmental Protection and Natural Resources.

stration of increased policing is the fact that the number of arrests for violations has increased dramatically. Though the chart below is not specific to environmental violations in forestry, it demonstrates that the Government believes that its reforms in environmental policing have been successful.

Currently, about 300,000 hectares of forest are controlled by local authorities. Central Government was planning to transfer an additional 800,000 hectares to local control, but this process is currently delayed as there was little clarity on exactly how local government would finance the additional responsibility. In terms of community access, in 2007 the Government initiated a programme that provided rural households with five square meters of firewood for free. Beyond that, local households have to pay GEL 3 per square meter, in addition to cutting and transportation costs.<sup>225</sup>

The second major change to forestry management and protection is only just starting. In the 2005 assessment of the Economic Development and Poverty Reduction Plan, the main solution offered to this problem was long-term leasing of forests.<sup>226</sup> Long-term leasing can provide incentives for the leaser to manage the resource sustainably and will provide the Government with much-needed income. As things stand, four land plots have been sold on

twenty year leases, covering a territory of about 80,000 hectares. There are currently a negligible number of land plots held under a one year lease.<sup>227</sup>

### Human development

The concerns about deforestation result from two factors. First, there is often a sense that the Georgian forests, following decades of abuse, have been severely damaged. In extreme cases, this belief can lead to the conclusion that logging should not be allowed at all until the forests have been allowed to recover:

Many forest lands in the Samtskhe-Javakheti, Imereti, Ajara, and Kakheti regions are close to complete degradation. The process is already irreversible. If the situation is not changed without delay, a generation of Georgians will be obliged to live in a completely deforested country. Most forest lands are in such poor condition that we just cannot afford to cut them down in the near future.<sup>228</sup>

A more moderate view is that certain sections of the Georgian forest are highly vulnerable, and logging should only be allowed in those areas that are shown to carry robust stocks of wood and where logging will not lead to soil erosion, landslides or flooding. In order to target the forests in this way, it is suggested that a number of components would have to be

in place. First, the Government would have to know what wood stocks already exist and where it is appropriate to allow logging. Second, they would need contracts that place limitations on the use of leased forests to ensure long-term management. Third, the system would have to be well policed. Critics are unsure about all three.

The most crucial issue is generally considered to be the need for an inventory. A national inventory would allow the Government to systematically identify which land plots are best suited for long-term lease and would provide a baseline for assessing forest usage by private companies. Because of the Government's failure to provide this assessment, the World Bank suspended the last USD 11 million of the Forests Development Project.<sup>229</sup> Even some people in the Ministry accept this point; as one Ministry of Environment official acknowledged, 'of course, an inventory would be the proper way to go forward in order to ensure the sustainability of the forests.'<sup>230</sup>

The terms of the contract are also crucial. The Government has suggested that the licensee should undertake an inventory; however, the effectiveness of this strategy depends on the way in which this inventory is certified. Initially, the Government planned to demand certification from the Forestry Stewardship Council. As an internationally recognized standard, this gave some environmental NGOs confidence in the process. Since that time the certification requirements have weakened and confidence has collapsed.<sup>231</sup> In addition, while this certification, in the best circumstances, might ensure that the inventory was done correctly by licensees, it would not resolve the problem of how the Government should select appropriate plots in the first place.

In terms of policing, it was originally hoped that handing over control of the forest through long-term leasing agreements could bring illegal logging under control, since those who own the land would have a vested interest in protecting it. Unfortunately, this has created two conflicting issues. On the one hand, it is not clear that the forestry service will have the resources to either police the leased land or to stop logging on un-leased land.

Revealing illegal logging in the forest requires involvement of enormous human resources, along with respective knowledge and

experience, which, unfortunately, are still lacking... each of the foresters is in charge of thousands of hectares and their salaries are extremely low.<sup>232</sup>

The second problem is that by encouraging over-zealousness in the authorities and giving entirely private ownership to businesses, local populations could be restricted from accessing forests, even for non-timber resources, like the collection of fallen wood, fruits and mushrooms. The main resolution to this problem, as envisaged by the Government, has been the assignment of lands to local authorities. However, the localization of control has not so far been as extensive as the Government planned and while there is a general feeling that the provision of local access could and should work in principle, poor local management has, so far, created an inequitable outcome for local communities.<sup>233</sup>

## Water

After the collapse of the Soviet Union, Georgian water infrastructure rapidly deteriorated as a result of discontinued repair works, lack of proper monitoring, theft and corruption. In the 1990s, the crisis of potable water supply in Georgia had two components. First, there was the problem of access. In a Socio-Economic Inventory Assessment carried out by CHF International in 2005, about 30 percent of the population was still not connected to water supply. Second, the damaged infrastructure and contaminated surface water allowed for microbiological contamination.<sup>234</sup> As a result, the same CHF International study indicates that water supply was the fourth largest problem in Georgia for both urban and rural populations.<sup>235</sup>

The bad provision of potable water resulted from poorly maintained pipes and a pricing structure that encouraged waste. In 2004, Tbilisi lost about 45 percent of its water through pipe leakages.<sup>236</sup> Across the country, about 50-60 percent of the water was being lost to leakage due to poor infrastructure.<sup>237</sup> Undercharging also resulted in over consumption. Up until 2007, the household water tariff in Tbilisi covered only about 30 percent of the actual cost of the water supply.<sup>238</sup> Not only were charges low, but collection rates for even these

small charges were poor. The water tariff collection rates fell sharply in Georgia through the 1990s and only about one third of bills were being paid in 2003.<sup>239</sup>

In Tbilisi, production was about 800 litres per capita in 2004.<sup>240</sup> Since 45 percent of this was lost in leakages, it can be estimated that consumption was 440 litres per day. This is very high. Western European countries consume between 100-250 litres per day.<sup>241</sup> As a result of leakages and over consumption, provision was very poor. About 30 percent of the population outside of Tbilisi received water for less than 12 hours per day.<sup>242</sup> In 2005-2006 the second largest city of Georgia, Kutaisi (185,000 inhabitants) still had running water only for three hours every second or third day and practically no running water the rest of the time.<sup>243</sup>

Microbiological contamination was caused by out-of-date and poorly-maintained filtration systems as well as a system of controls that had collapsed. The number of municipal laboratories responsible for water quality checks sharply declined during the 1990s while the remaining laboratories were poorly equipped and only partially operational.<sup>244</sup> By the year 2000, more than 60 percent of the urban water supply and sanitation infrastructure was totally depreciated.<sup>245</sup>

The broken infrastructure and lax controls have resulted in the serious deterioration of potable water quality across the country, causing a number of epidemic outbreaks of infectious diseases and high rates of gastrointestinal illnesses, both in the capital and in the regions throughout the 1990s.<sup>246</sup> According to the 2004 Kutaisi Environmental Report, the high rates of diarrhoea and hepatitis A in some districts of Kutaisi were associated with water and sewage pipe failures in the city.<sup>247</sup> In rural areas with intensive agriculture and dense populations, the lack of access to regular drinking water supplies combined with significant microbiological contamination of individual wells and spring water used for drinking.<sup>248</sup>

The need for clean water is not hard to explain in human development terms. Its absence constitutes a huge inefficiency, disrupting the most basic of activities and presenting a huge cost in time. Polluted water also creates widespread health problems, which are a drain on public and private resources. A lack of clean

drinking water is also a sign of extreme inequity and a source of profound insecurity. Other human development goals are practically irrelevant without access to this basic human right.

### The reforms

From 2004, the newly elected government in Georgia considerably intensified its efforts to optimize the management of potable water resources and increase the funding of municipal infrastructure, both from state budgetary resources and international donor assistance. In Tbilisi, extensive reconstruction and rehabilitation works were carried out between 2005 and 2007. All major drinking water quality monitoring laboratories have been refurbished and equipped with modern computerized systems.<sup>249</sup>

Most central water pipelines have been rehabilitated and the number of emergency shut-downs, as well as the scale of water losses, has decreased significantly. A total of 59 kilometres of water pipeline network were replaced in the capital in those two years compared to 18 kilometers per year before that.<sup>250</sup> The rehabilitation of another 150 kilometers of pipes is planned for the near future.

Extensive rehabilitation projects are also underway outside of the capital. With co-financing from international donors and several development banks, work is underway to rehabilitate the water network of Kutaisi.<sup>251</sup> Work is also being carried out to rehabilitate networks in Poti (45,000 inhabitants) in order to provide the city with 24-hour safe drinking water within three to four years.<sup>252</sup> The Georgian government is co-financing the full rehabilitation of the Batumi water infrastructure, which is planned to be completed by the end of 2009.<sup>253</sup>

In October 2007, as part of the government's generally liberal approach to economic development, the Zhinvali water supply system, which provides potable water to the capital and its surroundings, was privatized in a public-private partnership with investment group Multiplex Solutions. The buyer committed to investing USD 350 million to improve the provision of potable water while maintaining the level of tariffs for household consumption at its current GEL 2.4 until 2010.<sup>254</sup> For the 2010-2014 peri-

od, the tariffs are expected to be raised to GEL 2.95. Installation of communal water meters began immediately after the privatisation.

Significant progress has also been made with regards to collection rates for water charges. In Tbilisi, the water charge collection rates for households increased to 54 percent in 2004 from 40 percent in 2003. Most of this progress was made thanks to the new combined billing initiative.<sup>255</sup>

### Human development

There is no publicly-available research on the extent to which water provision has improved since the reforms started. Anecdotal evidence would certainly suggest that the water supply in Tbilisi has improved, but repairs in the other municipal areas are ongoing and so it is probably too soon to tell. Even in the absence of initial findings, however, it is hard to see this development as anything but a great improvement in human development terms. Some of the costs of these innovations have been passed onto the consumer. The household tariff in Tbilisi has doubled, but the level is still fairly low at GEL 2.4 per family member per month from January 2007.<sup>256</sup>

Although the government generally regards the reforms introduced in the water sector as a great success, some environmental NGOs and independent experts working in the field have raised a number of concerns regarding recent water policies. First, the reform is criticized for a lack of dissemination of relevant information and public participation. In an open letter to the EBRD (one of the major lenders to the water projects), a group of NGOs complained about their lack of access to project documents such as feasibility studies and audits of the company's accounts.<sup>257</sup> They also argue that no social assessment has been undertaken to identify required mitigation measures for low-income households, which may have suffered or may suffer from tariff hikes. The Municipality of Tbilisi is trying to address this issue by offering a 50 percent discount on the water supply services to 60,000 individuals who are registered as living under the poverty line.<sup>258</sup>

Another source of concern is the significant delay in the development of legislative and institutional frameworks for integrated water

management, which would allow for more strategic and long-term governance of water resources.<sup>259</sup> Such system of management would have significant implications for access to safe drinking water in terms of both water quantity and quality. The system would guarantee sustainable use of water resources. It would help to ensure the relevant quality of a drinking water and its sources, including ground water, which is the main source of potable water in the country.

Although the draft concepts on integrated water management and water resource management policy of Georgia have been prepared by the Ministry of Environment Protection and Natural Resources, their approval has been delayed.<sup>260</sup>

It is undeniable that, since 2003, the Government has made (and continues to make) significant progress in improving access to drinking water, particularly in urban communities. Behind this there has been a dramatic increase in state funding for infrastructure rehabilitation works and a range of resources drawn from international donors. Higher water tariffs in the capital combined with the trend of improving water charge collection rates will help further rebuild and better maintain the infrastructure in Tbilisi and make the system as a whole vastly more sustainable. Of course, many cities outside of Tbilisi have not seen such significant increases, and extension of coverage to rural areas will probably take far more time, but the initial phase of the improvements seems to be a success.



# Notes

1. Currency conversions are made using yearly averages. When looking at trends this can exaggerate increases over the 2003-8 period since the dollar has depreciated by 29% over that time.
2. These are central Government budget figures. The 2003 figures are almost certainly understated since more of the budget was locally administered in 2003..
3. Using 1990 as a benchmark for GDP is problematic, since it is commonly accepted that GDP, under the Soviet System, was routinely exaggerated for political reasons. However, anecdotal evidence certainly suggests that most people experienced a vastly higher standard of living under the Soviet System than they do now.
4. Jonathan Wheatley (2005), *Georgia from National Awakening to Rose Revolution*, Aldershot, Ashgate Publishers, p103.
5. United Nations Development Program (2003), *Improving Targeting of Poor and Extremely Poor Families: The Construction of Poverty Maps at the District Level*, Georgia, p7.
6. Government of Georgia (June 2004), *The Government's Strategic Vision and Urgent Financing Priorities in 2004-2006*, Brussels Donor Conference.
7. Figures provided by Camrin Christensen (April 2007), *Transparency International, Georgia. The Transparency International Corruption Perception Index is a composite of six major international reports. However, TI will not provide the exact composition of the number.*
8. Jonathan Wheatley (2005), *Georgia from National Awakening to Rose Revolution*, Aldershot, Ashgate Publishers, p105.
9. President Mikhail Saakashvili (2004), *Inaugural Speech*, Tbilisi, Georgia.
10. Government of Georgia (March 2006), *Presidential Decree No155, On Approving the Action Plan for the Implementation of the Georgian National Anti-Corruption Strategy*, p9.
11. The three local NGOs that were involved in this process were Transparency International, Georgia; Georgian Young Lawyers Association; and Young Economists Association.
12. Government of Georgia (June 2005), *Presidential Decree No 550, On the Approval of Georgia's National Anti-Corruption Strategy*, Tbilisi, Georgia.
13. Tamuna Karosanidze (2007), *National Anti-Corruption Strategy and Action Plan: Elaboration and Implementation*, Tbilisi, Georgia, Anti-Corruption Resource Centre .
14. Anti-Corruption Network (2006), *Anti-Corruption Report for Central and Eastern Asia* (<http://www.OECD.org/data/OECD/10/11/38009260.pdf>), p7.
15. UNDP communication (May 2008) with Lasha Mgeladze, Head of the Public Service Bureau.
16. World Bank (2008) 'Georgia: Licensing', *Doing Business in the South Caucasus*, (<http://doingbusiness.csera.org/georgia/doingbusiness/licensing.htm>).
17. American Bar Association Central European and Eurasian Law Initiative (ABA/CEELI) (September 2005), *Judicial Reform Index* ([http://www.abanet.org/ceeli/publications/jri/jri\\_georgia.pdf](http://www.abanet.org/ceeli/publications/jri/jri_georgia.pdf)).
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19. Ibid.
20. Interview with Giorgi Ebanidze (June 2008), Head of the Bureau of the Chairman of the Supreme Court of Georgia. Information gathered by the Disciplinary Collegium of the High Council of Justice.
21. Supreme Court of Georgia *Judicial Strategy. Main Directions of the Court Reform.*, Tbilisi, Georgia ([http://www.supremecourt.ge/georgian/strategia\\_eng.htm](http://www.supremecourt.ge/georgian/strategia_eng.htm))
22. UNDP interview with Zaza Meishvili, (June 2008), Deputy Chair Supreme Court of Georgia.
23. Ibid.
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28. Venice Commission Council of Europe (March 2007), *Opinion on the Law on Disciplinary Responsibility and Disciplinary Prosecution of Judges of Common Courts of Georgia* ([http://www.venice.coe.int/docs/2007/CDL-AD\(2007\)009-e.asp](http://www.venice.coe.int/docs/2007/CDL-AD(2007)009-e.asp)); and Nino Kalandadze (September 2007), 'Judicial Reforms in Georgia', *Central Asia-Caucasus Institute Analyst* (<http://www.cacianalyst.org/?q=node/4702>).
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30. Fraser Institute (2007), *Economic Freedom of the World: 2007 Annual Report*, p21.
31. Eight judicial members elected by the Conference of Judges and the chairman of the Supreme Court constitute the majority of the High Council of Justice. Two members of the council are appointed by the President and three members are elected by Parliament. The head of the Legal Committee of Parliament, currently a member of the ruling party, is an ex-officio member of the High Council of Justice. U.S. Department of State, Bureau of Democracy ,Human Rights and Labor (2007), *Country Report on Human Rights Practices in Georgia*, (<http://www.state.gov/g/drl/rls/hrrpt/2007/100560.htm>).
32. Connection with the Consideration of the Third Report of Georgia, Human Rights Committee 91st Session (<http://www2.ohchr.org/english/bodies/hrc/docs/Georgiawrittenreplies.pdf>)
33. Nino Kalandadze (September 2007), 'Judicial Reforms in Georgia', *Central Asia-Caucasus Analyst* (<http://www.cacianalyst.org/?q=node/4702>).
34. Government of Georgia. (2007), *Replies of the Government of Georgia to the list of issues to be taken in connection with the consideration of the third report of Georgia*, Human Rights Committee 91st Session (<http://www2.ohchr.org/english/bodies/hrc/docs/Georgiawrittenreplies.pdf>).
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40. UNDP interview with Zaza Meishvili (June 2008), Deputy Chair, Supreme Court of Georgia.
  41. Supreme Court of Georgia, Judicial Strategy. Main Directions of the Court Reform., Tbilisi, Georgia ([http://www.supremecourt.ge/georgian/strategia\\_eng.htm](http://www.supremecourt.ge/georgian/strategia_eng.htm)).
  42. Georgia Today (2007), Trial by Jury: More Democracy or a Face-Lift for the Georgian Judiciary? ([http://www.georgiatoday.ge/article\\_details.php?id=4122](http://www.georgiatoday.ge/article_details.php?id=4122)).
  43. UNDP interview with Nino Zuriashvili (June 2008), Project Director of investigative journalism group Studio Monitor.
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  45. International Republican Institute (September 2007), Georgian National Voter Survey, Tbilisi, Georgia p19.
  46. Figures provided by Camrin Christensen (April 2007), Transparency International, Georgia..
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  54. European Neighbourhood Policy (2008), Implementation of the European Neighbourhood Policy in 2007: Progress Report Georgia.
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  61. Vidmantas Jankauskas and Teimuraz Gochitashvili (2008), 'Development of the Georgian Electricity and Gas Markets in Line with EU Energy Policy', The Georgian Economic Trends: Quarterly Review, February 2008, Tbilisi, Georgia, Georgian-European Policy Legal Advice Centre.
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82. World Economic Forum, Global Competitiveness Report (2007-2008). Viewing the 'National Balance Sheet for Georgia', (<http://www.gcr.weforum.org/>).
83. International Monetary Fund (March 2007), Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion, p7
84. European Bank for Reconstruction and Development, Economic Statistics and Forecasts: transition indicators (<http://www.ebrd.org/country/sector/econo/stats/tic.xls>).
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88. To put this another way, while an income tax exemption means that you don't pay income tax, a VAT exemption means that you don't charge tax on the goods you sell. A farmer producing goods that are exempt still has to pay VAT on the fertilizer used.
89. Molly Corso (10 March 2006), 'Georgia's Opposition Cashes in on Cash Register Process', Eurasianet (<http://www.eurasianet.org/departments/business/articles/eav031006.shtml>).
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91. Government of Georgia, Ministry of Defence, Strategic Defence Review: Final Report 2007, p95.
92. Unfortunately, the World Bank does not provide comparative figures for previous years on this variable in Georgia. World Bank (2008), Ease of Doing Business Report: 2008. (<http://www.doingbusiness.org/ExploreEconomies?economyid=74>) However, it remains 22 percent to export and 12 percent cheaper to import than the Organization of Economic Cooperation and Development average.
93. Esben Emborg, in an interview with GHN News Agency, (18th July 2007).
94. Georgian-European Policy and Legal Advice Centre (February 2008), Georgian Economic Trends: Quarterly Review, p40.
95. Georgian-European Policy and Legal Advice Centre (Feb 2008), Georgian Economic Trends: Quarterly Review, p40. A large proportion of this increase in hydrocarbon imports will probably reflect the increase in price of this product on the world market, and particularly coming from Russia. This is a combination of two figures, the value for 'oil and oil products' and the value for 'oil gases and hydrocarbons'.
96. UNDP interview with Vakhtang Lejava (May 2008), First Deputy Minister of Economic Development
97. Pierre Garello, et al (2007), Assessment of the Impact of Potential Free Trade Agreement Between EU and Georgia, UNDP, Georgia.
98. Interview for another project with Richard Hurelbrink, General Director of AgVantage (20th August 2007).
99. State Department of Statistics, Food Security Situation: Trends in Figures (January 2008), p17
100. 'Form A Certificates' are necessary to gain access to the EU under GSP+. About USD 64 million (or around half of the total applications) were allocated to the export of nuts in 2007. Information provided by the Ministry of Finance (May 2008).
101. State Department of Statistics (January 2008), Food Security Situation: Trends in Figures, p17.
102. European Commission (April 1998), Implementation of the European Neighbourhood Policy in 2007, Brussels, (<http://www.delgeo.ec.europa.eu/en/index.html>) P11
103. Transparency International (December 2006), Where Do We Stand?: Georgia's Achievements and Challenges Through Different Lenses, Tbilisi, Georgia, p2.
104. FDI is usually distinguished from 'portfolio investment', where the investor simply buys shares in a company but has no involvement (and usually expects no involvement) in the decisions of the company.
105. Georgian-European Policy and Legal Advice Centre (February 2008), Georgian Economic Trends: Quarterly Review, Tbilisi, Georgia p41.
106. Witold J. Henisz and Bennett A. Zelner (2006), AES Telasi: Power Trip or Power Play?, The Wharton School of Business, University of Pennsylvania, p6.
107. European Commission (April 1998), Implementation of the European Neighbourhood Policy in 2007, Brussels (<http://www.delgeo.ec.europa.eu/en/index.html>) P16
108. According to the USAID Office of Energy and Environment, prices have not changed significantly between September 2003 (the date of the last price increase) and May 2006. (E-mail correspondence, 2 May 2008).
109. The paper uses Rustavi as a sample case for consumption outside of Tbilisi.
110. Georgian-European Policy and Legal Advice Centre (February 2008), Georgian Economic Trends: Quarterly Review, Tbilisi, Georgia P17
111. Ibid.
112. International Republican Institute (Sept 2007), Georgian National Voter Survey, Tbilisi, Georgia p10
113. Caucasus Research Resource Centres (2008), Data Initiative.
114. Government of Georgia (2005), Economic Development and Poverty Reduction Program: Progress Report, Tbilisi, Georgia, p4. The Government has not released this figure since 2005, instead releasing a 'relative poverty' figure which is probably more accurately described as a measure of income distribution than poverty.
115. International Monetary Fund (March 2007), Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion, p15.
116. Ministry of Labor Health and Social Affairs: Social Subsidies Agency (Sept 2007), Report on the Recipients of Social Assistance, Tbilisi, Georgia, Government of Georgia.
117. Data refer to the most recent year available during the period of 1990-2005
118. The GINI index is a standard measure of income inequality
119. European Commission (April 1998), Implementation of the European Neighbourhood Policy in 2007, Brussels, (<http://www.delgeo.ec.europa.eu/en/index.html>), p11.
120. International Development Association (May 2007), Program Document for a Proposed Third Poverty Reduction Support Operation, p19
121. Ibid. p20
122. Ministry of Economic Development: Department of Statistics (1998), 1997 Statistical Yearbook, Tbilisi, Georgia, Government of Georgia, p46.
123. Data provided by the State Department of Statistics (June 2008).
124. European Commission (April 1998), Implementation of the European Neighbourhood Policy in 2007, Brussels, (<http://www.delgeo.ec.europa.eu/en/index.html>), p11
125. International Monetary Fund (March 2007), Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion, p6.
126. UNDP interview with Vakhtang Lejava (May 2008), First Deputy Minister of Economic Development.
127. State Department of Statistics (June 2008).
128. International Republican Institute (Sept 2007), Georgian National

- Voter Survey, Tbilisi, Georgia. p7.
129. Transparency International (2007), *Fighting Unemployment in Georgia*, Tbilisi, Georgia.
  130. State Department for Statistics (June 2008). Figures are yearly averages.
  131. This analysis is reasonable from first principles. VAT is 18 percent, which means that if 100 percent of goods were taxed then VAT, would equal 18 percent of GDP. VAT has gone up from 4.8 percent of GDP in 2003 to 11.5 percent of GDP in 2007. This means that the majority of goods have their price impacted by VAT. Ibid. p26.
  132. George Welton (December 2007), *Environmental Overview for CARE Long-Range Strategic Planning Mid-Term Review*, Tbilisi, Georgia, CARE Georgia, p10.
  133. Department of Statistics (2008), 'Food Security Situation: Trends in Figures', Government of Georgia p11
  134. Based on figures provided by the State Department of Statistics and own calculations. It is more useful in this context to look at the central government expenditure, rather than consolidated expenditure (which would include local Government expenditure), since state budget expenditure contains projections for 2008.
  135. Social Services Agency (2008), (<http://ssa.gov.ge/index.php?id=265>).
  136. Social Services Agency (2008), *The Number of Registered Vulnerable Families in the Database and Persons Receiving Assistance*, (<http://www.ssa.gov.ge/index.php?id=266>). The system for assessing need is currently changing from one that assesses assets (like quality of housing, ownership of a TV, car etc) to one that focuses on revenue. This should not, by itself, dramatically increase the number of people covered. UNDP interview with David Pavliashvili (June 2008), Head of Social Welfare, Ministry of Labour, Health and Social Protection.
  137. The reason that a much larger proportion of families is covered than the proportion of the population is that smaller families are less likely to have at least one working member In addition, probably the poorest group in Georgia is single pensioner households. There are 16,420 single pensioner households in Georgia receiving a supplementary benefit. Ibid.
  138. All figures derived on numbers of pensioners and social assistance grantees derived from the SSA website. This assumes that pensions and social assistance levels remains constant throughout the year.
  139. Ana Matiashvili (2004), *Education of Internally Displaced Persons in Georgia and Related Issues*, Tbilisi, United Nations Development Program, p12.
  140. Ibid.
  141. UNICEF (1999), *The analysis of the situation of children's school education in Georgia in 1998 – 1999*, Tbilisi, Georgia
  142. Ministry of Finance (2008), *State Budget for 2003–2007*, Government of Georgia ([http://www.mof.ge/Default.aspx?sec\\_id=1482&lang=1](http://www.mof.ge/Default.aspx?sec_id=1482&lang=1))
  143. with ([http://www.mof.ge/Default.aspx?sec\\_id=770&lang=1](http://www.mof.ge/Default.aspx?sec_id=770&lang=1)) for 2008 projections accessed May 2008
  144. The State provides free 12-year secondary education for all its citizens; it consists of primary school (grades 1 to 6), lower secondary (7 to 9) and upper secondary (10 to 12). Basic nine-year education is compulsory.
  145. Ministry of Education and Science of Georgia ([http://www.mes.gov.ge/upload/text/geo/1207130469\\_2008%20wllis%20budget.pdf](http://www.mes.gov.ge/upload/text/geo/1207130469_2008%20wllis%20budget.pdf)).
  146. The bulk of the secondary education reform has been carried out with the finance and technical support of the World Bank's Education System Realignment and Strengthening Program (ESRSP), otherwise known as the Ilia Chavchavadze Project.
  147. This will be carried out by the National Education and Accreditation Center of Georgia. The learning outcomes of pupils will be assessed through both national and international assessment programs (PIRLS and TIMSS), to be able to compare performance of Georgian pupils with learning achievement of their foreign peers.
  148. Ketevan Rostiasvili (2004), *Corruption Problems in the System of Georgian Higher Education*, Tbilisi, Georgia, Transnational Crime and Corruption Research Center, p49.
  149. During the first years of the reform, on the basis of Unified National Examinations, applicants are admitted only to BA programs countrywide, but from 2009 the Unified National Examinations will also apply to students entering MA programs.
  150. Parliament of Georgia, (2004), *Law of Georgia on Higher Education*. [http://www.parliament.ge/index.php?lang\\_id=GE0&sec\\_id=69&kan\\_det=det&kan\\_id=24](http://www.parliament.ge/index.php?lang_id=GE0&sec_id=69&kan_det=det&kan_id=24). Article 63/1.
  151. Ibid. Article 74/3.
  152. National Center for Education and Accreditation. Higher education establishments accredited for five years from 2007–2008, ([http://www.nea.ge/default.aspx?sec\\_id=50&lang=1](http://www.nea.ge/default.aspx?sec_id=50&lang=1)).
  153. The program is currently divided into two parts: The Rustaveli Foundation (for social sciences and humanities) and the Georgia National Science Foundation (for natural sciences).
  154. Three BA programs (Pedagogy, Law and Medicine) are to be regulated by the state, and there are no Major and/or Minor programs within them.
  155. BCG, (2007), *Education Reform Survey Report*. (BCG are a local polling organization)
  156. Transparency International (December 2006), *Where Do We Stand?: Georgia's Achievements and Challenges Through Different Lenses*, Tbilisi, Georgia, p1.
  157. Martin Godfrey (February 2007), *Georgia: Education Policy Note*. (Unpublished assessment for the Ministry of Education), Tbilisi, Georgia, p2.
  158. Marc D. Shapiro et al (2007), *Evaluation of the Ilia Chavchavadze Program in Reforming and Strengthening Georgia's Schools* ([http://reform.edu.ge/files/100\\_2\\_594352\\_IC%20Evaluation%20Report%202007%20Final.pdf](http://reform.edu.ge/files/100_2_594352_IC%20Evaluation%20Report%202007%20Final.pdf)) See also: BCG, (2007), *Education Reform Survey Report* (BCG are a local polling organization)
  159. Martin Godfrey (February 2007), *Georgia: Education Policy Note* (Unpublished assessment for the Ministry of Education). Tbilisi, Georgia, p31.
  160. *Georgian-European Policy and Legal Advice Centre* (February 2008), *Georgian Economic Trends: Quarterly Review*, Tbilisi, Georgia, p27.
  161. Martin Godfrey (February 2007), *Georgia: Education Policy Note*. Tbilisi, Georgia, (Unpublished assessment for the Ministry of Education), p24.
  162. Ibid. p2.
  163. Ibid. p28.
  164. *Caucasus Research Resource Centres* (2008), *Data Initiative*, Tbilisi, Georgia.
  165. Tamuna Karosanidze and Camrin Christensen, (2005), 'A New Beginning for Georgia's University Admissions', *Stealing the Future*, Transparency International (Tbilisi, Georgia), p36. (<http://www.transparency.org/content/download/2174/12808>).
  166. Ibid. p39.
  167. First-year students were not asked this question since they cannot compare corresponding issues with the previous years.
  168. Tinatin Zurabishvili, (2006), *Reform of Higher Education in Georgia and its Impact on the "Culture of Corruption" at the universities*.
  169. Ministry of Education (May 2008) 'Student Support in Georgia', *Bologna Conference on Mobility*.
  170. Ibid. p21.
  171. CDC (2005), *Georgia Reproductive Health Survey, 2005* p.2
  172. David Gzirishvili and George Mataradze, *Healthcare Reform in Georgia*, Curatio International Foundation ([http://www.curatiofoundation.org/curatio/attachments/att\\_58650Georgia%20Health%20Sector%20Reform.pdf](http://www.curatiofoundation.org/curatio/attachments/att_58650Georgia%20Health%20Sector%20Reform.pdf))
  173. Ibid.
  174. Vakhtang Megrelishvili and Tata Chanturidze (forthcoming), *Georgian Health Care System Reform Overview*, Oxford Policy Management Georgia.
  175. Ibid.
  176. Akaki Zoidze, Avtandil Jorbenadze, David Gzirishvili and George Gotsadze (March 1999), *Health Reform and Hospital Financing in Georgia*, CMJ Online (<http://www.cmj.hr/1999/40/2/10234066.htm>)
  177. State Department for Statistics of Georgia (1999), *Statistical Yearbook of Georgia*. p. 115.

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179. Vakhtang Megrelishvili and Tata Chanturidze (forthcoming), Georgian Health Care System Reform Overview, Oxford Policy Management Georgia.
180. UNDP interview (May 2008) with senior health professional.
181. Vakhtang Megrelishvili and Tata Chanturidze (forthcoming), Georgian Health Care System Reform Overview, Oxford Policy Management Georgia.
182. Ibid.
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184. Ministry of Finance (accessed May 2008), State Budget for 2003-2007, Government of Georgia ([http://www.mof.ge/Default.aspx?sec\\_id=1482&lang=1](http://www.mof.ge/Default.aspx?sec_id=1482&lang=1)) and ([http://www.mof.ge/Default.aspx?sec\\_id=770&lang=1](http://www.mof.ge/Default.aspx?sec_id=770&lang=1)).
185. Vakhtang Megrelishvili and Tata Chanturidze (forthcoming), Georgian Health Care System Reform Overview, Oxford Policy Management Georgia. Forthcoming
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187. USAID Georgia (April 2007), Note to Support the Decision Making and Implementation of the Health Financing Reform in Georgia Draft Version.
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# Annexes

## Annex 1. Human development: concept

“The contrast between what great things human beings can achieve and what limited lives most women and men end up living is truly remarkable.”

Amartya Sen (Economics Nobel laureate 1998)

The following is a very brief synopsis of the origins, definition and broad characteristics of the human development approach.

### Origins of the human development approach

The human development approach arose as a result of growing criticism of the leading development approach of the 1980s, which presumed an automatic link between economic growth and human advancement. Dr. Mahbub ul Haq, the Pakistani economist who founded the Human Development Reports, came to recognize the need for an alternate development model due to many factors prevalent during the 1980s, including:

- The belief in the power of market forces to spread their benefits and end poverty, predominant since the Second World War, started to show its limits.
- The human cost of Structural Adjustment Programmes were increasingly becoming apparent.
- Social ills (crime, weakening of social fabric, pollution, etc.) were still spreading even in cases of strong and consistent economic growth.
- A wave of democratization raised new aspirations for people-centred development models.

### Definition

Human development can be defined as a process of enlarging people’s choices and building human capabilities (the range of things people can be and do), enabling them to: live a long and healthy life, have access to knowledge, have a decent standard of living and participate in the life of their community and the decisions that affect their lives.

Human development has always been ‘open-ended’ in that there can be as many dimensions to it as there are ways of enlarging people’s choices. There is no firm agreement on the key dimensions of human development; they can evolve over time and vary from country to country.

The following are currently considered central to the human development approach:

**Efficiency:** Efficient use of resources and increase of their availability. Human Development is pro-growth and productivity.

**Equity:** Distributive justice, especially for choices and opportunities.

**Empowerment and participation:** Particularly democratic governance, gender equality, civil and political rights and cultural liberty.

**Sustainability:** For present and future generations in ecological, economic and social terms

**Human Security:** In daily life, against chronic threats like hunger and abrupt disruptions

such as joblessness, famine and conflict.

The human development approach is holistic and integrated, in that it strives to find the virtuous circle between *Efficiency* (to increase availability of goods/services for basic needs), *Equity* (in the distribution of opportunities) and *Freedom* (for both intrinsic and instrumental value). It is an action-oriented paradigm, coined within the UN and seeking practical change. It recognises that there is no automatic link between economic growth and human progress – this link must be made by deliberate policymaking at all levels and by many actors, including the state.

The human development paradigm sees poverty as human poverty, a multi-dimensional condition defined as the denial of choices and opportunities to lead a tolerable life, including lack of necessities for material well-being (such as income, education, health, safe water) *plus* denial of opportunities to enjoy dignity, self-respect and other basic rights.

Growth is necessary but not sufficient. It is an important means to enlarge human choices but it is not an end in itself. The structure and quality of growth matters. Growth at all costs can result in:

- *Jobless* growth that does not expand employment opportunities.
- *Ruthless* growth, where the fruits of growth mostly benefit the rich.
- *Rootless* growth that can stifle cultural diversity and identity.
- *Futureless* growth that depletes natural resources.
- *Voiceless* growth where there is no expansion of democracy or empowerment.

### **Human development and the Millennium Development Goals (MDGs)**

The MDGs are human development goals, although they do not reflect all of the key dimensions of human development. The MDGs highlight the distance to be travelled; the human development approach focuses on how to reach these goals.

Human development is concerned with equity and distribution and attempts to understand the causes and consequences of inequality. Global and national MDGs and indicators are, on the whole, inequality-neutral.

Find out more on <http://undp.org>

## Annex 2. Statistical annex:

### Human Development Indices for Georgia

#### Human Development Indices

Human development is about the realization of human potential. It is about what people can do and become (their capabilities) and about the freedom they have to exercise real choices in their lives. Critical to progress in human development is the ability to measure and closely monitor it. The global Human Development Report has created and developed four main *composite human development indices* to assess measurable dimensions of human development. These are the human development index (HDI), the human poverty index (HPI), the gender-related development index (GDI) and the gender empowerment measure (GEM).

In general, a *composite index* is a unit-less number that combines various indicators or statistics to convey a larger picture. A composite index is formed when individual indicators are compiled into a single index on the basis of some underlying model.

**Human Development Index (HDI)** is the first composite index. It measures average achievement in a country in three basic dimensions of human development:

- A long and healthy life, as measured by life expectancy at birth
- Knowledge, as measured by adult literacy rate (with two-thirds weight) and the combined primary, secondary and tertiary gross enrolment ratio (with one-third weight)
- A decent standard of living, as measured by GDP per capita in purchasing power parity (PPP) terms in US dollars

The Human Development Index varies between zero and one; with higher values corresponding to the higher level of human development. Global HDR uses two cut-off lines—countries with HDI higher than 0.800 are considered as ‘high human development’, with HDI between 0.800 and 0.500 as ‘medium human development’ and lower than 0.500 as ‘low human development’.

**Gender-related Development Index (GDI)** was designed to take into account gender differences in the level of human development. GDI is a composite index measuring average achievement in the same three basic dimensions captured in the human development index, but adjusted to account for inequalities between men and women. GDI varies between zero and one. Higher values correspond to the higher level of human development and bigger differences with HDI correspond to the higher inequalities between men and women. Consequently, GDI should be considered together with HDI and attention should be paid to differences between them, not only to absolute level of GDI (as countries with low HDI cannot achieve high GDI). It should be also noted that the GDI takes into account differences between men and women without taking into account who is better off. In other words, lower life expectancy for men penalizes the index in the same manner as lower incomes among women do.

**Gender Empowerment Measure (GEM)** focuses on women’s opportunities rather than their capabilities, and captures gender inequality in three key areas:

- Political participation and decision-making power, as measured by women’s and men’s percentage shares of parliamentary seats
- Economic participation and decision making power, as measured by two indicators—women’s and men’s percentage shares of positions as legislators, senior officials and managers, and women’s and men’s percentage shares of professional and technical positions.
- Power over economic resources, as measured by women’s and men’s estimated earned income (PPP USD)

GEM varies between zero and one, with higher values of GEM corresponding to higher equality between women and men in the country (or, in other words, to lower inequality).

**Human poverty indices for developing countries (HPI-1) and for selected high-income OECD countries (HPI-2)** are composite indices measuring *deprivations* in the three basic di-

mensions captured in the human development index (a long and healthy life, knowledge, a decent standard of living) and also capturing social exclusion in HPI-2.

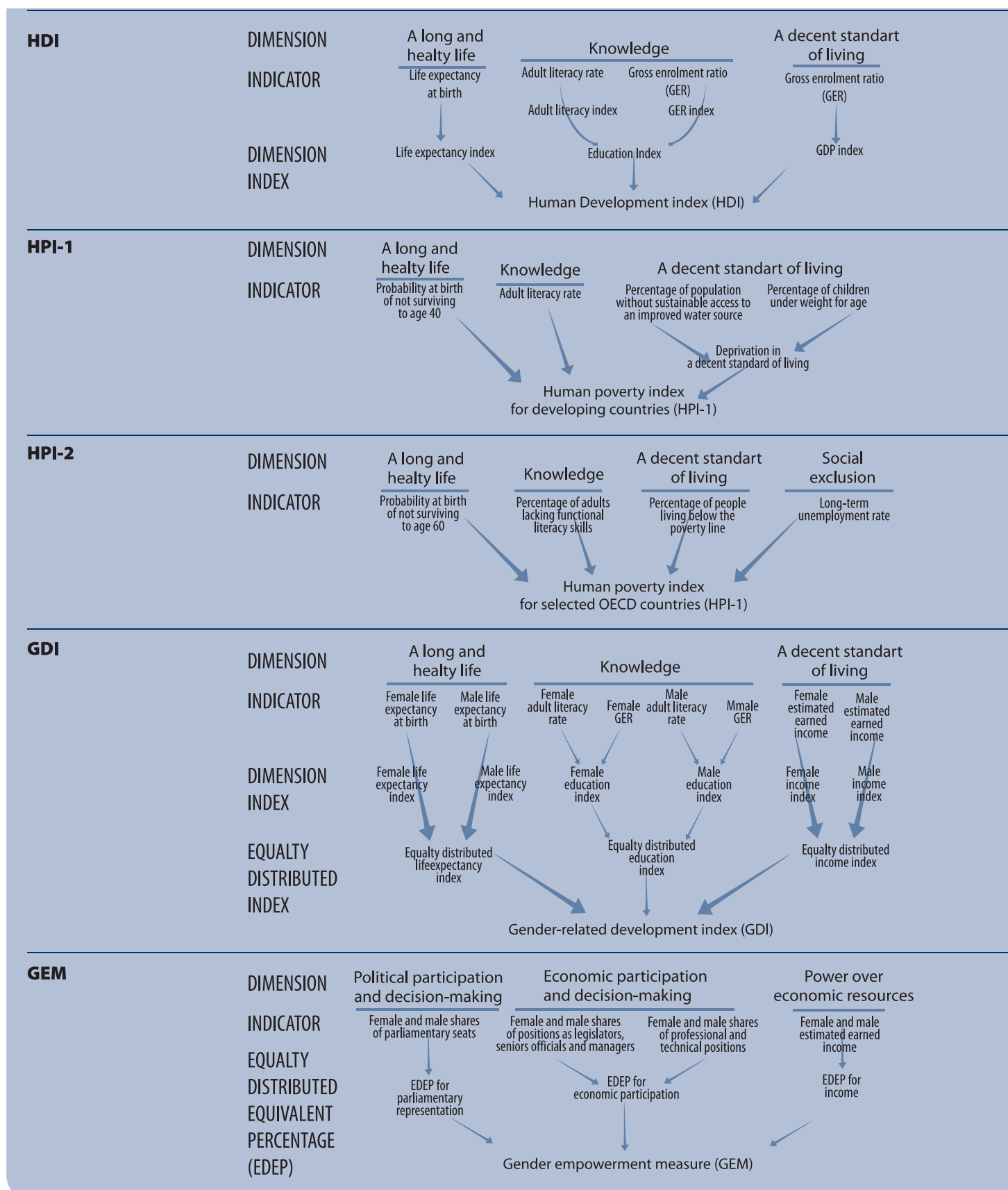
Human poverty indices are measured in percent and vary between 0 and 100. As they measure *deprivations*, they have a negative twist (contrary to the HDI and GDI, which measure *development* and have positive twist) and higher values of HPI-1 and -2 correspond to higher levels of deprivation, higher multi-dimensional poverty and, thus, lower development.

Component	Indicators for developing countries (HPI-1)	Indicators for selected high-income OECD countries (HPI-2)
A long and healthy life: vulnerability to death at relatively early age	probability at birth of not surviving to age 40	probability at birth of not surviving to age 60
Knowledge: exclusion from the world of reading and communications	adult illiteracy rate	percentage of adults (ages 16-65) lacking functional literacy skills
A decent standard of living: lack of access to overall economic provisioning	percentage of the population not using improved water source and the percentage of children under weight-for-age	percentage of people living below the income poverty line (50% of the median adjusted household disposable income)
Social exclusion		rate of long-term unemployment (12 months or more)



Figure A2

## Links between different Human Development Indices



## Human Development Index

As the table above notes, the Human Development Index tries to combine an understanding of health, knowledge levels in a country and wealth to get an overview of the general well-being and opportunities presented to most of society. In this measure, health is evaluated through a measure of average life expectancy, knowledge is measured by a combination of literacy and school enrolment and wealth is assessed by a calculation of per capita GDP, corrected for the purchasing power of the local currency. Below is a summary of these individual figures for Georgia.

**Figure A2.1: HDI index for Georgia and its components**

	HDI	Life Expectancy Index	Education Index	GDP Index	Life expectancy at birth	Literacy rate	Combined enrolment rate	GDP per capita, PPP USD
2000	0.749	0.773	0.963	0.510	71.4	99.64	89.5	2127
2001	0.748	0.777	0.944	0.523	71.6	99.64	83.8	2300
2002	0.749	0.776	0.934	0.536	71.5	99.64	81.0	2486
2003	0.764	0.771	0.962	0.558	71.3	99.64	89.3	2836
2004	0.760	0.760	0.947	0.573	70.6	99.64	84.9	3101
2005	0.771	0.768	0.951	0.593	71.1	99.64	86.2	3485
2006	0.778	0.771	0.950	0.614	71.3	99.64	85.6	3952

Source: Own calculations, statistical expert Nodar Kapanadze, demographic experts Giorgi Tsaladze and Nikoloz Maghlaperidze, State Department of Statistics.

## Gender-related Development Index (GDI)

The gender-related development index takes these same figures and calculates how well the two genders score relative to one another. While the HDI measures average achievement, the GDI adjusts the average achievement to reflect inequalities between men and women in the following dimensions:

A long and healthy life, as measured by life expectancy at birth.

Knowledge, as measured by the adult literacy rate and the combined primary, secondary and tertiary gross enrolment ratio.

A decent standard of living, as measured by estimated earned income (PPP USD).

Figure A2.2 GDI Index for Georgia and its components

	GDI	HDI	Life expectancy at birth		Adult literacy rate		Combined enrollment rate		Percentage share of economically active population		Ratio of female non-agricultural wage to male non-agricultural wage	Estimated Earned Income (PPP USD)	
			Female	Male	Female	Male	Female	Male	Female	Male		Female	Male
2000	0.740	0.749	75.0	67.6	99.53	99.77	89.3	89.1	48.2	51.8	0.53	1333	3015
2001	0.744	0.748	75.0	68.0	99.53	99.77	85.0	86.3	48.3	51.7	0.58	1531	3161
2002	0.742	0.749	75.0	68.0	99.53	99.77	81.5	81.9	47.3	52.7	0.56	1567	3514
2003	0.754	0.764	74.3	68.0	99.53	99.77	88.8	88.2	47.2	52.8	0.52	1695	4117
2004	0.755	0.760	74.3	66.8	99.53	99.77	86.0	87.1	47.6	52.4	0.55	1962	4380
2005	0.765	0.771	74.6	67.3	99.53	99.77	87.3	88.6	46.9	53.1	0.54	2133	5002
2006	0.773	0.778	75.5	67.0	99.53	99.77	86.7	87.8	46.3	53.7	0.59	2518	5546

Source: Own calculations, statistical expert Nodar Kapanadze, demographic experts Giorgi Tsuladze and Nikoloz Maghlaperidze, State Department of Statistics

## Human Poverty Index

Like the Human Development Index, when assessing poverty it is important to consider health, knowledge and standard of living. However, for the two different UNDP human poverty indices, the emphasis is not simply on the level of development. The HPI looks at how likely it is that members of a given society will suffer from severe limitations on their possibilities.

### HPI-1 or the measure of human poverty in the context of developing countries

HPI was designed to measure deprivations<sup>1</sup> in the three basic dimensions captured in the human development index. It looks at health by assessing how many people will not survive to 40 years old, assesses knowledge by looking at literacy rates and assesses physical standard of living by looking at how much of the population does not have access to water and how much of the population is under-weight.

<sup>1</sup> As HPI measures *deprivation*, it has a negative twist. The lower HPI-1, the less 'poor' people are in country and the better is the situation. HDI, GDI, and GEM have positive twists; the higher the index, the higher the level of human development and the better the situation.

**Figure A2.3** HPI-1 index for Georgia and related imensions in 2000-2006

	HPI-1	Probability at Birth of Not Surviving to age 40 (times 100)	Adult illiteracy rate	Households with severe or extreme deprivation in access to an improved water source	Children under weight for age
2000	15.3	7.70	0.36	40.4	3.1
2001	14.5	8.00	0.36	38.0	2.9
2002	13.6	8.16	0.36	35.7	2.7
2003	15.2	8.21	0.36	40.6	2.5
2004	14.4	8.79	0.36	38.3	2.3
2005	14.0	8.91	0.36	37.1	2.1
2006	13.5	8.98	0.36	35.6	1.9

Source: Own calculations, statistical expert Nodar Kapanadze, demographic experts Giorgi Tsuladze and Nikoloz Maghlaperidze, State Department of Statistics

The HPI-1 index was constructed for developing countries, and probably is not the best reflection of the particularities of a post-Soviet country, like Georgia, with inherited health protection system and close to 100 percent literacy. Components of HPI-1 index suggest that the Georgian population faces very limited deprivation in the knowledge and malnutrition domains.

Deprivation in access to basic infrastructure (like potable water), however, tells a more interesting story. On the one hand, a majority of the Georgian population has access to 'improved

**Figure A2.4** Water availability by household

Water source, percent of Georgian families	2000	2001	2002	2003	2004	2005	2006	2007
Potable water through tap in dwelling, total	48.5	50.4	50.8	44.6	46.0	48.3	49.5	46.5
available 24 hours	25.2	24.1	23.7	22.1	23.4	26.1	27.1	27.0
available 8-24 hours	7.6	9.6	13.1	11.9	12.8	10.7	10.5	9.3
Potable water through water tap in yard or neighbourhood, total	23.4	22.2	22.4	23.0	23.8	22.5	21.9	23.6
available 24 hours	9.4	9.9	11.5	11.7	13.2	11.9	12.0	12.3
available 8-24 hours	1.7	1.7	2.1	3.1	2.5	2.7	2.9	2.7
Well in yard or neighbourhood	21.6	18.3	17.9	21.0	20.3	20.3	19.5	20.8
Spring in yard or neighbourhood	5.3	7.5	7.8	10.1	8.9	7.2	7.5	7.9
River, lake, channel	0.4	0.5	0.4	0.5	0.6	0.1	0.1	0.2
Other	0.8	1.0	0.7	0.8	0.6	1.6	1.5	1.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Statistical expert Nodar Kapanadze, State Department of Statistics

water sources', however quality and reliability of these sources vary significantly (see table below). For the sake of simplicity, it is broken down into five categories. Improved or piped water 24 hours a day in the house was not considered deprivation. 24hrs outside the house or 8-24hrs supply inside was considered 'insignificant deprivation'. Light deprivation was 0-8hrs inside the house or 8-24hrs outside the house. Severe deprivation is less than 8hrs outside the house or dependence on a well or a spring and extreme deprivation is anything else.

With this classification, the following breakdown is produced:

**Figure A2.5** Water deprivation by household

	2000	2001	2002	2003	2004	2005	2006	2007
Deprivation is absent or not applicable	25.2	24.1	23.7	22.1	23.4	26.1	27.1	27.0
Insignificant deprivation	17.0	19.5	24.6	23.6	26.0	22.6	22.5	21.6
Light deprivation	15.2	15.9	12.9	11.3	11.5	12.4	12.0	10.4
Severe deprivation	36.4	34.3	32.9	37.3	35.6	33.8	32.7	35.8
Extreme deprivation	1.2	1.5	1.1	1.3	1.1	1.7	1.6	1.3
Total	95.0	95.4	95.2	95.7	97.7	96.6	95.9	96.1

Source: Own calculations

### HPI-2 or the measure of human poverty for selected OECD countries

Like the previous poverty indicator, HPI-2 focuses on the position of those in a society who would usually be considered poor or disadvantaged. However, since this is aimed at more developed countries, the focus is not placed upon extreme physical deprivation, and, in particular, not on physical survival. In addition, social inclusion is added as a fourth dimension of human poverty.

Therefore, for health the HPI-2 looks at the probability of surviving to 60; for knowledge it assesses the level of 'functional literacy' rather than illiteracy; for standard of living it looks at the percentage of the population living below the relative poverty line and adds to that a measure for social exclusion, provided by the long-term unemployment rate.

**Figure A2.6** HPI-2 Index for Georgia and Values of Its Dimensions in 2000-2006

	HPI-2	Probability not surviving 60 (times 100)	Lack of Functional Literacy	Income Poverty (below 50% of median income)	Long Term Unemployment Rate (as % of labour force)
2000	20.7	28.00	9.5	23.3	6.0
2001	19.2	26.78	9.3	20.2	6.2
2002	19.5	26.95	8.6	20.8	7.0
2003	19.7	27.24	10.1	20.7	5.8
2004	20.4	28.88	9.0	20.6	6.1
2005	19.2	27.50	9.4	18.4	6.8
2006	19.3	27.40	9.5	19.0	6.5

Source: Own calculations, statistical expert Nodar Kapanidze, demographic experts Giorgi Tsuladze and Nikoloz Maghlaperidze, State Department of Statistics

## Gender Empowerment Measure

The Gender Empowerment Measure looks at how well represented women are to men in positions of authority. It considers three factors: political participation and decision-making by looking at the proportion of parliamentary seats taken by women; economic participation and decision making by analyzing the role of women as legislators, managers or professionals; and power over resources by analyzing relative income.

**Figure A2.7**

GEM for Georgia and Values of Its Certain Dimensions in 2000-2006

	GEM	Equally Distributed Share of Parliamentary Seats	Equally Distributed Share of Economic Participation	Equally Distributed Earned Income Index	Seats in Parliament held by women (% of total)	Female legislators, senior officials and managers (% of total)	Female professional and technical workers (% of total)	Ratio of estimated female to male earned income
2000	0.368	0.254	0.805	0.042	7.3	24.5	67.7	0.44
2001	0.401	0.255	0.901	0.048	7.2	33.9	65.4	0.48
2002	0.380	0.238	0.853	0.050	6.8	27.0	63.6	0.45
2003	0.397	0.241	0.875	0.056	7.4	28.9	63.0	0.41
2004	0.408	0.327	0.838	0.063	9.4	25.3	63.6	0.45
2005	0.423	0.341	0.855	0.070	9.9	26.4	62.3	0.43
2006	0.445	0.341	0.909	0.082	9.9	32.5	61.8	0.45

Source: Own calculations, statistical expert Nodar Kapanidze, demographic experts Giorgi Tsuladze and Nikoloz Maghlapiridze, State Department of Statistics

## Human development in Georgia in the regional context

Cross-country comparisons of human development are extremely interesting; however, they are also hard to do. The principal issues are availability and comparability of data. *The Global Human Development Report* provides international comparisons, based on the data collected and adjusted by international organizations, to make data comparable across countries. The back side of this is lack of reverse comparability with national statistical data.

The most recent *Global Human Development Reports* for 2007 and 2008 placed Georgia in the 'medium human development' group of countries, with HDI of 0.754 and rank of 96. Other countries of the CIS have similar values of HDI, while new EU member states have much higher HDI values. No GDI value was published, but GEM for Georgia has value of 0.414, showing serious gender inequalities in society, much higher than for new EU member states, where GEM values are 0.60-0.65.

**Figure A2.8** Global Human Development Indices in Europe and CIS region, 1990-2005

	HDI 2005	HDI Rank 2005	GDI 2005	GEM 2005
<b>CIS Countries</b>				
Armenia	0.775	83	0.772	..
Azerbaijan	0.746	98	0.743	..
Belarus	0.804	64	0.803	..
Georgia	0.754	96	..	0.414
Kazakhstan	0.794	73	0.792	0.469
Kyrgyzstan	0.696	116	0.692	0.302
Moldova	0.708	111	0.704	0.547
Russian Federation	0.802	67	0.801	0.489
Tajikistan	0.673	122	0.669	..
Turkmenistan	0.713	109	..	..
Ukraine	0.788	76	0.785	0.462
Uzbekistan	0.702	113	0.699	..
<b>New EU member states</b>				
Bulgaria	0.824	53	0.823	0.606
Croatia	0.850	47	0.848	0.612
Cyprus	0.903	28	0.899	0.580
Czech Republic	0.891	32	0.887	0.627
Estonia	0.860	44	0.858	0.637
Hungary	0.874	36	0.872	0.569
Latvia	0.855	45	0.853	0.619
Lithuania	0.862	43	0.861	0.669
Poland	0.870	37	0.867	0.614
Romania	0.813	60	0.812	0.497
Slovakia	0.863	42	0.86	0.630
Slovenia	0.917	27	0.914	0.611
<b>South-East Europe and Turkey</b>				
Albania	0.801	68	0.797	..
Bosnia and Herzegovina	0.803	66	..	..
Macedonia (TFYR)	0.801	69	0.795	0.625
Turkey	0.775	84	0.763	0.298

Source: Global Human Development Reports 2007 and 2008

While human development indices in new EU member states and southeast Europe and Turkey grew more or less steadily during the last 15 years, in CIS countries they deteriorated considerably in the beginning of 1990s and then recovered slowly during the following decade. HDI for Georgia followed a similar path and now Georgia is positioned at 96<sup>th</sup> place out of 177 countries. Georgia's globally reported HDI of 0.754 for 2005 is close to the CIS average, slightly higher than of neighbouring Azerbaijan and slightly lower than that of neighbouring Armenia.

Figure A2.9

## Human development trends in Europe and CIS region, 1990-2005

	1990	1995	2000	2005	HDI Rank 2005
<b>CIS Countries</b>					
Armenia	0.737	0.701	0.738	0.775	83
Azerbaijan				0.746	98
Belarus	0.790	0.755	0.778	0.804	64
Georgia			0.748	0.754	96
Kazakhstan	0.771	0.724	0.738	0.794	73
Kyrgyzstan				0.696	116
Moldova	0.740	0.684	0.683	0.708	111
Russian Federation	0.815	0.771	0.782	0.802	67
Tajikistan	0.703	0.638	0.640	0.673	122
Turkmenistan				0.713	109
Ukraine	0.809	0.756	0.761	0.788	76
Uzbekistan	0.704	0.683	0.691	0.702	113
Unweighted Average CIS Countries	0.759	0.714	0.729	0.746	
<b>New EU member states</b>					
Bulgaria	0.794	0.785	0.800	0.824	53
Cyprus	0.851	0.870	0.893	0.903	28
Czech Republic	0.845	0.854	0.866	0.891	32
Estonia	0.813	0.792	0.829	0.860	44
Hungary	0.813	0.817	0.845	0.874	36
Latvia	0.804	0.771	0.817	0.855	45
Lithuania	0.827	0.791	0.831	0.862	43
Poland	0.806	0.822	0.852	0.870	37
Romania	0.777	0.772	0.780	0.813	60
Slovakia				0.863	42
Slovenia	0.851	0.857	0.891	0.917	27
Unweighted Average New EU member states	0.818	0.813	0.840	0.867	
<b>Southeast Europe and Turkey</b>					
Albania	0.704	0.705	0.746	0.801	68
Bosnia and Herzegovina				0.803	66
Croatia	0.812	0.805	0.828	0.850	47
Macedonia (TFYR)				0.801	69
Turkey	0.683	0.717	0.753	0.775	84
Montenegro				0.763	
Serbia				0.760	
Unweighted Average South-east Europe and Turkey	0.733	0.742	0.776	0.793	

Source: Global Human Development Reports 2007 and 2008



## Sources of data and methodology of calculation

### Life expectancy at birth and probability at birth of not surviving to age 40 and 60

These data originate from the Georgian national State Department of Statistics and rely on statistics for registered births and deaths in Georgia. Unfortunately, the system has some issues in adequate registration of births and deaths, which lead to two main concerns:

1. Under-reporting of death figures, particularly in rural areas.
2. Reporting of population (both male and female) at higher than actual rate.

The level of under-reporting is so severe that, after the 2002 census, the death figures for the previous years had to be recalculated. The death rate for 2000 was increased from 413,20 to 474,10 and for 2001 was increased from 39,339 to 46,218. After the census, a lack of sufficient correction of death registrations resulted in a perceived increase in life expectancy. Currently, under-reporting cases of death is estimated at 20-25 percent according to two independent opinions.<sup>1</sup>

For calculating HDI and HPI indices, a corrected life expectancy figure was used by national demographic experts Giorgi Tsuladze and Nikoloz Maghlaperidze on the basis of mortality figures provided by the Department of Statistics, and a model mortality table for a corresponding region. For groups where reported mortality was significantly below expected, mortality was corrected up to the model table value.

‘Probability at Birth of Not Surviving to age 40 and 60’ are also based on sex-age specific mortality rates by the Department of Statistics and adjusted by the same experts. For HPI calculation, corrected mortality tables were used, as explained above.

### Adult literacy rate

The 2002 census discovered a literacy rate in Georgia of practically 100 percent in both sexes. No data are available for years between censuses; however there are no reasons to believe it has fallen since that time. In addition, the Multiple Indicator Cluster Survey (MICS) conducted by UNICEF in 1999 and 2005 has a large enough sample size to allow the calculation of national literacy rate. According to MICS, adult literacy rates were 99.1 percent and 99.3 percent in 1999 and 2005 respectively.

### Combined gross enrolment ratio

The gross enrolment ratio expresses the number of students enrolled in primary, secondary and tertiary levels of education, regardless of age, as a percentage of the population of official school age for the three levels. This would ideally be generated by comparing demographics on the number of school-age students with Ministry of Education figures on school enrolment. However, unreliable demographic information, especially for small age groups, makes this figure impossible to calculate using cross-Ministerial figures. Thus, household survey data was used by the National Statistical Expert for calculating the combined enrolment ratio. In particular, the ratio was calculated on the basis of information obtained through access to education module and household roster for population from age six to 17.

### Assessment of earned income

Again, the Household Survey produced by the State Department of Statistics is used for calculating non-agricultural earned income in GEL. These figures are then adjusted for purchasing power, using the USD PPP calculation of the World Bank.

### Gross domestic product (GDP)

The only source of information on GDP is the State Department of Statistics. SDS cal-

<sup>1</sup> Meeting with George Tsuladze, independent demographic expert, 16 April 2008; and meeting with Teimuraz Gogishvili, Georgian National State Department of Statistics, 16 April 2008.

culates this most significant macroeconomic indicator quarterly. The Department of Statistics provides GDP in GEL and this is adjusted to take account of the purchasing power of the GEL using the World Bank Purchasing Power Parity (PPP).

### **Proportional share of population without access to improved water source**

The sources of information for this figure are the State Department of Statistics' household survey and the UNICEF multiple indicator cluster survey. The Household Survey was used because the results provide the necessary time-series. Comparison of Household Survey and MICS data shows that they generally coincide. More details on classification of access to water deprivation are provided in section on calculation of HPI-1.

### **Lack of functional education and skills among adults**

While there is no current specific research on this subject, the Household Survey could be used as a proxy. The underlying assumption was that adult people with basic or lower education have insufficient functional education.

### **Proportional share of under weight-for-age children**

The only source of this information in Georgia is the UNICEF Multiple Indicator Cluster Survey conducted in 1999 and 2005. This suggests that 3.3 percent of the child population was underweight in 1999 and 2.1 percent in 2005. For the years between surveys, a linear change was assumed.

### **Proportional share of population with less than 50 percent median earned income.**

One standard measure for poverty is to look at what percentage of the population who earn less than half the median income. 'Median income' and 'proportional share of the population with less than 50 percent median earned income' were calculated by Nodar Kapanidze, a National Statistical Expert using the Department of Statistics Household Survey data.

### **Long-term (more than 12 months) unemployment level**

The Department of Statistics calculated the unemployment rate using the Household Survey and the ILO definition of unemployment. Unemployment over 12 months was classified as 'long-term'.

### **Distribution of economically active population according to gender**

Household Survey data of the State Department of Statistics was used for calculating this indicator. This data contains information on economic status and economic activity.

### **Distribution of people at senior and decision-making positions according to gender**

Household Survey data of the State Department of Statistics was used for calculating this indicator. This data contains information on economic status and factual employment. Professions are classified according to International Standard Classification of Occupations (ISCO). This classification captures nine levels of qualification:

- representatives of all levels of government and governance bodies including management staff of institutions, organizations and enterprises;
- specialists with highest level of qualification
- specialists with medium level of qualification
- clerical staff
- employees of service and trade spheres
- qualified workers in the fields of agriculture, forestry, hunting and fishing

- qualified workers in the fields of industry, arts, construction, transport, communication, geology and extracting
- operators of machines and equipments
- non-qualified workers.

Gender-wise distribution of only first level professional employees was used for calculating this indicator.

### **Parliamentary representation according to gender**

Data were provided by the State Department of Statistics.