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***Annex to :***

**”European Neighbourhood Policy”**

**Country Report**

**Georgia**

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## 1. INTRODUCTION

On 1 May 2004, the enlargement of the European Union took place with the accession of ten new Member States. It has brought changes to the EU's political geography offering new opportunities to deepen existing relations between the Union and its neighbours to the East and to the South. The Union is determined to further develop partnerships with its neighbours to mutual benefit, promoting security as well as stability and prosperity. The EU's external borders will not become new dividing lines but the focus of enhanced co-operation.

The European Neighbourhood Policy (ENP) sets ambitious objectives for partnership with neighbouring countries based on commitments to shared values, key foreign policy objectives and political, economic and institutional reforms. Partner countries are invited to enter into closer political, economic and cultural relations with the EU, to enhance cross border co-operation and to share responsibility in conflict prevention and resolution. The Union offers the prospect of a stake in its Internal Market and of further economic integration. The speed and intensity of this process will depend on the will and capability of each partner country to engage in this broad agenda. The policy builds upon the existing framework of co-operation.

Following a recommendation made by the Commission, the Council on 14 June 2004 decided to offer Georgia, Armenia and Azerbaijan the opportunity to participate in the European Neighbourhood Policy, *inter alia* stating:

*"This marks a significant step forward in the Union's engagement with the region. Each country will be given the same opportunity to develop its links with the EU, including through action plans, and will be treated in its individual merits in line with the general policy of the ENP. The Council also invited the Commission, and the SG/HR for issues related to political cooperation and the CFSP, to report on progress made by each country with regard to political and economic reforms".*

In the present report, the Commission provides an assessment of bilateral relations between the EU and Georgia. It reflects progress under the Partnership and Co-operation Agreement, and describes the current situation in areas of particular interest for this partnership: the development of political institutions based on the values – democracy, the rule of law, human rights – enshrined in the Agreement, regional stability and co-operation in justice and home affairs, and economic and social reforms that will create new opportunities for development and modernisation, for further liberalisation of trade and for gradual participation in the Internal Market. The report provides guidance for the Commission recommendations on developing joint ENP action plans and serves as a basis for assessing future progress in the Union's relations with Georgia.

### 1.1. Relations between the European Union and Georgia

The **EU-Georgia Partnership and Cooperation Agreement (PCA)** was concluded in 1996, entered into force in 1999 and forms the legal basis of EU-Georgia relations. Respect for democracy, principles of international law, human rights and market economy principles are the essential elements on which the EU-Georgia partnership is based. The PCA provides for wide-ranging cooperation in the areas of political dialogue, trade, investment, economic, legislative and cultural cooperation. This dialogue builds upon the shared commitment to promote international peace and security as well as the peaceful settlement of disputes. Through the PCA, which also eliminates trade quotas and the protection of intellectual,

industrial and commercial property rights, the parties have accorded each other Most Favoured Nation (MFN) treatment and Georgia benefits from the EU's General System of Preferences (GSP).

The various joint **institutions** set up under the PCA (Cooperation Council, Cooperation Committee, Sub-Committee on Trade, Economic and Related Legal Affairs, as well as the Parliamentary Cooperation Committee) have functioned smoothly and have ensured a regular political dialogue. Cooperation Councils have been held annually since 1999, the latest in Brussels in September 2004.

At the General Affairs Council of February 2001, the EU confirmed its willingness to play a **more active political role in the South Caucasus** region and its intention to look for further ways in which to support efforts aiming at prevention and resolution of conflicts in the region and to participate in post-conflict rehabilitation. The Foreign Ministers of Georgia, as well as Armenia and Azerbaijan, welcomed the EU's commitment to play a more active role in the region in the Joint Communiqué issued on 30 October 2001 on the occasion of the Cooperation Councils with the three countries.

In 2001-2, EU-Georgia relations were adversely affected by a number of security incidents. In December 2001, a member of staff of the EC Delegation in Georgia, Guenther Beuchel, was murdered. Then in June 2002, a TACIS contractor, Peter Shaw, was kidnapped and held for five months. The perpetrators of these serious crimes have never been identified and brought to justice by the Georgian authorities. The deterioration in the security situation led the European Commission to review its policy towards Georgia. This resulted in the adoption of a revised Country Strategy Paper in September 2003 (see 1.2).

In July 2003, the EU Council appointed Ambassador Heikki Talvitie as the first **EU Special Representative for the South Caucasus**. His mandate is, inter alia, to assist the Council in developing a comprehensive policy towards the South Caucasus, to contribute to conflict prevention and assist the conflict settlement mechanisms in the region. Since the "Rose Revolution", Ambassador Talvitie has paid particular attention to Georgia and has met regularly with the new Georgian leadership, the CoE, OSCE, Russia, Turkey and the US. He has also assisted in the efforts to find a peaceful solution to the situation in Ajara and has held regular talks with the separatist leaders in Abkhazia and South Ossetia. The Commission and EU SR Talvitie have closely coordinated their activities.

The changes brought about by Georgia's "**Rose Revolution**" in November 2003, including the subsequent holding of relatively free and fair presidential and parliamentary elections, were strongly welcomed by the EU. The strong commitment of the Georgian authorities to implement their reform plans, notably in the field of good governance, has also been warmly welcomed by the EU. The EU has increased levels of contacts. Interim President Ms Nino Burjanadze met President Prodi and SG/HR Solana in Brussels in December 2003, SG/HR Solana and the Foreign Minister of the EU Presidency, Brian Cowen, visited Tbilisi in January 2004, President Saakashvili and Prime Minister Zhvania visited Brussels in April and June respectively and Commissioner Potocnik and President Prodi visited Georgia respectively in July and September.

The Council's decision on 14 June 2004 offering the inclusion of Georgia (together with Armenia and Azerbaijan) in the **European Neighbourhood Policy** marks a significant step forward in relations between the EU and Georgia. Georgia has welcomed its inclusion and has expressed its readiness to exploit the opportunities thereby opened up.

In July 2004, the EU launched operation EUJUST Themis in Georgia, a **rule of law mission** established using the civilian crisis management arrangements within the European Security and Defence Policy. The mission is designed to assist Georgia to develop a horizontal strategy to guide the reform process in the criminal justice sector.

In July 2004, the Georgian government adopted a decree establishing a “**Commission for Georgia’s integration into the EU**” chaired by the Prime Minister. The commission’s aims are *inter alia* to facilitate PCA implementation and participation in ENP. EU departments are to be established in sectoral ministries. Approximation of Georgian legislation with that of the EU remains an important aspect of the EU-Georgia PCA and much remains to be done in this field. In 2003, the former governmental commission on PCA implementation adopted a national programme on the harmonisation of legislation. The new government has instructed sectoral ministries to develop action plans for harmonisation and inter-ministerial expert groups have been formed to take the process forward.

## 1.2. Community assistance

EC assistance to Georgia from 1992-2004 has amounted to almost €420 million. **Humanitarian assistance** (notably ECHO and Food Aid Operations through the European Agricultural Guarantee and Guidance Fund, EAGGF) has accounted for €160 million and has in particular contributed to alleviating the very serious humanitarian situation in the mid 1990’s. TACIS national allocations represent more than €110 million and the Food Security Programme has disbursed over €70 million.

Since Georgia’s independence, the **TACIS** programme has contributed to the transition towards a market economy, notably by providing assistance in the fields of legal and regulatory reform, support for Georgia’s WTO accession and the approximation of Georgian legislation to that of the EU. High levels of corruption and weakness in respect for the rule of law have, in the past, limited the impact of EU support for Georgia.

The **Food Security Programme** has been an important instrument supporting reform in the area of agriculture, social security and public finance management. Implementation has been hampered by past governments’ reluctance to execute budget-lines targeted by FSP support.

The **Macro-Financial Assistance** programme has provided balance of payments and budgetary support (€ 110 million in loans, and € 55 million in grants, of which € 31.5 million have actually been disbursed) and has assisted in Georgia’s debt reduction strategy. Georgia’s difficulties in complying with its agreements with the IMF have also in the past adversely affected the ability of the EC to implement its FSP and Macro-Financial Assistance Programme.

The **European Initiative for Democracy and Human Rights** has provided support for Georgian civil society and has funded joint EC-Council of Europe programmes in Georgia, including in the area of judicial reform. The EU has also provided support for Georgian security and for settlement of its internal conflicts through the rehabilitation instrument (Abkhazia and Tskhinvali region/South Ossetia) and **CFSP Joint Actions** (support to Georgian border guards and support to the Joint Control Commission of the Georgian-Ossetian conflict settlement process).

The **revised Country Strategy Paper for Georgia 2003-2006** identifies three areas on which a coordinated use of all EU/EC policy and assistance instruments would be focussed: 1)

promoting rule of law, good governance and respect for human rights and democratic institutions, including the strengthening of civil society actors; 2) reducing poverty; 3) enhancing stability and security through confidence building measures aiming at the prevention and settlement of internal conflicts and actions in favour of the affected populations.

Following the “Rose Revolution” in November 2003, the EU has offered its support to the new Georgian authorities in developing and implementing their ambitious reform plans. Immediate support for the Presidential and parliamentary elections in January and March 2004 was provided through the Rapid Reaction Mechanism. FSP disbursements assisted Georgia during the difficult winter months following the Rose Revolution.

In June 2004, the Commission co-chaired, with the World Bank, a **donors’ conference** on Georgia at which a total of €850 million was pledged for the period 2004-2006. The EC, for its part, pledged a total of €125 million taking total EC assistance to Georgia for the period 2004-2006 to €137 million, a doubling of assistance compared with 2001-2003. Particular emphasis has been placed by the EC on assisting Georgia, through the Rapid Reaction Mechanism and Tacis, in reform of the judicial and rule of law sectors as well as in capacity building in key institutions including the Georgian parliament.

**Total EC grants to Georgia 1992-2004** (in addition to the figures below, Georgia benefits from grants under the Tacis Regional Programme – Traceca, Inogate, Natural Resources)

|   | 1992 | 1993  | 1994  | 1995  | 1996  | 1997  | 1998  | 1999  | 2000  | 2001  | 2002    | 2003   | 2004    | Total M€ |
|---|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|---------|--------|---------|----------|
| Humanitarian Aid:                               |      | 11.78 | 17.81 | 27.45 | 10.20 | 5.80  | 6.41  | 6.93  | 2.62  | 1.05  | 2.00    | 2.20   | 4.00    | 98.25    |
| EAGGF   |      |       |       | 41.00 | 21.55 |       |       |       |       |       |         |        |         | 62.55    |
| Exceptional Humanitarian Aid                    |      | 6.00  |       |       |       |       |       |       |       |       |         |        |         | 6.00     |
| Aid against effects of Russian financial crisis |      |       |       |       |       |       |       | 4.00  |       |       |         |        |         | 4.00     |
| Food Security Programme                         |      |       |       |       | 18.25 | 16.00 |       | 12.00 |       |       |         | 13.00* | 12.00*  | 71.25    |
| TACIS National Allocations                      | 9.00 | 4.00  | 4.00  | 6.00  | 8.00  | 8.00  | 8.00  | 8.00  | 11.00 | 4.00  | 14.00** |        | 27.00** | 111.00   |
| Rehabilitation in Conflict Zones                |      |       |       |       |       | 3.50  | 6.50  | 7.50  |       |       |         |        | 2.00    | 19.50    |
| Macro-financial assistance (disbursed)          |      |       |       |       |       |       | 10.00 | 9.00  |       | 6.00  |         |        | 6.50    | 31.50    |
| CFSP***   |      |       |       |       |       |       |       |       | 1.09  | 0.25  | 0.10    | 0.16   |         | 1.60     |
| EIDHR   |      |       |       |       |       |       |       |       |       | 0.23  | 2.50    | 2.82   | 2.00    | 7.55     |
| RRM   |      |       |       |       |       |       |       |       |       |       |         | 2.00   | 4.65    | 6.65     |
| Total M€  | 9.00 | 21.78 | 21.81 | 74.45 | 58.00 | 33.30 | 30.91 | 47.43 | 14.71 | 11.53 | 18.60   | 20.18  | 58.15   | 419.85   |

\* Disbursed

\*\* 2-year allocations

\*\*\* The CFSP budget of the EC is also used to finance the activities of the EU Special Representative for the South Caucasus and the rule of law mission in Georgia - EUJUST Themis

## 2. POLITICAL ISSUES

### 2.1. Democracy and the rule of law

Georgia's **Constitution** was adopted in 1995 and most recently amended in February 2004. It provides for the separation of powers. The **President** of Georgia is directly elected for five year terms and may serve for two consecutive terms. He/she is the Head of State and leads

and exercises internal and foreign policy. He/she may dismiss parliament, appoints the Prime Minister and gives consent to the appointment of other Ministers and may dismiss the Ministers of Internal Affairs, Defence and State Security on his/her own initiative. He presides over the Council of Justice and appoints and dismisses judges. The **Parliament** of Georgia is elected every four years and comprises 150 members elected by proportional representation and 85 by a majority system. It conducts a vote of confidence on the presentation of the composition and programme of the government. It may impeach the President. Under the Constitution, once Georgian jurisdiction has been re-established over all Georgian territory, two chambers of parliament will be created.

The flawed parliamentary elections of 2 November 2003 caused major, peaceful popular protests and led to the resignation of President Shevardnadze on 23 November. **Presidential elections** were held on 4 January 2004. The joint candidate of the political forces which had led the November protests, Mikheil Saakashvili was elected President of Georgia with 96.2% of the vote. According to the OSCE/ODIHR the elections “demonstrated notable progress over previous elections and in several respects brought the country closer to meeting OSCE commitments and other international standards”.

Amendments to the Georgian constitution, creating the post of Prime Minister, dealing with certain aspects of relations between the President, government and parliament and executive-judiciary relations, were adopted by the outgoing parliament in February 2004. The amendments were considered and approved ignoring a constitutional provision requiring a one-month public debate. While welcoming the aim of the proposed changes, the Venice Commission of the Council of Europe stated that “considerable further discussion and the refinement of the amendments before their adoption would be advisable”. Representatives of Georgian civil society have criticised the amendments as increasing the power of the executive over parliament, giving the president significant discretion in dissolving parliament and influence over the judiciary.

Repeat elections for the 150 seats in the Georgian parliament elected by proportional representation were held in March. Although irregularities were identified, most notably in the Autonomous Republic of Adjara, the OSCE/ODIHR Election Observation Mission described them as the most democratic since independence. Only two electoral blocs passed the threshold of 7%. The electoral bloc of the National Movement – Democrats (bringing together the parties of President Saakashvili, Prime Minister Zhvania and Speaker of Parliament Burjanadze) gained a strong majority with 153 out of the 235 seats and can rely also on the support of a number of independents, thus establishing a strong majority in support of the reform programme. The Georgian government’s document presented to the June international donors’ conference in Brussels enumerated five national objectives; 1) strong democratic institutions; 2) good governance; 3) development of human resources; 4) protection of cultural heritage; 5) preservation of territorial integrity and national security. On this basis, the Georgian government has identified 4 goals for 2004-2006: 1) rooting out corruption and mismanagement; 2) restoration of lasting stability; 3) reduction of poverty; 4) establishment of sustainable economic growth. In this context, the government has endorsed the 2003 Economic Development and Poverty Reduction Programme.

An immediate concern of Tbilisi, particularly following the electoral irregularities during the parliamentary elections in March, was the **situation in Adjara**. Popular protests eventually led to the resignation of the Head of the Autonomous Republic of Adjara, Aslan Abashidze, in May 2004. New elections to the Adjaran parliament – the Supreme Council – were held on 20 June, after which the Georgian parliament passed a Constitutional Law on the Status of the



Autonomous Republic of Adjara. The law accords the President of Georgia considerable powers over the Adjaran structures established by the Constitutional Law.

**Local authorities** have fairly limited powers and responsibilities in Georgia. Under the 2001 law on local self governance and governance, Georgia comprises 12 regions (including the autonomous republics of Adjara and Abkhazia), 76 districts (*rayons*) and approximately 1100 municipalities. Regional administrations are led by governors appointed by the President. The districts perform state functions at the local level and come under central government. Cities and municipalities elect local Councils (*Sakrebulo*) and those Councils then elect executive organs (*Gamgeoba*) answerable to them. In cities and rural municipalities with populations of more than 5,000, the heads of the executive bodies (*Gamgebeli*) are directly elected. The cities of Tbilisi and Poti are exceptions since the President directly appoints the Mayors/*Gamgebeli* (from the elected members of the district Council, in the case of Poti). A State Committee on decentralisation was set up in April 2004 by the Prime Minister in order to prepare a strategy and programme for reform. Georgia ratified the European Charter of Local Self Government in October 2004, thus complying with one of its commitments made on acceding to the Council of Europe.

Following the adoption of the Constitution in 1995, a new **legal system** was established with a Constitutional Court and a three-level system of common courts: district, regional and Supreme Court. The Supreme Court is the court of final instance. Soviet laws have been replaced by new Civil, Administrative and Criminal Codes. The new government has embarked on a plethora of reforms concerning the judiciary and law enforcement agencies. However, a general concept for reform and key legislation has not been developed. In October 2004 an inter-ministerial working group was set up to develop a strategy for criminal justice legislation, to be supported by EUJUST Themis. As part of reform of the legal profession coordinated by the Council of Justice, examinations have been held since November 2003 aiming at establishing a unified professional association of lawyers. Despite the legislative reforms in the period 1999-2003, serious problems remained with the independence and effectiveness of the judiciary. The Constitutional amendments of February 2004 led in June to modification of the Law on Common Courts: the High Council of Justice, now chaired by the President, is responsible for disciplinary proceedings, recruitment, selection, training and dismissal of judges (appointed for 10 years) as well as financial and material provision for the judiciary.

The **civil service** is undergoing significant reform and restructuring as part of the present government's policy of improving governance and fighting corruption. A Civil Service Council and Civil Service Bureau have been set up by Presidential decree to promote the creation of a modern public service. The number of Ministries has been reduced from 18 to 14 and numerous state departments and agencies have been abolished or brought under the responsibility of Ministries. The Law on Public Service has been amended and the Law on the Structure, Competencies and Rules of Activity of the Government has been adopted. There is no single uniform system for the recruitment, remuneration and training of public servants. The EC provides assistance for reform of the Ministries of Justice and Interior, the penitentiary system and the Prosecutor General's Office, as well as the establishment of a probation system.

The Public Defender of Georgia (**Ombudsman**) is entrusted with supervision of state institutions and providing recommendations with respect to the protection of human rights and fundamental freedoms. The provisions governing the Public Defender correspond to European standards. However, the Law on the Public Defender contradicts other legal acts

and the law is not applied in practice. Moreover, the frequent changes of Public Defender, including lengthy gaps between appointments, as well as the limited resources at the Defender's disposal, have meant that the post of Defender has yet to gain a high degree of public confidence.

Georgia has ratified the Council of Europe Civil Law Convention on **Corruption**. It has signed but not yet ratified the Council of Europe Criminal Law Convention on Corruption. Since 1999 Georgia has been a member of the Council of Europe's Group of States against Corruption (GRECO) which monitors compliance with undertakings contained in the above-mentioned legal instruments. Transparency International's 2004 Corruption Perceptions Index ranked the country in 133<sup>rd</sup> place which indicated that there was perceived to be a very high level of corruption. In January 2004, the OECD Anti-Corruption Network for Transition Economy recommended the strengthening of the institutional capacity of anti-corruption bodies, as well as the streamlining of relevant investigation and law enforcement agencies. As part of the new authorities' anti-corruption drive, a significant number of arrests on corruption charges have been made since the "Rose Revolution" and plea-bargaining has been used as an alternative to prison.

## 2.2. Human rights and fundamental freedoms

Georgia has ratified the core UN Human Rights Conventions and the fundamental Conventions of the International Labour Organisation. The 3 UN Optional Protocols on the Conventions against Torture and the Rights of the Child have not been signed by Georgia. Georgia acceded to the Council of Europe (CoE) in 1999 and has ratified most core Council of Europe Conventions, except for the European Social Charter.

Legislation to ensure respect for the principle of **freedom of expression** and **media independence** was adopted following independence. The Law on **freedom of speech** and expression was adopted in June 2004 and work is underway to transform the state television service into a public service broadcaster. However, concerns have been raised by civil society in recent months relating to the independence of the media in light of links between the owners of media outlets and former opposition/current leadership.

Georgia is the only former Soviet republic without a law on religion to define the rights and obligations of **religious communities**. The status of the largest religious community, the Georgian Orthodox Church, was regulated by a concordat signed in 2002 which provides various privileges, including the right to provide religious education in schools and broad powers to decide on the status of other religious communities. The Catholic Church was expected to gain legal status in 2003 but the signing of an agreement was abruptly cancelled by the then government. The Jehovah's Witnesses were able to restore their legal status as a non-commercial organisation at the end of 2003. Members of minority religious communities have suffered many attacks from extreme Orthodox groups. The new authorities have expressed determination to eliminate religious persecution, although criticism has been raised notably by the UN Rapporteur on Freedom of Religion concerning the excessive force used by the police during certain arrests.

**Freedom of association** is effectively protected by the Georgian Civil Code. Overall, Georgian legislation provides a relatively favourable climate for the development of civil society. According to **NGO** sources, there are approximately 4,600 NGOs.

Georgia has ratified all ILO fundamental conventions (forced labour, freedom of association, child labour and discrimination in employment) except Convention 154 on collective bargaining. The Georgian Constitution and law provide the right for citizens to form and join **trade unions**. However the practice of collective bargaining is not widespread. There are some restrictions on the right to strike.

**Torture** and ill treatment of detainees, as well as excessive use of force by law enforcement bodies, remains an issue of concern although the current authorities are committed to improving the situation. The Council of Europe's Committee for the Prevention of Torture (CPT) visited Georgia in 2001 and made wide-ranging recommendations concerning the rights of detainees and prisoners. Visits from the CPT have subsequently taken place in 2003 and 2004 and a further report is expected in 2005. NGOs have reported significant numbers of cases of torture since the "Rose Revolution".

Georgia has ratified Protocols 6 and 13 to the European Convention on Human Rights abolishing the **death penalty** in all circumstances. While a de facto moratorium is in place in Abkhazia, a number of death sentences have been passed since its self-declared independence from Georgia.

Georgia ratified the Rome Statute on the **International Criminal Court** on 5 September 2003, but signed an Article 98 agreement with the US in May 2003.

The Constitution provides for sexual equality but **discrimination against women** is still a problem. Women's access to the labour market has improved (47% in 2000) but women are still under-represented in key professions and remain primarily confined to low-paying, low-skilled positions. Sexual harassment in the workplace has been a growing problem and societal violence against women remains a social problem.

The years of conflict, economic crisis and tradition of isolating **children** with disabilities have resulted in large numbers of children without parental care or a protective child-friendly environment. Large numbers are located in institutions and an estimated 2,500 are homeless and vulnerable. The EC's Food Security Programme has provided support to children in institutions and to the reform of the Georgian child-care system. Worsening education and health care systems are also seriously affecting children's well-being in Georgia.

Georgia has yet to ratify the Council of Europe's Framework Convention on **National Minorities** or sign the European Charter for Regional or Minority Languages. There are sizeable Armenian and Azeri communities living in some of the poorest areas of Georgia. The government has committed itself to developing a civic integration strategy and the authorities are working with the OSCE High Commissioner for National Minorities to implement a Conflict Prevention and Integration Programme in Samtskhe-Javakheti, a region where the Armenian-speaking community finds itself isolated from the rest of Georgia. Georgia also needs to comply with the commitment made on acceding to the Council of Europe to ensure the repatriation and integration of the Meskhetian population which was deported to Central Asia from Georgia during Stalin's era.

### 2.3. Foreign Relations - General

Georgia is a member of the UN, the Council of Europe, OSCE, Commonwealth of Independent States, Black Sea Economic Cooperation Organisation (BSEC) and the GUUAM

(Georgia, Ukraine, Uzbekistan, Azerbaijan and Moldova) regional grouping as well as the IMF, the World Bank, WTO and EBRD. It is a party to the Nuclear Non-Proliferation Treaty.

The main strands to its foreign policy are integration in European and Euro-Atlantic structures; development of relations with Russia based on mutual respect; promotion of regional cooperation with its neighbours. **NATO membership** is also an objective. It is a member of the Euro-Atlantic Partnership Council and participates actively in NATO's Partnership for Peace programme.

**Relations with the Russian Federation** have been subject to tensions ever since the break-up of the Soviet Union, due particularly to the separatist conflicts in Abkhazia and South Ossetia. The alleged presence of Chechen terrorists on Georgian territory, the lack of an agreement on a timetable for the withdrawal of the remaining Russian military bases from Georgia in implementation of the 1999 OSCE Istanbul Summit commitments, and Georgia's energy dependence on Russia have contributed to tensions. Since the "Rose Revolution", the new Georgian leadership has attempted to put Georgia-Russia relations on a new footing: Georgia-Russia bilateral negotiations on Russia's WTO accession have been finalised, Georgia has proposed enhanced anti-terrorist and border cooperation and has introduced a simplified visa regime which has yet to be reciprocated. Work on a bilateral framework treaty has progressed during 2004 but the finalisation of the treaty has been set back by events in the Tskhinvali region/South Ossetia in August (see 2.4) and by continuing lack of agreement over the issue of foreign forces/bases on Georgian territory.

Given its geo-strategic position, particularly as a transit route between Europe and Asia, Georgia is a strong promoter of **regional cooperation**. The new Georgian authorities have sought to develop cooperation with its South Caucasus neighbours Armenia and Azerbaijan. The Baku-Tbilisi-Ceyhan oil pipeline and Baku-Tbilisi-Erzrum gas pipeline, due to become operational in 2005-6, will have important benefits for the region and beyond. Georgia has also used its recent chairmanships of BSEC and GUUAM to promote cooperation between these regions and the EU. Georgia-Ukraine relations are likely to intensify following the elections in the two countries in 2004.

Georgia is a participating State of the UN Programme of Action to Prevent, Combat and Eradicate the Illicit Trade in Small Arms and Light Weapons in All its Aspects (UNPoA). Anti-personnel mines remains an issue of concern in Georgia. Georgia has not acceded to the 1997 Ottawa Convention on the Prohibition of the Use, Stockpiling, Production and transfer of Anti-Personnel Mines and on their Destruction. Georgia is a party to the 1980 Convention on Conventional Weapons (CCW) and its original Protocol II, but has not ratified Amended Protocol II. Georgia has placed high importance on its contribution to **counter-terrorism**. It offered its airspace and air-fields for the campaigns in Afghanistan and Iraq. It dispatched a unit to Afghanistan to participate in the International Security Assistance Forces (ISAF) and also has a peacekeeping contingent in Iraq. The United States has given significant support to the country notably through the "Georgia Train and Equip Programme" which, from 2002 to 2004, has helped Georgia to combat the threat from Chechen and other foreign terrorist elements who had sought shelter in the Pankisi Gorge in northern Georgia. From 1999-2004, the OSCE ran a Border Monitoring Operation along part of the Russian-Georgian border, in the context of which the EU provided support to Georgian border guards.

## 2.4. Territorial and other conflicts/disputes

Due to the two unresolved territorial disputes in Abkhazia and the Tskhinvali region/South Ossetia, nearly 18% of Georgian territory remains beyond the control of the Georgian authorities. The two conflicts have created more than 260,000 internally displaced persons (IDPs).

Following several years of deteriorating interethnic relations between the then Autonomous Soviet Republic of **Abkhazia** and the authorities in Tbilisi, military confrontation erupted in Abkhazia in 1992. The separatist regime won a de facto victory in 1993 over the forces of the newly independent Georgia which resulted in the forced expulsion of the Georgian population from Abkhazia. A ceasefire was effectively established towards the end of 1993 and in 1994 a CIS peacekeeping force, drawn from the Russian Federation, was created, overseen by the UN Observer Mission in Georgia (UNOMIG). The conflict erupted again in 1998 when Abkhaz militia attacked Georgian returnees to the Gali district, creating a further wave of IDPs. Further hostilities took place in 2001 in the Kodori Gorge.

Conflict settlement efforts have taken place in several frameworks: the Russian mediated Coordinating Commission (Georgian and Abkhaz representatives) and the UN-led Geneva process structured around a Coordinating Council and three working groups on security, refugees/IDPs and socio-economic issues. The UN chairs these bodies, with Russia as facilitator, and participation of OSCE, UNOMIG, UNHCR, UNDP and the Group of Friends of the UN Secretary-General for Georgia as observers (France, Germany, Russia, UK and US). A document on the “Basic principles on the distribution of competencies between Tbilisi and Sukhumi” was agreed by the UN Security Council in January 2002 as the basis for negotiations on the political status of Abkhazia within Georgia. The Abkhaz have, however, refused to accept this as a basis for discussion.

Since 1993, Russia has increased its influence in Abkhazia, notwithstanding its official policy of recognition of the sovereignty and territorial integrity of Georgia. Russian passports and citizenship have been granted to the population of Abkhazia and there are increasing commercial connections between Abkhazians and Russians. In Sochi in 2003, Presidents Putin and Shevardnadze agreed to promote conflict settlement efforts along three parallel tracks: resumption of rail traffic between Georgia and Russia through Abkhazia; rehabilitation of hydro-electric installations along the Enguri river; return of IDPs to the Gali region. In September 2004, the rail link between Sukhumi and Sochi was restored. The Georgian authorities have protested that this link goes against the Sochi accords which foresaw parallel progress on all three tracks and, for Georgia, notably progress on the internationally-supervised return of IDPs to Gali.

It is expected that a meeting with the two parties, within the Geneva process, may be held in Spring 2005 after the formation of a new Abkhaz “government” following the repeat “presidential elections” in Abkhazia on 12 January

With regard to the Abkhaz conflict, the EC has undertaken a rehabilitation programme related to the Enguri dam and associated generating station, has provided humanitarian aid to the victims of the conflict and has undertaken confidence building projects with local NGOs. A rehabilitation programme is now being planned, in close coordination with the UN agencies on the ground, to encourage economic rehabilitation and the rebuilding of communities in the zone of conflict. The EU Special Representative for the South Caucasus has visited Abkhazia on several occasions, working in close coordination with the European Commission, and is in

close contact with the UN SG's Special Representative, Ambassador Heidi Tagliavini and all parties involved with the conflict settlement process.

The conflict in the former Autonomous Oblast of **South Ossetia** also erupted in the period following the break-up of the Soviet Union. The conflict with the separatists in Tskhinvali resulted in the displacement of ethnic Georgians from South Ossetia, while Ossetians from other parts of Georgia moved to South or North Ossetia (in the Russian Federation). A ceasefire was signed in 1992 and Joint Peacekeeping Forces from Russia, North Ossetia and Georgia (500 each) were deployed in the zone of conflict.

A conflict settlement process was established with the creation of the Joint Control Commission between the four parties: Georgia, South Ossetia, North Ossetia and the Russian Federation. The OSCE acts as a facilitator. An expert group, created by the four parties, has discussed the political status of South Ossetia. A draft of a document was discussed at its fourth meeting in 2000 – the so-called “Baden document” - remains the nearest the negotiations have come to defining the outline of a possible solution. In recent years the EC has been invited to the JCC and expert group meetings in light of EU financial assistance in the conflict zone.

As in Abkhazia, most of the population in South Ossetia has been granted Russian passports and citizenship. South Ossetia has in recent years become a haven for smuggling operations which have also provided the major source of income for the separatist leadership in Tskhinvali. As part of its anti-corruption campaign, the Georgian government began anti-smuggling operations in May 2004 around the Tskhinvali region, increasing the Georgian military and police presence. The situation deteriorated in August with the first killings in a number of years. A ceasefire was negotiated that month and a process of demilitarisation begun. Prime Minister Zhvania met with the South Ossetian leader Kokoity in November 2004. The process of demilitarisation is still to be completed.

The EU Special Representative has been in close contact with all parties to the conflict since he took up his functions, working in close coordination with the European Commission. The EC is providing significant economic rehabilitation assistance to the zone of conflict as well as support to IDPs although implementation of the most recent tranche of €2.5 million has proven difficult.

## **2.5. Justice and Home Affairs**

Since independence, Georgia's population has decreased by almost 1 million from 5.4m to 4.5m. A first wave of emigration in the early 1990s was due to the break-up of the Soviet Union and Georgia's internal conflicts. A second, in the late 1990s, reflected the lack of economic and social improvement in Georgia. Today, with its unresolved internal conflicts and its geographic position as a transit country, Georgia is faced both with a serious problem of illegal migration and human trafficking as well as a large IDP population.

In 1999, Georgia ratified the 1951 Geneva Convention on the status of **refugees** and its Protocol. Georgia's national law on refugees contains several provisions which are not in line with the Convention. There is no specific readmission legislation in place in Georgia although it has signed a readmission treaty with Switzerland. The Ministry of Refugees and Accommodation has registered 3,856 Chechen refugees as of April 2004.

The capacity of the government to manage **migration** has remained low due to limited financial resources, lack of experienced staff, an unwieldy bureaucracy and a high level of informal payments. Insufficient coordination and cooperation among concerned Ministries remained a problem.

As stated elsewhere in this report, an extensive reform process is underway in the area of the **police and the judiciary**. This remains a key priority of the Georgian government and is therefore substantially supported by the EU and the rest of the donor community. In March 2004, the government initiated a complete reform of the state law enforcement system in general and the police force in particular. The Ministry of Interior has been divided into two parts, responsible for civilian functions and the police force respectively, and has reduced its staff by 15,000 to a total of 50,000. Certain civilian functions have been devolved to the Ministry of Justice and other agencies.

As regards **judicial cooperation**, Georgia has ratified the 1957 European Convention on Extradition and the 1959 European Convention on Mutual Assistance in Criminal Matters and its 1978 Additional Protocol. It has not signed the Second Protocol on Mutual Assistance in Criminal Matters. Georgia is a party to the 1980 Hague Convention on Child Abduction since 1997 (accession/ ratification, 24/07/1997).

**Border management** remains among the top issues on the Georgian Government's agenda. The OSCE's Border Monitoring Operation along Georgia's border with the republics of Ingushetia, Chechnya and Dagestan of the Russian Federation has recently come to an end following the refusal of Russia to renew the operation's mandate. The EU has provided support to the Georgian Border Guards to assist in the prevention of the spill-over of the Chechen conflict. The EC is now assisting the Ministry of Interior in its reforms to incorporate the formerly separate Border Guards Service and to demilitarise the Ministry's structures.

Georgia is both a source and transit country for the **trafficking** of women and men for the purposes of sexual exploitation and forced labour. The two Protocols to the UN Convention against Transnational Organised Crime, dealing with Trafficking in Persons and Smuggling of Migrants, were signed in 2000 but have still to be ratified. In 2003 the Criminal Code was amended to criminalise trafficking in persons and an Action Plan for Combating the Trafficking of Persons was adopted by the government. Georgia does not, however, have mechanisms for protecting and assisting victims. In February 2004, the National Security Council established a high-level working group to propose new measures to step up the fight against human trafficking.

Given its geographic location, **drug trafficking** is an issue of great concern – it is currently a secondary transit route for heroin from Afghanistan. Georgia has been a party to the UN Drug Convention since 1998. Since 2001, the EU has been funding the Southern Caucasus Action Programme on Drugs (SCAD) aimed at building capacity and improving regional cooperation to stop the flow of narcotics. Counter-narcotic efforts are now coordinated through an inter-agency group chaired by the Ministry of the Interior.

Georgia has yet to ratify the UN Convention against Transnational **Organised Crime** which it signed in 2000 nor has it signed the Protocol against the Illicit Manufacturing and Trafficking in Firearms, their parts and components and ammunition. The internal conflicts, the high levels of corruption and the collapse of state authority over recent years has made Georgia fertile ground for organised crime, including illicit trade in arms. In addition to its anti-

corruption drive and efforts to re-establish state authority notably through reform of the law enforcement agencies, during 2004, the Georgian authorities have undertaken important steps to tackle the criminal gangs operating in Georgia, notably through operations carried out by law enforcement agencies in western Georgia.

Sources of **laundered money** in Georgia are primarily corruption, financial crime and, in particular, smuggling rather than narcotics related proceeds. Georgia is a member of the Council of Europe's group "MONEYEVAL" and was evaluated in 2000. In May 2004, Georgia ratified the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of Proceeds from Crime. In January, Georgia's national Anti-Money Laundering Law entered into force and created a Financial Intelligence Unit (the Financial Monitoring Service) within the National Bank of Georgia. Further work is needed to bring Georgian legislation in line with internationally recognised standards, notably those of the OECD's Financial Action Task Force (FATF). However, the new Georgian authorities are taking measures to tackle money laundering. A financial police under the responsibility of the Minister of Finance was given responsibility in February 2004 for detecting and pre-investigating economic crimes and a National Money Laundering Prosecution Unit has also recently been established within the Prosecutor General's Office.

### **3. ECONOMIC AND SOCIAL SITUATION**

#### **3.1. Macroeconomic and social outlook**

##### *3.1.1. Recent economic developments and outlook*

Georgia is in the group of lower middle income countries, with a GNI per capita of about \$830 (\$2,540 in terms of purchasing power parity). Georgia has a small open economy with a population of about 4.6 million and a nominal GDP level of about \$3.9 billion in 2003. The economic hardship of the transition process is illustrated by the fact that real GDP remains at below 50% of the pre-transition level (1990). A solid growth path was resumed in 2001. Agriculture continues to have a prominent role (about 20 %of GDP) while services and some segments of industrial production have picked up.

Economic growth picked up by 11.1% in 2003, driven by construction (including in particular the Baku-Tbilisi-Ceyhan oil pipeline, which has spill over effects in the services sector). Strong real GDP growth continued in 2004, reaching 9.4% for the first half of the year. According to official estimates, the share of non-recorded economy is at about 30% of total output. Recent estimates indicate that the share of informal economy in the total output started to decline in 2004 in the new political environment. Foreign direct investment in oil and gas pipelines is the main engine of growth in the short-term (2005/2006). The development of infrastructure and financial services is widely regarded as a key for fostering future economic growth. Agriculture and tourism in particular have untapped potential.



**Table. Georgia - Selected Economic Indicators, 2000-2004**

|  | 2000  | 2001  | 2002  | 2003  | 2004* |
|--|-------|-------|-------|-------|-------|
| Real GDP growth (%)                              | 1.9   | 4.7   | 5.5   | 11.1  | 8.5   |
| Nominal GDP (millions of lari)                   | 6,013 | 6,638 | 7,448 | 8,565 | 9,760 |
| Exchange rate (lari per euro, end of period)     |       | 1.82  | 2.18  | 2.59  | 2.4   |
| Consumer price inflation (% , period average)    | 4.0   | 4.7   | 5.6   | 4.8   | 5.8   |
| Unemployment rate (ILO definition)               | 10.3  | 11.1  | 12.3  | 11.6  | 12.4  |
| Poverty rate (% of population)                   | 51.8  | 51.1  | 52.1  | 54.5  | na    |
| Fiscal balance (% of GDP, cash basis)            | -2.6  | -1.6  | -1.9  | -1.3  | -1.8  |
| Broad money (% change)                           | 39.0  | 18.5  | 17.9  | 22.8  | 27.0  |
| Exports of goods and services (% of GDP)         | 36.0  | 30.4  | 30.2  | 33.2  | 35.5  |
| Imports of goods and services (% of GDP)         | 45.3  | 42.5  | 40.1  | 45.6  | 49.0  |
| Current account balance (% of GDP)               | -4.3  | -6.4  | -5.8  | -7.2  | -7.5  |
| Gross international reserves (months of imports) | 1.0   | 1.4   | 1.7   | 1.3   | 1.6   |
| External public debt (% of GDP)                  | 51.3  | 51.7  | 52.4  | 46.2  | 37.0  |
| External debt service (% of exports)             | 13.5  | 4.9   | 3.6   | 4.5   | 6.0   |
| Domestic public debt (% of GDP)                  | 18.5  | 16.7  | 15.0  | 15.3  | 11.0  |

Sources: IMF, Eurostat

\* Projection

### 3.1.2. *Fiscal management, monetary policy and exchange rate policy*

The tax-to-GDP ratio increased over the 1990s to 14.2% in 2000, remaining at that level until 2004. The overall fiscal balance was, however, reduced to about 2% in 2001-2003. This was achieved through frequent budget sequestrations. Poor budget preparation and execution resulted in the build-up of large expenditure arrears (mostly wages, pensions and social allowances), reaching the level of about 4% of GDP in 2003. Decisive action by the new government in early 2004 in combating pervasive evasion of taxes, excises and import duties has begun to bring more revenues to the central government, notably since the reintegration of Adjara in the central government revenue collection.

As a result of improved fiscal performance, yields on treasury bills declined to 13 % from a peak of 77% in October 2003. The stock of expenditure arrears has been reduced and all remaining expenditure arrears are planned to be paid in 2005. The gap between actual and potential tax collection is being narrowed down. In 2004 the tax revenues-to-GDP ratio is estimated to have reached about 18 %. A comprehensive tax reform is now under way.

The transit fees from the pipelines will provide an additional source of revenues of up to one percent of GDP in the medium term. A medium-term expenditure framework is now being developed with international donor support. Under a new budget systems law, adopted in 2003, a treasury reform is being implemented to strengthen budget execution. These reforms are recognised as a priority to move towards sustainable and transparent reorientation of budgetary expenditures in the areas of health, education and social protection. A recent assessment conducted by the EC encourages the authorities to continue reforms in the entire budget system, including also internal and external audits.

The National Bank of Georgia (NBG) has maintained a consistently prudent monetary policy stance. The IMF and the EC have found that safeguards to ensure sound management are generally adequate at the NBG, but its de facto independence could still be enhanced. Following a sharp depreciation of the Georgian Lari during the Russian crisis, consumer price inflation peaked at 19% in 1999. After an increase at the end of 2003, consumer price inflation has again slowed down in 2004 to 5.9% year-on-year in September, largely owing to appreciation of the Lari. Georgia's exchange rate regime is classified as 'managed floating' where the NBG normally intervenes only to smooth short term fluctuations. The decrease in dollarisation in 2004 is a positive sign. The share of foreign-currency deposits is nevertheless still high at 79% of total deposits.

The gross international reserves of the NBG increased substantially in 2004, in terms of imports coverage, the reserves are equivalent to about two months of imports (excluding pipeline related imports).

### *3.1.3. External situation*

The current account deficit (including official transfers) narrowed down to 6% over the period 1997-2002. Because of the large import demand related to on-going pipeline construction, the deficit is estimated to have increased in 2003 and 2004 to around 8% of GDP.

Georgia's public and publicly guaranteed external debt amounted to US\$1.8 billion in June 2004. (45% of GDP) Georgia restructured its bilateral debt obligations through agreements with the Paris Club in 2001 and again in July 2004. Under the economic programme supported by the IMF, Georgia has abstained from borrowing on commercial terms and continues to rely on access to concessional funds from IFIs and donors.

### *3.1.4. Social situation and human development policies*

In 2003 the proportion of population living below the poverty line was estimated at 54.5% and the proportion living in extreme poverty was at 16.6%, with a worsening trend for recent years. The unemployment rate was about 13% in early 2004 with urban unemployment around 25%. Self-employment accounts for 66% of total employment. In June 2003 the Economic Development and Poverty Reduction Programme (EDPRP) was adopted by the previous government. The present government is currently making the programme more operational by linking EDPRP priorities to the budget process. The government plans to reform the present system of poverty benefits from 2005 onwards. The Government has prepared the first Progress Report on EDPRP implementation showing that significant progress was made already in 2004. Payment of arrears on pensions was a particular achievement in poverty reduction.

Current public expenditure on **public health** is low at 6% of all Government spending (2003) and as a percentage of GDP (only about 1%). This is still well below the targets of the EDPRP. The 1997 Law on Medical Insurance introduced a social insurance system managed by the publicly-owned State United Social Insurance Fund (SUSIF). The SUSIF is primarily funded through a mandatory payroll tax, with employers expected to contribute 3% and employees 1% of salary. As contribution rates remain low, revenue from this tax covers only 70% of its budget, with the remainder depending on transfers from the central (20%) and local budgets (10%). The Government provides contributions for the unemployed, pensioners, and children. The SUSIF funds various health programmes and engages hundreds of health-care

providers (1999: nearly 700) under contract, as all health-service providers ceased to be directly managed by the health ministry in 1999. Private insurance schemes are scarce.

### *3.1.5. Sustainable development*

The Georgian Economic Development and Poverty Reduction Strategy requires a national strategy for **sustainable development** to be prepared. The government plans to present this strategy in 2005. A National Commission for Sustainable Development was established in 1996 but only modest progress can be recorded.

## **3.2. Structural reforms and progress towards a functioning and competitive market economy**

### *3.2.1. State involvement in the economy and privatisation*

The share of the private sector is about 65% of the GDP. Georgia has completed price liberalisation and administratively set prices account for 3% of the CPI basket.

Although still to be completed, the small scale **privatisation** process has produced over 17,000 small private enterprises since 1993. On the other hand, several privatisation attempts of large-scale enterprises resulted in failures (e.g. in telecommunications) due to lack of investor interest. In mid-2004 a list of 372 non-strategic assets targeted for privatisation in the short-term was announced, and progress has already been made in its implementation. The EBRD, the World Bank and the IFC advise the government with a view of ensuring a transparent privatisation policy and effective management of remaining state assets (notably the railways). The discussion on what constitute strategic assets and what is to be done with them is underway. Compared to other parts of Georgia, relatively little progress in privatisation had until recently been made in the Autonomous Republic of Adjara. Private investments in the development of the tourism sector are now expected.

Only about 25% of arable agricultural land has been privatised, and around 30% of state-owned land is leased out. Private ownership of land is fragmented and the average size of private farms is very small. Overall, labour productivity is low in the agricultural sector and the lack of effective collateral limits access to credit from financial intermediaries.

### *3.2.2. Regulatory framework and private sector development*

In June 2000 Georgia became member of the World Trade Organisation (WTO). Further harmonisation of legislation still has to be carried out and implemented to meet WTO requirements.

Regarding competition policies, the 1996 Law on Monopolistic Activity and Competition prohibits agreements or decisions which restrict competition, the abuse of a monopolistic position and unfair competition. The state is also subject to a number of prohibitions, including on the granting of fiscal or other privileges which give economic agents advantages over their competitors, and on state monopolisation which leads to a restriction of competition. Enforcement is carried out by the State Anti-monopoly Service. The Ministry of Economic Development has initiated a discussion on the future direction and institutional arrangements for competition policy. As a first step, the Price Control and Anti-Monopoly agencies have been merged recently, involving downsizing of the new agency's staff. There is currently no uniform **state aid** surveillance or control regime comparable with that of the EU.

In a recent survey by the EBRD, Georgia's insolvency legislation was found to have only a low level of compliance with international standards, notably given its poor treatment of creditors.

A new labour code has been elaborated recently.

### 3.2.3. *Financial sector*

Concerning **banking**, the National Bank of Georgia (NBG), established in 1991, has made solid progress in strengthening banking regulation and supervision, including orderly resolution of insolvent banks. Banking legislation, mostly adopted during the period 1995-1997, is compatible with the Basle Core Principles on Banking Supervision, and the CAMEL rating system is applied by the NBG. All commercial banks are required to apply the international accounting standards since 2001.

In 2004 the number of commercial banks decreased to 22 as a result of strengthened supervision by the NBG. The policy focused on banking sector consolidation and transparency, increasing the capitalization of banking institutions and intensifying intermediary functions. It also concentrated on establishment of specific financial markets and the promotion of trust towards the banking system. As of January 2005 the minimum capital requirement is increased to GEL 6.4 million (approx. €2.7 million). Fulfilling this requirement presents a problem for smaller banks and further consolidation of the banking sector is expected. The NBG plans to increase the minimum capital requirement gradually up to GEL 12 million by 2008 in line with EU standards. Non-performing loans have been at a fairly stable level between 7-8 % of all loans. Most recent data for 2004 show, however, a decrease to slightly below 6%.

Although growing rapidly, the banking sector is still small with total assets of only 16% of GDP. Domestic credit to the private sector amounts to just 9% of GDP. Real interest rates remain high due to weak financial intermediation and high risk premia (partly attributable to insecure collateral). In 2004 lending rates have been between 15-25 %. Longer term loans are not yet available and therefore, for instance the housing loan market is underdeveloped in comparison to potential demand. A credit reporting system and a public registry of secured interests are already being developed while preliminary discussions on the introduction of a deposit insurance system are also underway. The recent de-dollarisation trend has been visible especially in current deposits whereas the public prefers to place longer term savings mostly in foreign currency. Foreign banks operated in accordance with Georgia's common banking legislation and were not subject to any special or additional requirements.

The process of aligning Georgian legislation in the **insurance** sector with international standards began in 1997. The insurance sector is regulated by the 1997 Law on Insurance. It has been amended in 1998 to abolish restrictions on foreign ownership of insurance companies. Supervision is carried out by the Insurance State Supervision Service of Georgia. The service is an independent governmental body which coordinates insurance activity, secures the solvability of insurance companies, supervises insurance activity and participates in the revision process of insurance policy and its implementation. In 1999 the Insurance State Supervision Service became a member of the International Association of Insurance Supervisors. One of its main objectives is the assistance and supervision of Georgian insurance activities according to international standards. The insurance market is still quite small with 16 insurance companies. Private pension insurance is provided by three private pension funds.

The Georgian stock exchange started trading in 2000 and is still in early stages of development, with a market capitalisation of about 5.5% of GDP (2003). A **securities** commission was set up in 1999 but it is not considered fully independent yet. Pursuant to the Law of Georgia on Securities Market and the Statute of the National Securities Commission of Georgia the most important powers granted to the Commission are supervision over the activity of securities market participants, control over their compliance with the requirements set by the law and application of relevant administrative measures against them. The Parliament of Georgia adopted legislation to amend existing laws in 2003 such as the Law of Georgia on Securities Markets, the Code of Administrative Offences. Parliament had also approved amendments to the Law "on Entrepreneurship" providing for improved stockholder protection. The Treasury bills market, established in 1997, has been developed in a systematic manner by the Ministry of Finance and the NBG in recent years.

#### *3.2.4. Relations with other donors*

The new government's reform commitments quickly won wide support from the international financial institutions and the donor community. The government's economic programme for 2004-2007 is supported by the **IMF** under the Poverty Reduction and Growth Facility (IMF Board approval on 4 June 2004, the first review was completed in December 2004). In addition, the **World Bank** resumed its adjustment lending to Georgia in June 2004, and several sectoral lending projects are being prepared as well. The **EBRD** adopted a new Country Strategy for Georgia in July 2004 in which a more active cooperation with local financial institutions is foreseen in channelling funding to SMEs in particular.

Generous support was manifest at the **Donors' Conference** co-chaired by the Commission and World Bank in Brussels in June 2004, the total amount of pledges reaching about €850 million. In order to enhance absorption of this assistance, discipline is required on all sides. Donor coordination is being enhanced through follow-up mechanisms. The government recognises that effective aid coordination will only be achieved through clear national strategies which are linked to the country's own planning and budgeting processes. Several EU Member States have provided assistance to Georgia since independence. Georgia is eligible for grants from the US Millennium Challenge Corporation, and the government is reviewing potential development projects for MCC funding.

### **3.3. Trade-related issues, market and regulatory reform**

Georgia became a member of the **WTO** in June 2000. Work is still in progress on adopting the required legislation. Georgia accounts for a very small share of world trade.

The EU is Georgia's first trading partner accounting for some 34% of Georgia's total trade. Yet bilateral trade is very small: €640 million in 2003 (figures recalculated for EU 25). Turkey and Russia are Georgia's second and third trading partners respectively, accounting for 15% and 10% of Georgia's total trade. Georgia's other regional trade relations are most significant with Azerbaijan, Ukraine and Turkmenistan.

Trade with the EU has increased significantly between 2000 and 2003. The increase was particularly strong in 2003 with imports from the EU up by 20% over 2002 and exports to the EU up by 11%. The construction of the Baku-Tbilisi-Ceyhan oil pipeline provides a partial explanation of these increases. EU imports from Georgia in 2003 stood at €287 million and EU exports to Georgia amounted to €349 million, with a consequent trade deficit for Georgia of €60 million or 10% of total bilateral trade. Bilateral trade is concentrated in a limited

number of sectors. Georgia's main registered exports to the EU consist of energy (oil), base metals, precious stones and processed agricultural goods. Georgia imports machinery, vehicles, chemicals and textiles from the EU. The bilateral agreement on trade in textiles lapsed with the accession of Georgia to the WTO in 2000. Since then trade in textiles has been conducted with no quantitative restrictions or surveillance.

Georgia is a beneficiary of the EU's **Generalised System of Preferences (GSP)** and has requested to benefit from the granting of the special incentive arrangement for the protection of labour rights. The request is currently being assessed by the Commission. The GSP has enabled Georgia to diversify somewhat its exports to the EU and to increase its total preferential exports to the EU significantly in recent years (+52% in 2002 compared with 2001).

Georgia also benefits from GSP arrangements in its trade with the US, Japan, Canada, Switzerland and Turkey. Georgia has free trade agreements with Armenia, Azerbaijan, Kazakhstan, Russia, Turkmenistan and Ukraine. Georgia ratified the GUUAM free trade agreement at the end of 2002.

**Agriculture and food processing** represent very important sectors of the Georgian economy accounting for 20% of GDP and more than 50% of employment. Agricultural land accounts for around 3 millions hectares, roughly 2 million of which is pastureland and 1 million arable of which 0.5 million is irrigated. Georgian agricultural exports to EU-25 accounted for about €26 million in 2003. The main exports are wine, nuts and mineral water. Land privatisation has only partially been completed (75% remains in state ownership). Agricultural and marketing services also need to be developed. The average size of privatised land parcels is 0.22 hectare resulting in the creation of a large number of smallholdings providing little more than subsistence level incomes to a large part of the rural population. The agricultural sector suffers *inter alia* from poor infrastructure, limited access to credit facilities and the incomplete process of land reform. The EDPRP and government document to the donor conference both stress the importance of the continued reform of the agricultural sector. An agriculture strategy is expected to be adopted soon and a new draft law on additional privatisation of arable land is under consideration.

Regarding **veterinary and phytosanitary issues**, Georgia has adopted over the recent years a number of new basic laws covering food safety, veterinary, and plant protection issues. However, minimum international standards for food safety are not yet achieved and legislation does not contain risk management components. The sector lacks funding to ensure adequate nationwide food safety structures. The quality of inspection and testing is far from reaching international standards and inspection bodies and laboratories have overlapping responsibilities. Food borne diseases and endemic zoonoses cause public health threats. The lack of slaughterhouses undermines food safety of meat production. Georgia is a member of the World Trade Organisation (WTO), Food and agriculture Organisation (FAO), World Health Organisation (WHO), International Office for Epizooties (OIE) but is not a signatory to the International Plant Protection Convention (IPPC).

The **Customs** Department of the Ministry of Finance is responsible for the administration of customs in Georgia. Since independence, Georgia's customs system has been faced with multiple problems: the need to build a system from scratch given its unprotected borders with other ex-soviet republics and its closed border with Turkey prior to 1991; the lack of Georgian jurisdiction over Abkhazia and South Ossetia and, until recently, the lack of control over Adjara; weak management, and lowly motivated and unqualified staff. These factors

contributed to bribery and corruption. The new Georgian government has therefore made reform of the customs service an important priority. Following the adoption in May 2004 of the Customs System Development Strategy, a new regulation and structure of the Customs Department entered into force in August 2004, the number of staff have been reduced and personnel reform has been introduced (80% of customs officials are currently on temporary contracts). A new Law on the Customs Service is currently being drafted. This should have a positive effect in the fight against corruption. Since 1998, Georgia has used the 1996 version of the Harmonised system nomenclature. The Georgian Government is preparing to submit the new Customs Code to the Parliament designed to bring customs legislation and procedures in line with international and European standards. Secondary legislation is currently being developed with EC assistance. A Public Council to discuss customs issues with the operators has also been established.

A customs declaration processing system (ASYCUDA) based on selectivity is in place. However, its use and development should be further enhanced in order to fully benefit from customs automation. A customs data network, covering the whole customs territory is under construction. The technical equipment and the infrastructure, both in customs offices and at the border are being upgraded with the assistance of foreign donors. A customs laboratory is being set up. Pre-shipment inspections are applied on exports from Georgia. Georgia signed a bilateral agreement on transit with Armenia. An ad-valorem customs fee of 0.15% is levied on some customs procedures.

The **Tax** Department within the Ministry of Finance is in charge of the registration of taxpayers, tax collection, tax control and reporting. An overall reform of the Tax Department started in 2000 with external assistance, with the aim to strengthen administrative and operational capacity, including computerisation, to reduce the number of staff and to modernize the tax legislation. The new Tax Code entered into force in January 2005. The number of taxes has been reduced from 22 to 7 and the administrative procedures are being simplified. In order to make the tax reform revenue-neutral, the tax base will be broadened by eliminating many existing tax exemptions, moreover, the excise tax rates will be increased and tax collection will be strengthened. Since 1 October 2004, the Tax Department central structure and local offices have been restructured. A Large Taxpayers Inspection office and an Excise Taxpayers Inspection have already been set up. Concerning VAT, a 20% standard rate is applied until July 2005, and a large number of goods are either zero-rated or VAT exempt. In the new code the VAT rate is reduced to 18% and exemptions are reduced to the minimum. At present, excise duty is applied to alcohol, oil products, tobacco, cars and some sea products. Under the Tax Code, excise on export of scrap metal will be applied. The profit tax rate remains at 20% while income tax rate is reduced to 12%.

As regards **technical regulations and standards for industrial products**, Georgia committed itself on acceding to the WTO to adopt a new standards system comprising voluntary and mandatory international technical regulations replacing the Soviet system of mandatory standards by 2003. In this perspective, the Law on Standardisation, adopted in 1999, introduced the principle of voluntary standardisation. In practice however, obsolete Soviet standards are still being used. In 1998 the Georgian State Department for Standardisation, Certification and Metrology (Sakstandarti) was established to carry out state supervising and controlling activities in these fields. All goods and products produced in, imported into or exported from Georgia have to meet Georgian standards and receive certification from Sakstandarti. Reform efforts have been largely focussed on the adoption of EU standards. Conformity Assessment is regulated by the Law on Certification of Products and Services adopted in 1996. It provides for the general rules for the system of mandatory

and voluntary certification. In September 2002 the State Minister adopted an order on the Strategy for Establishment of Conformity Affirmation in Georgia. The order provides for the new concept on implementation of the EU conformity assessment and quality affirmation system into Georgian legislation.

Georgian legislation in the field of **intellectual and industrial property rights** is broadly consistent with the TRIPS Agreement which Georgia must apply as a WTO member. Georgia's Law on Patents and Trademarks was passed in 1999. In addition, the Georgian Civil Code on "Intellectual Property Law" provides protection for intellectual property rights. The PCA requires Georgia to provide for a level of IPR protection similar to that existing in the EC, including effective enforcement means. Georgia has now acceded to all key IPR treaties and conventions but further steps are needed to ensure full compliance with the relevant PCA obligation. The implementing agencies for policy formulation and implementation are the following: the Georgian National Intellectual Property Centre (Sakpatenti) responsible for matters involving industrial property rights and appellations of origin; the Copyright Agency, responsible for copyrights, and the Ministry of Agriculture for plant variety protection. The Cultural Department within the MFA is responsible for copyrights on literary, artistic, musical, photographic, and audiovisual works. Despite the body of protective legislation, actual enforcement of intellectual and industrial property rights in Georgia remains weak thus creating little incentive for foreign companies to enter the Georgian market. This is especially true in the areas of computer software and audio- and video-tapes. Responsibility for enforcement is shared between the Ministry of Interior and the Customs Department of the Ministry of Finance as regards enforcement at Georgia's borders.

The State Department for **Statistics** of Georgia (SDSG) acts on statistical legislation from 1997 based on the UN fundamental principles of official statistics. The lack of funding poses a serious threat to the sustainability of statistical system, which employs in total 540 persons, of which 204 in the Central Office. The current reorganization plan, which includes a serious reduction of staff (65% in total number and 72% in regional offices) could create problems for statistical data collection and dissemination and seriously influence data availability and quality.

The SDSG functions as co-ordinator of the statistical system of the country and has some access to administrative registers and receives some data from other ministries and departments. Governmental services remain the most important users, but the needs of other users are also taken into account. There is a permanent exchange of external trade data with Eurostat, and due to external assistance, some progress can be registered, especially in statistical classifications as well as in national accounts, structural business statistics, household budget surveys partly non-observed economy and industry statistics. Moreover, the Agricultural Census has taken place in 2004.

The present statistical system needs assistance in order to make further improvement towards compliance with international standards, with emphasis on those used in the EU.

The Chamber of Control (CoC) is the supreme audit institute in Georgia and is regulated by a 1997 law. It supervises the expenditure of the state funds and other state assets under the responsibility of the Parliament. The Chamber of Control of Georgia is a member of the INTOSAI (International Organization of Supreme Audit Institutions) since 1992. The Chamber has been reformed with the assistance of international donors. The reform involved drafting of legislation in the area of financial **control**, including amendments to the law of the Chamber of Control, the setting of audit standards based on international audit methodology,



the drafting of a code of ethic for CoC activity, and the preparation of a strategic development plan.

**Public procurement** is regulated by Law on State Procurement (LSP) of 1998. The LSP is modeled on the UNCITRAL Model Law. The law was amended in 2001 to extend its applicability to off-budget funds and to give the implementing agency, the State Procurement Agency, increased autonomy. The Law applies to the procurement of all goods, works and services funded from the State and local budgetary resources, and the budgets of local units. The LSP does not include provisions that would limit the participation of foreign bidders in open tenders per se. To promote the development of domestic contracting and manufacturing industries, a 15% margin of preference is granted in the evaluation of bids offering inputs (material and labor) from Georgia when foreign and domestic bidders participate in the tender. The regulating and monitoring body that ensures compliance with the Law on State Procurement by all public entities is the State Procurement Agency (SPA). SPA has authority to develop normative regulations and standard bidding documents and is responsible for training and dissemination of information about procurement, and for monitoring, supervision, and conducting administrative reviews. Procurement related to state security is excluded from the LSP. The other exception is state procurement related to state secrets. Emergency provisions for sole sourcing are also applied widely in practice.

Concerning **provision of services and the right of establishment**, the main legislation governing foreign investment includes the Constitution (1995), the Civil Code (1997), the Tax Code (1997), and the Customs Code. Other legislation aimed at establishing favourable conditions - but not preferential treatment - for foreign investors includes *i.a.* the Law on Entrepreneurs (as amended in 1999) and the Law on Promotion and Guarantees of Investment Activity (1996). Georgia has agreements on avoiding double taxation with 26 countries and it has concluded bilateral investment agreements with 22 countries. Foreign investors enjoy the same rights and protection as physical and legal persons of Georgia. Investment in certain sectors is prohibited or subject to licensing investment (*i.a.* creation, production and proliferation of nuclear, bacteriological and chemical weapons; importation of radioactive and toxic waste). Permission is required in sectors such as establishment of casinos and gambling houses and the organization of games and lotteries; banking; insurance; issuance of securities. A new Law on Bookkeeping and Accounting had been adopted by Parliament in 1999. Audit services are regulated by the Audit Board established under the Parliament of Georgia.

Georgia has drafted and adopted new laws and amended existing legislation related to trade in services to make the legislative basis consistent with the Agreements of the World Trade Organization. Concerning specific services sectors, a Law on Business Licensing, of 1999, provides the framework for licensing the sectors of insurance, banking, securities, air and maritime transport, auditing services, construction and design, and private education services, including licensing agency and uniform procedures to be followed.

### **3.4. Transport, energy, information society, environment, research and innovation, people-to-people contacts**

The **transport** sector falls under the responsibility of the Ministry of Economic Development. This follows many years of substantial restructuring of the government's involvement in the sector - separating operational from policy formulation and regulatory functions. The different transport sectors are overseen by regulatory authorities. Public sector road transport companies have been privatized. Georgia's transport policy aims to develop the country as an important transit country in light of its geographic position on the historical "Silk Road". The

TRACECA initiative (TRANsport Corridor Europe-Caucasus-Asia) has over the past decade played an important role in the efforts to reestablish this corridor in the region, but substantial further infrastructure and institutional development is needed in order to further facilitate the co-operation across the corridor.

In the **road sector** the development of in particular more efficient road freight operations has been encouraged by the launch of a number of sector reforms, which are also introducing stricter technical standards. Adherence and implementation of international sector conventions is an explicit policy goal. Road safety is an issue of concern that is also being addressed by the transport safety agency. In the **rail sector** restructuring and commercialisation of the incumbent railway operator pose a challenge and inter-modal transport needs to be more fully exploited.

In the **aviation sector**, the main regulatory institution is the Civil Aviation Authority, affiliated to the Ministry of Economic Development. CAA is responsible for air traffic management, regulation, supervision, inspection, certification, licensing and civil aviation security in all airports. Georgia pursues a pro-active policy of gradual liberalisation of the sector. A new Aviation Code is currently under preparation, with a view to opening the market to competition and further strengthening the safety and security standards as well as improving the efficiency of the administration. The international airport in Tbilisi has recently been refurbished. The privatization of Georgian Airlines, the state-owned national carrier, is currently being considered. Georgian Airlines controls the main concessions in the airports such as ground handling and catering. Georgia has recently negotiated a horizontal aviation agreement with the Community, amending bilateral air services agreements between Georgia and the EU Member States.

In the **maritime sector**, the improvement of the efficiency of sea ports and maritime operations is a policy goal. Georgia's two main ports (Poti and Batumi) are managed by the State Enterprise Management Agency. The efficiency of port operations leaves considerable room for improvement. Also inadequate capacities in the ports pose a problem. The Government has been tendering port operations in Poti port in order to increase the efficiency of the port. Insufficient flag state control has resulted in the Georgian fleet being classified in the "very high risk" category on the black list of the Paris MoU. Also port state control is ineffective.

In satellite navigation, initial exchanges of information started within the TRACECA framework in 2004 on the contribution that GALILEO navigation, tracking and positioning services can make to the safety and efficiency of land, maritime and air travel both nationally and regionally.

Georgia is a net **energy** importer. Gas, accounting for 25% of energy needs, is imported mainly from Russia. Georgia produces some oil and considerable quantities of hydropower (up to 80% of electricity production) and has some gas and coal reserves. It is a key international transit country for Russian and, increasingly, Caspian supplies. The Black Sea port facilities and the Baku-Supsa oil pipeline (transiting Caspian oil) are currently the main assets in this regard. Georgia plans to enhance its transit role for Caspian resources through increasing the capacity of the Baku-Supsa pipeline and the completion of the Baku-Tbilisi-Ceyhan (Turkey) oil pipeline (operational in 2005) and the Baku-Tbilisi-Erzurum (Turkey) gas pipeline (completion by 2006). These developments are also fundamental for the EU's security of energy supply, in particular in relation to other ongoing projects including: the Turkey-Greece gas interconnector; the "Nabucco" gas pipeline (from Turkey to Austria); the

Trans-Balkan gas project (from Greece to Austria); the extension of the Odessa-Brody oil pipeline to Poland; and the Constantza-Trieste as well as the Burgas-Alexandropolis oil pipelines. In addition, Georgia plans to enhance hydro-electricity exports to Armenia and Turkey. The fragile economy will increasingly benefit from the additional income to be generated from the projects.

The Ministry of Energy is the main energy policy body. The 2004 energy sector strategic Action Plan 2004-2005 aims at self-sustainability and at improving security of supply. It notes that the energy infrastructure has deteriorated to the point where, without additional investments, the risk of catastrophic system failure will become unacceptably high within the next two-three years. Moreover, the electricity and gas sectors suffer from severe financial difficulties due to non-payment, corruption and theft, which constrain new investments. Electricity outages occur frequently, especially in wintertime. The Action Plan, an important step to find solutions for the critical state of the sector, aims at further addressing the serious deficiencies. In 2004 the government adopted strengthened legislation to reduce theft and other corrupt practices. A debt resolution agency is being established, a programme to install metering devices at wholesale and individual customers level was initiated and some investment funds have been set aside (US\$35 million in 2004). A multi-annual investment plan is due for spring 2005. Addressing the sector challenges is crucial for economic development and poverty reduction.

The 1999 Laws on Electricity and Gas and on Oil and Gas constitute the basic framework for the sector. Amendments to these laws have been adopted as far as the Law on Electricity is concerned and are in preparation for the others. The independent National Energy Regulatory Commission oversees the sector. The state subsidises substantially certain companies. New tariff methodologies are being developed.

The formerly vertically integrated electricity sector was separated into generation, transmission and distribution. Private companies manage financially the remaining state owned electricity companies Wholesale Electricity Market (GWEM), the transmission company GSE and United Distribution Company. UES owns stakes in certain generators and the Tbilisi distributor. The Abkhazian electricity distribution company, consuming 15% of total Georgian production, makes no payments for the electricity it receives from GWEM.

The state owned Georgian Gas International Corporation owns and operates the gas networks. Russian Gazprom plays a dominant role in the Georgian gas business *inter alia* through imports and shares in distributors. Georgia signed recently a 25 year agreement with Gazprom for gas supplies and joint infrastructure work. Georgia wishes to increase, beyond hydropower, the use of renewable energy sources (notably biomass, geothermal, but also wind and solar). Energy efficiency should considerably be improved. A TACIS Energy Efficiency Centre is functioning. Georgia does not operate nuclear plants, but it suffered in 1998 from radiological accidents. The control of radioactive sources, including avoiding illicit trafficking, requires attention.

The Department for Information and Communication Technology within the Ministry for Economical Development is responsible for the policy in the **Information Society** sector as well as for the industrial policy in the field of electronic communications.

Based on the Law of Post and Communications of 1999, a Regulation on Interconnection of Telecommunications Networks was issued. Licences are awarded by the Georgian National

Communications Commission (GNCC) after an open tender procedure. The GNCC also establishes price cap regulations and prepares measures towards tariffs rebalancing.

Although all e-communications markets have been liberalised, the level of competition in local and long distance fixed voice telephony is limited because of the dominant positions of the two main network operators.

Fixed voice telephony is provided by Georgia Electric Communications (local service) and Georgian Telecom (long distance and international services). There were about 590,000 fixed lines at the end of 2003 (14% penetration rate).

The three mobile telephony operators are providing services for about 580,000 subscribers (about 13% penetration rate); competition between these operators stimulates considerable growth in this market.

The markets for data communications and Internet are stagnating because of insufficient digital infrastructure, due to lack of investment in the sector. There are not more than four suppliers of broadband data services and three Internet service providers of which only one offers ADSL services; therefore, only about 150,000 people used Internet at the end of 2003 (3.5% penetration)

Regarding the **audiovisual sector**, there are, alongside the public sector, a large number of independent and public TV and radio stations. Georgia's rich cultural heritage is - together with its natural environment - an asset to enhance exchanges and tourism. Legislation in this area includes the Laws on Culture, on Protection of Cultural Heritage and on the Regulation of Export-Import of Cultural Works. The 'Cultural policy of Georgia' programme aims *inter alia* at cooperating in the context of the Council of Europe and with Azerbaijan and Armenia. The Government's Strategic Vision and Urgent Financing Priorities 2004-2006 considers cultural heritage protection as key for national recovery.

As regards **environment**, the Georgian National Environment Action Plan adopted in 2000 sets out nine priorities: water supply and pollution; air pollution; resource use; waste and chemicals management; land resources; protection of the Black Sea; forests and forestry; global environmental problems; and problems in the State system for environment and nature use management. A National Environmental Health Action Plan was approved in 2003 and selected municipalities are elaborating local environment action plans. Georgia published in 1996 its first report on the state-of-the environment.

When adopting the Constitution in 1995, Georgia committed itself to protecting the nation's natural and cultural environment and promoting the rational and sustainable use of natural resources. Framework laws on environment protection and environment permits were adopted in 1996. A draft law on public access to environmental information and decision-making has also been prepared, but not adopted.

The Ministry of the Environment and Natural Resources was established in 1991. A number of other Ministries are involved in environment matters, such as the Ministries of Economic Development and Energy. The Institute for Environmental Protection is responsible for environmental standards and norms. A State Committee for Climate Change was established in 1996 and the Government has developed a National Climate Change Programme and an Action Plan. Regional and local environmental structures are weak.

Georgia has adopted some sector and issue specific legislation such as on air quality, waste management, water quality, soils, nature protection and chemicals. The 1999 law on ambient air protection makes use of several EU requirements. Georgia plans to introduce legislation on integrated pollution prevention and control by 2006.

Sector specific programmes have been prepared including on integrated coastal zone management, forest management, water management and environmental impact assessment. The Ministry of Environment and Natural Resources administers a monitoring system.

Georgia has participated in the Danube - Black Sea Task Force. It has ratified several international and regional environment conventions, to which it is party, and has in particular acceded to the Kyoto Protocol on climate change. Georgia has signed but not yet ratified the Strategic Environmental Impact Assessment Protocol of the Espoo Convention on Environmental Impact Assessment.

In Georgia **Research and Innovation** activities are modest. There is no national Research and Innovation strategy. The Ministry of Education and Sciences, responsible for the policy development in the sector, is in the process of being restructured. The Academy of Science, which has a staff of about 6000 researchers, will be restructured in the near future. However in the scientific community there is an active interest in scientific cooperation with the EU as reflected in the Georgian participation under the 5th Framework Programme. Georgia participated in 17 research contracts under the 5th Framework Programme. These concerned joint research projects using thematic networks and co-ordinated actions involving 18 Georgian participants, the majority of which were from Academia. Objectives focused on specific measures for international cooperation, information technology and energy. By April 2004, 31 Georgian bodies participated in the first two calls for proposals under the 6th R&D Framework Programme, submitting 26 proposals of which one was selected. The proposals were principally addressed at nanotechnologies (7 proposals), specific measures for international co-operation (4 proposals), information technology (3 proposals) and environment (3 proposals). Around twenty proposals with Georgian participation were unsuccessfully submitted to subsequent calls Georgia has an active National Contact Point from the private sector responsible for the Information Society Technologies (IST) part of the 6th Framework Programme.

Georgia's **education system** provides for compulsory primary, basic (grades 7-9) and secondary levels. There are both public and private institutions. Education is in principle free up to grade 9, but children of less privileged parents including the rural population face increasing difficulties with informal payments (e.g. fees, school supplies). Enrolment rates are generally very high. Education and training are faced with serious challenges: declining quality (e.g. unclear standards and assessments), corruption, lack of clear strategic vision, very low availability of funding (for e.g. salaries, equipment including learning material, buildings), organisational deficiencies, inadequate link to the market needs, reduced access to higher education for the poorer citizens and reduced access due to subjective entrance examinations.

The Government wishes to address these challenges with the aim of integrating Georgia into the European Higher Education space. Strategic documents, including the Economic Development and Poverty Reduction Programme, consider human resources as a priority for development. The reform framework includes the 1995 "State Programme for Education Reform and the Plan of its Realization", the Education Law adopted in December 2004 by Parliament and the Law on initial vocational education and training. Georgia participates in

the Tempus programme for the modernisation of higher education through exchange projects and structural measures that aim at reinforcing local reform capacities. Improved education will reduce youth emigration and create conditions for enhancing their role in the labour market and in strengthening civil society. Georgia participates in the Youth Programme on cooperation in the field of non-formal education for young people particularly through multilateral youth exchanges, trans-national European voluntary service as well as training for youth workers and capacity building for youth NGOs. Regional youth activities are conducive to creating a new generation with an open mind towards the region. Current visa requirements and procedures create certain difficulties to youth mobility.

The reform of the **public health** structure, initiated in 1995, introduced organisational and management changes, geared towards decentralisation, social insurance, privatisation and the contracting of health care services. The Economic Development and Poverty Reduction Programme (EDPRP) recognises the need of improvement to the health-care system to ensure financial and geographic accessibility to minimum health services throughout the country. The system inherited from Soviet times was generally hospital-oriented with a curative focus on inpatient care. Primary health care units in rural and urban areas were generally not staffed by specialists, and an integrated model of family medicine did not exist.

The Ministry of Labour, Healthcare and Social Protection (MoLHSP) is the lead agency for the health care system. A National Institute of Health (NIH) provides scientific and technical advice to the ministry. Decision-making has widely been delegated to twelve Regional Health Departments. The MoLHSP develops accreditation and licensing procedures as well as issues medical guidance. Municipal health authorities operate hospitals, polyclinics and primary health care (PHC) services on a local level. Municipal authorities levy and provide funds in accordance to their population size. The PHC system is designed to emphasise health promotion, disease prevention, and health protection. A 2000-2009 health programme, reflected in a 1999 National Health Policy Document, re-states the aim to shift health care to preventive activities as well as regulation and accreditation of health services and training. The country has set itself targets to establish a functioning network of PHC-centres. Under the Economic Development and Poverty Reduction Programme, the Georgian Government is planning a number of steps to be taken, within the scope of the budget, during 2005 to improve the access to healthcare for the deprived. To this end, the MOLHSP intends to clearly determine the basic package of medical care and introduce a new methodology of tariff setting.

The health system aims to provide Basic Benefit Packages (BBP) of (subsidised) health care services throughout the country. Due to the fragmentation of the PHC system, it is poorly utilised. Many facilities only see few patients each day. Many polyclinics and ambulatories are ill-equipped. Over-staffing remains widespread. Some parallel health care systems still exist. Despite its limited funding, the scope of services covered by the BBP was expanded, often for political reasons. Patients remain widely ill-informed of their entitlements under this system. In 1995, payments for certain health services not covered under the BBP were legalised under a system of regulated fees. However, informal payments are still widespread, representing a burden for the sick, often resulting in actual exclusion of the poor from health-care. Various estimates put private spending at over two thirds of total health expenditure. All pharmaceuticals must be purchased directly by patients, except for some provided under the BBP scheme. Although Georgia developed an Essential Drug List (EDL) in 1995, thus providing for generic drugs approval, patients can generally buy all drugs without prescription, due to lacking implementation of regulatory requirements for pharmacies and drug sellers.

Health care, including structural hospital reform, actually often depends on international financial assistance that is either provided through the United Nations System (WHO, UNICEF, etc.) or from bilateral donors. Georgia has two state and thirty private medical schools that are registered in the country. Almost all of these schools are located in the capital, Tbilisi; only three are in the regions. Two state universities (Tbilisi State University and the State Medical University) offer a formal program in public health and public health management. Entry into medical schools exceeds the needs of the over-populated health service by a factor of ten.