

March 20, 1997

**Statement by Mr. Yakusha on Georgia  
Executive Board Meeting 97/26  
March 21, 1997**

On behalf of my Georgian authorities, let me express their sincere gratitude to the staff for the valuable assistance and the advice they have provided so far, as well as for their efforts in preparing the comprehensive reports on Georgia, which describe very well both the economic achievements and the challenges that still lie ahead. In addition to that, my Georgian authorities are especially thankful to the Fund's management for helping the country to *normalize the relations with its creditors and to secure the full financing of the program* throughout 1997. The Georgian authorities have greatly benefitted from cooperation with the Fund and the Fund's overall role in stabilizing the economy is deeply appreciated.

Based on the achievements of the implementation of the program during 1996, my authorities are requesting the Fund's support for the program of economic policy measures under the second year of the ESAF arrangement.

The strengthening of Georgia's track record on stabilization and structural reforms has continued at an impressive pace. According to the revised estimates, real GDP growth during 1996 was around 10.5 percent - significantly higher than the 8 percent envisaged by the original ESAF arrangement. The latest data on economic activity in January 1997 suggest that growth has further accelerated compared with the respective period in 1996. The downward trend of inflation has also exceeded the original program expectations by a substantial margin and the record has remained rather satisfactory: inflation was 14 percent over 1996 compared to 57 percent in 1995. In addition, the adherence to sound monetary policies and the restructuring of the financial sector, as well as the completion of the small-scale privatization program and the privatization of over half of the large state enterprises, are serious pillars for sustaining the momentum of financial stabilization in 1997. Tenders and cash auctions open both to domestic and foreign investors will be the primary methods of privatization.

It is necessary to point out that the improvements in macroeconomic stability in 1996 were achieved by simultaneously addressing rather important social goals. Within the education and health care sectors, dollar wages increased significantly since the beginning of the stabilization efforts in late 1994. One of the priorities in the 1997 budget deals with the basic education and health spending, and it is envisaged that the efforts undertaken during the first year of the program's implementation are to continue in order to reverse a decrease of the relative size and quality of these essential services, which occurred during the hyper inflationary episode of 1993-1994. During 1995, the shares of overall expenditures on these two items were increased to 5.1 percent and 6.7 percent, respectively. Although the final data for 1996 are not available yet, there are indications that the upward trend has continued.

According to the staff's estimates, the expenditures on health and education in 1997 are budgeted to reach even higher levels, amounting to 18 percent of the total central and local government expenditures, or 6.5 percent and 11.5 percent, respectively.

The achievement of even lower inflation in 1997 is to be supported by various economic policy measures. Among these, the maintenance of a stable exchange rate has an important role. The authorities fully agree with the staff's assessment that the current exchange rate policy has served Georgia well and that it has contributed a lot towards restoring the overall confidence in governmental policies. In this light, the exchange rate will be allowed to appreciate in case net international reserves rise substantially over the program targets.

Georgia became an Article VIII member towards the end of the first yearly arrangement under the ESAF program, and my authorities are fully committed to maintaining current and capital account convertibility. In order to provide for more transparent and liberal terms in accessing the domestic market, a new Foreign Investment Law, drafted in collaboration with the World Bank, became effective in December 1996. The changes in the regulation of exports envisaged for 1997 will be in line with this stance. A further decrease in the relative size of the current account deficit is envisaged, bringing it down to about 7 percent of GDP. It is envisaged that the main factor behind such a development is a continued recovery of exports, which has been recorded to date. However, the external sector developments in 1997 and onwards will still depend highly on continued balance of payments support in the form of grants and loans on the one hand, and on the creditors's approval to debt-service rescheduling of the pre-1995 debt on the other. Further external support on concessional terms would facilitate the implementation of the envisaged structural reforms and it would be perceived as an additional sign that the authorities' policies continue to follow a favorable path. My authorities will continue to honor their obligation to deposit funds in the special account with De Nederlandsche Bank and they have already started making the appropriate debt-service payments by using the funds from this account.

Further efforts are envisaged to continue the banking sector restructuring, and to consolidate the results that have already been achieved in this respect. Prudential regulations are to be strictly enforced and, according to the consolidation program, the number of banks (62 by the end-1996 compared to over 100 at end-1995) is to be further reduced through, inter alia, the closing of non-certified banks in an orderly manner. Progress in completing the financial sector restructuring will be monitored, it being one of the structural benchmarks.

The authorities are fully aware that compliance with the program targets for 1997 would be impossible to achieve without the new effort on the fiscal front. In order to attain a more sustainable fiscal position and to reduce the dependence of government finances on external loans and grants, the main objective for 1997 will be to further reduce the overall deficit. According to the preliminary data, the overall deficit of the public sector has fallen from 5.3 percent of GDP in 1995 to 4.5 percent in 1996. It is envisaged that the deficit will further decrease to 2.8 percent of GDP during 1997, while all outstanding arrears as of

January 1, 1997, are expected to be eliminated by year-end, thereby continuing the trend established throughout the first year of the program. Improvement of revenue performance remains an important task for the period ahead, and in addition to the increase in tax collection by 3 percentage points of GDP in 1996 compared to 1995, my authorities would expect a further increase of 2.5 percent in 1997 as a result of numerous improvements in tax and customs administration. On the expenditure side, the tight stance for 1997 will be accompanied by an improvement in the quality of the fiscal adjustment. Further cuts are expected in the number of public sector employees, thus reducing the number by some 40 percent since late 1994, while providing the incentives to recruit and to retain quality staff. This would further contribute towards institution building efforts of my authorities and towards improving the quality of governance in Georgia.

While these efforts have been setting the stage for further healthy growth and a *financially stable economic environment*, there are still numerous challenges ahead for my authorities. They stand prepared to enforce additional measures in case of the emergence of risks that could endanger the comprehensive implementation of the program and they are ready to maintain a continuous working dialogue with the staff in this respect.

