ECONOMIC SECURITY OF GEORGIA: CHALLENGES AND THE BEST WAYS TO ADDRESS THEM

Threats and Challenges for Sustainable Economic Growth project is implemented through the Policy, Advocacy, and Civil Society Development in Georgia (G-PAC) program of East-West Management Institute (EWMI).

This program was made possible by the generous support of the American people through the United States Agency for International Development (USAID).

The contents of this study do not necessarily reflect the views of USAID or the United States Government.
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ACKNOWLEDGEMENTS

We express our gratitude to the National Security Council and Atlantic Council of Georgia for their valuable assistance and cooperation provided in the preparation and completion of this study.
INTRODUCTION

Since July 2011 Economic Policy Research Center has been implementing the project - Threats and Challenges for Sustainable Economic Growth, within the framework of East West Management Institute (EWMI) Policy, Advocacy and Civil Society in Georgia (G-PAC), a four-year initiative funded by USAID, which aims to strengthen civil society's role in advocating for and influencing the development and effective implementation of public policy.

The purpose of this study is to brief the National Security Council of Georgia on major challenges with the greatest potential to hinder economic development of the country and outline the areas for recommendations. National Security Council can serve as a high level authority for facilitating the open and comprehensive policy debate with the relevant state bodies and take a very active part in setting the domestic policy agenda.

In the National Security Concept economic and social challenges facing Georgia are identified as poorly developed economy, lack of competitiveness, decline in education and health care standards, worsening of demographic situation, lack of employment, and high level of poverty. Unequal social and economic development and inexistence of a strong middle class along with regional economic disparities are considered as a potential source for social and political extremism.

For the purpose of overcoming the above challenges, the National Security Concept identifies the multiple policy priority areas, such as strengthening budgetary policy, flexible monetary policy, support to the private sector development, institutional deregulation, SME support, investment and business climate improvement, shortening economic disparities, and creation and implementation of special development programs for mountainous areas. Support of development of agriculture through support land market development and investment climate improvement is also regarded as a priority. In addition, basic infrastructure development, tourism and transit support, and prevention of unfair competition are also stated as priorities. As priorities for social policy, poverty reduction, eradication of extreme poverty and social alienation, support to job creation, establishment of modern education standards, provision of universal primary and secondary education, improvement of higher education, reform of the pension and social security spheres, and reform of the health system are identified.

The above list encompasses almost all the spheres of the economy of Georgia. Unfortunately, meeting the above priorities is a huge task for any country. Instead providing in detail views on the topics above, we are concentrating our efforts on reviewing some of them - the study touches upon the following 3 issues: Macroeconomic Threats and Challenges, Current Stance of Land Market in Georgia, Healthcare as a part of National Security.
I MACROECONOMIC THREATS AND CHALLENGES

1. Purpose of this paper and a framework for policy analysis

The purpose of this paper is to brief the National Security Council of Georgia on major challenges with the greatest potential to hinder economic development of the country and outline the areas for recommendations. National Security Council can serve as a high level authority for facilitating the open and comprehensive policy debate with the relevant state bodies and take a very active part in setting the domestic policy agenda. We carefully reviewed the economic and social challenges statement and priorities for economic and social development outlined by the National Security Council of Georgia in the Concept of National Security Georgia. In addition to the above document, we relied on the provisions of the Organic Law of Georgia on Economic Freedom, enacted on July 1, 2011 (to be active from 2014) defining some key restrictions to government interventions in domestic economic affairs. These restrictions are obligatory ceilings in following three major functional areas: 1) consolidated state budget spending should not exceed 30% of GDP, 2) consolidated budget deficit should not exceed 3% of the GDP, and 3) state debt should not exceed 60% of GDP. In addition, introduction of new taxes except for excise tax is the subject of referendum initiated only by the government of Georgia. In exceptional cases such as recession and war the state budget can exceed the targets above. In addition, the government of Georgia can introduce a new tax for a temporary period, up to 3 years. In such a case referendum is not required. The Law on Economic Freedom defines the general modus operandi of the Georgian government and is a good example of enactment of the principle of minimal involvement of state in economic affairs. We believe that the above law is a serious step forward in institutionalizing the role of the government as a promoter of economic growth. Having said this, we also feel that much more can be achieved in this regard and Georgian authorities could impose much stricter rules on themselves. For example tighter ceiling on government spending to GDP could further promote economic growth.

2. Our approach

We fully share the declared philosophy of Georgian authorities, key values of which are minimum government intervention, primacy of private property and creation of fertile conditions for comprehensive functioning of free market competitive forces. Like any other country, Georgia is also facing multiple difficult problems, especially in light of still undergoing global economic crisis. These problems might pertain to relative underdevelopment of Georgian businesses, lack of modern technologies, properly educated workforce, lack of export base, and etc. We think that a government with liberal policy agenda can still play an important role in economic affairs but only by limiting its role in provision of services otherwise impossible in private sector or possible with much higher social costs.

Economic development is rather lengthy process, in which any government, in the best case scenario can play a role of supporter of growth. In this light, our purpose was to carefully analyze challenges and priorities set out in the National Security Concept on their consistency, reasonability, and achievability in the nearest future. By means of analyzing major threats to the Georgian economy, we outline the major threats that require attention from the high level state body such as National Security Council.

We think that during the past decade the most notable achievement of Georgian economy was substantial and consistent economic growth rate. Anything potentially hindering economic growth deserves attention of the National Security Council. The economic growth can be hindered by unbalanced state budget and rapid growth of state consumption in total consumption, increase of domestic and in particular state external debt, lack of investments in general economy, unemployment, stagnant education and poor health sectors.

3. Review of the National Security Concept and our key focus

In the National Security Concept economic and social challenges facing Georgia are identified as poorly developed economy, lack of competitiveness, decline in education and health care standards, worsening of demographic situation, lack of
employment, and high level of poverty. Unequal social and economic development and inexistence of a strong middle class along with regional economic disparities are considered as a potential source for social and political extremism. For the purpose of overcoming the above challenges, the National Security Concept identifies the multiple policy priority areas, such as strengthening budgetary policy, flexible monetary policy, support to the private sector development, institutional deregulation, SME support, investment and business climate improvement, shortening economic disparities, and creation and implementation of special development programs for mountainous areas. Support of development of agriculture through support land market development and investment climate improvement is also regarded as a priority. In addition, basic infrastructure development, tourism and transit support, and prevention of unfair competition are also stated as priorities. As priorities for social policy, poverty reduction, eradication of extreme poverty and social alienation, support to job creation, establishment of modern education standards, provision of universal primary and secondary education, improvement of higher education, reform of the pension and social security spheres, and reform of the health system are identified.

The above list encompasses almost all the spheres of the economy of Georgia. Unfortunately, meeting the above priorities is a huge task for any country, and especially for Georgia, which is far from the desired standards of living. Instead providing in detail views on the topics above, we are concentrating our efforts on briefing on some of them in light of the Law on Economic freedom. The issues we are concentrating ourselves on are fiscal in nature. Even the issue of inflation is discussed within the realm of the fiscal reality, since as we believe, the monetary policy of the country is reasonably sound and inflation problems are at least somewhat linked to fiscal imbalance.

4. Summary of Economic Threats

The treats to the economy might have multiple sources. The purpose of the chart below is to outline threats that can be positively affected by state and governmental policies. The threats in the figure 1 below are organized based on this principle. We have outlined threats in terms of their severity and urgency from the government to take necessary remedial action or support developments for elimination of the mentioned threats.

Figure 1 Summary of Economic Threats

<table>
<thead>
<tr>
<th>Threat</th>
<th>Degree of Severity</th>
<th>Urgency of Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unbalanced Budget</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increasing Domestic/Foreign Debt</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unemployment/Underemployment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary Education</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Secondary Education</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vocational Education</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Higher Education</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic Health Care</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monetary Policy/Financial Challenges</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food Security</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regional Disparities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income Disparities</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Critically Important
Highly Important
Moderately Important
We think that unbalanced budget poses the highest threat to the economy, especially in conjunction with increasing internal and external debt. The recent global crisis proves this postulate. Countries, with highest state budget deficit, unsound fiscal expenditure policies and large debt stocks, suffer the most from poor economic growth.

Recent economic growth of Georgia has largely been “jobless.” If such a situation continues, substantial portion of working age population will be forced to leave the country to find employment elsewhere.

Basic education is directly linked to employability of the workforce. Basic employment also comprises vocational schooling. Higher education is not discussed here, since we believe that higher education is much less important to job creation than primary and vocational schooling.

Poor health care conditions negatively affect the workforce performance, resulting in frequent illness and increased private and public costs for health care. Unfortunately, in Georgia there is a trend for increase of infectious and chronic diseases, which if not prevented, poses serious risk to the country’s development.

Negative trade balance, inflation, lack of savings, food security, and regional disparities are regarded as relatively moderate threats. All the threats, except for inflation, cannot be treated in the short term period and government’s room for maneuver is necessarily limited in these areas. Only inflation can be affected quickly, although in our opinion, Georgian inflation is largely caused by imported factors and unbalanced budget, not major problems in monetary policy.

5. Analysis of certain economic challenges

5.1 Unbalanced budget

Among the notable achievements of GoG after 2003 is a dramatic stabilization of macroeconomic stance, successful budgetary consolidation, massive and aggressive privatization campaign, substantial success in attracting FDI, and hence
accelerating economic growth rates. As a result of all the above, Georgian economy in general showed a rather healthy development trend during the several past years. The only major disruption to the economy occurred in 2008 as a result of negative consequences of war with Russia and global economic slowdown. Timely assistance from international community and resilient response to the issue by the government of Georgia allowed the economy to recover quickly and steer economy to growth patterns previously enjoyed.

Based on the vast amount of economic literature and declared philosophy of GoG Georgia, we think that the major challenge for the GoG is to maintain the small and efficient size of government operations to support high economic growth rates. In theory, as well as according to empirical literature, the total volume of government operations, reaches its maximum efficiency level at around 13-14 as a percentage of GDP. Afterwards incremental percentage of government consumption as a percentage of GDP results in 0,1-0,4% deceleration of economic growth rate. After budget expenditures reach 30% of GDP, the implications for growth are outright negative.

**Figure 3 Share of Government Consumption in GDP (%)** (www.geostat.ge)

In the Chart #3 above we estimated the share of three pillars of government operations as a share of GDP. The first pillar establishes the ratio of labor remuneration in the state sector to GDP (Gov Cons % GDP 1). The second pillar is the combined share of the first pillar and government expenditures on goods and services (Gov Cons % GDP 2). Third pillar (Gov Cons % GDP 3) denotes the share of total government operations to GDP. As we can see from the chart, the GoG was rather efficient in maintaining control over the first two pillars of expenditures but redistributive function of the government has been increasing much faster that GDP in the recent years. Interestingly, after reaching the threshold of 30% in 2009, it dropped back to 26%. This notwithstanding, it remains to be seen whether the government intends to further downsize its intervention in the economy. The Law on Economic Freedom ties the budget at a maximum of 30% of GDP but does not set the efficient target referred to above. Despite the fact that the law complicates adoption of a budget spending side of which exceeds 30% of GDP, it is maintained that in exceptional cases, such as economic recession, this threshold can be exceeded. We think it is a dangerous provision given the global economic recession and tight pressure on the government to meet the vast social payment obligations.
Figure 4 is drawn from the World Bank dataset and depicts the ratio of total budgetary expenditure dynamics for selected countries for the period of 2003-2009. Unfortunately, Georgia lags behind many countries in this area. Within this dataset, Georgia is probably the only country with a threefold increase of share of the government in the GDP. In the above table, there are countries with reasonably impressive levels of economic development, as well as per capita GDP growth rates. Many of the above countries have much more sophisticated social protection systems than Georgia but still manage to maintain more rigorous fiscal discipline even without formally binding itself by constitutional provisions. The table above demonstrates that successful countries can indeed demonstrate good economic growth without resorting to costly budgetary spendings resulting in extraction of productive resources from the marketplace, displacement of capital and workforce, distortion of incentives and loss of overall efficiency of the economy.

Figure 5 Per Capita GDP and Budget Expenses in GEL (www.geostat.ge)
In the figures #5 and #6 it can be inferred that the per capita budgetary expenses growth rate in Georgia substantially outpaced the growth rate of general economy. Of course, consolidation of state finances contributed tremendously to improvement of rule of law and implementation of infrastructure projects but this notwithstanding, we think that the government operations have been growing unnecessarily fast during the recent years. In addition, only in 3 of past 8 years did the growth rates of budgetary revenues outpace the growth rates of expenditures. This very fact creates additional pressure on public sector since there is a growing need to finance the resulting deficit through domestic and foreign debt.

Figure 7 Economic Growth Rate in Selected Countries (www.worldbank.org)

<table>
<thead>
<tr>
<th>Country Name</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>3.16</td>
<td>4.14</td>
<td>2.84</td>
<td>3.07</td>
<td>3.77</td>
<td>3.73</td>
<td>1.29</td>
<td>N/A</td>
</tr>
<tr>
<td>Brazil</td>
<td>1.15</td>
<td>5.71</td>
<td>3.16</td>
<td>3.96</td>
<td>6.09</td>
<td>5.16</td>
<td>-0.64</td>
<td>7.49</td>
</tr>
<tr>
<td>Canada</td>
<td>1.88</td>
<td>3.12</td>
<td>3.02</td>
<td>2.82</td>
<td>2.20</td>
<td>0.69</td>
<td>-2.77</td>
<td>3.21</td>
</tr>
<tr>
<td>Chile</td>
<td>3.92</td>
<td>6.04</td>
<td>5.56</td>
<td>4.59</td>
<td>4.60</td>
<td>3.66</td>
<td>-1.68</td>
<td>5.20</td>
</tr>
<tr>
<td>Cote d’Ivoire</td>
<td>-1.56</td>
<td>1.79</td>
<td>1.26</td>
<td>0.68</td>
<td>1.71</td>
<td>2.33</td>
<td>3.75</td>
<td>3.01</td>
</tr>
<tr>
<td>Georgia</td>
<td>11.06</td>
<td>5.86</td>
<td>9.60</td>
<td>9.38</td>
<td>12.34</td>
<td>2.31</td>
<td>-3.78</td>
<td>6.37</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>9.30</td>
<td>9.60</td>
<td>9.70</td>
<td>10.70</td>
<td>8.90</td>
<td>3.30</td>
<td>1.20</td>
<td>7.30</td>
</tr>
<tr>
<td>Korea, Rep.</td>
<td>2.80</td>
<td>4.62</td>
<td>3.96</td>
<td>5.18</td>
<td>5.11</td>
<td>2.30</td>
<td>0.32</td>
<td>6.16</td>
</tr>
<tr>
<td>Kyrgyz Republic</td>
<td>7.03</td>
<td>7.03</td>
<td>-0.18</td>
<td>3.10</td>
<td>8.54</td>
<td>8.40</td>
<td>2.89</td>
<td>-1.36</td>
</tr>
<tr>
<td>Mongolia</td>
<td>7.00</td>
<td>10.63</td>
<td>7.25</td>
<td>8.56</td>
<td>10.25</td>
<td>8.90</td>
<td>-1.27</td>
<td>6.37</td>
</tr>
<tr>
<td>Peru</td>
<td>4.03</td>
<td>4.98</td>
<td>6.83</td>
<td>7.74</td>
<td>8.91</td>
<td>9.80</td>
<td>0.84</td>
<td>8.78</td>
</tr>
<tr>
<td>Qatar</td>
<td>3.49</td>
<td>20.84</td>
<td>7.60</td>
<td>18.60</td>
<td>26.75</td>
<td>25.48</td>
<td>8.64</td>
<td>N/A</td>
</tr>
<tr>
<td>Singapore</td>
<td>4.60</td>
<td>9.24</td>
<td>7.38</td>
<td>8.70</td>
<td>8.77</td>
<td>1.49</td>
<td>-0.77</td>
<td>14.47</td>
</tr>
<tr>
<td>Spain</td>
<td>3.10</td>
<td>3.27</td>
<td>3.61</td>
<td>4.02</td>
<td>3.57</td>
<td>0.86</td>
<td>-3.72</td>
<td>-0.14</td>
</tr>
<tr>
<td>United States</td>
<td>2.50</td>
<td>3.59</td>
<td>3.06</td>
<td>2.67</td>
<td>1.94</td>
<td>-0.02</td>
<td>-3.50</td>
<td>3.00</td>
</tr>
</tbody>
</table>
In the figure 7 we present economic growth rates for the selected countries in the period of 2003-2010. As a rule, countries with small share of the state in the economy do considerably better than countries with bigger budget, of course at similar level of development. In addition, the increase of share of state in general economy, in general coincides with decline of economic growth.

**Figure 8 Total National Output and State sector Nominal Output in Thousand GEL**

![Graph showing Total National Output and State sector Nominal Output in Thousand GEL from 1997 to 2011.](image)

**Figure 9 Total National Output and State sector Nominal Output in Thousand GEL**

![Graph showing Growth of Nominal Output and State Sector Nominal Output in percentage from 1997 to 2011.](image)
The figures 8, 9, and 10 clearly demonstrate that increase of state output does not necessarily coincide with the increase of total output of the economy. Interestingly, from 2009 onwards after the international financial crisis, Georgian economy successfully returned to the previous development patterns demonstrating healthy growth rates without increase of state sector output of the correspondent magnitude. In the figure 10 it is very visible that correlation between the growth of nominal output and state sector output is at its highest when state output grows moderately. It must also be said that the 2004-2008 episode is a demonstration of improvement of overall quality of the public goods delivery capacity of the government that reached optimal level in 2008 and should not grow any further. After that marginal contribution of state expenditures to the economic development is either flat or negative. We think prior to 2004 the public sector was so weak in economic life that any attribution of state output growth contribution to overall output increase is great suspect.

After 2004 when large portions of grey economy were brought into the formal one and state acquired necessary accountability, data presented above is quite convincing for inference purposes. They demonstrate that the optimal levels of state consumption are reached in 2007 and there is no need for its further increase. Based on this we suggest, that the share of state expenditures in Georgian economy should first remain unchanged and then gradually decline to some 20% along the natural growth of the general economy.

With the abovementioned we postulate that increase of budgetary expenses is more the product of economic development not its driver. When government expenditure reaches certain level of GDP their marginal benefit inevitably go down. Another dangerous implication of uncontrolled growth of the state sector is accumulation of debt that naturally follows undesired growth of share of state expenditures in GDP.

**5.2 Growth of Domestic/External Debt**

Chart #11 depicts the foreign and domestic debt dynamics as % of GDP. Georgia was rather impressive in bringing debt to tolerable levels. Unfortunately, due to war with Russia, Georgia resorted to massive international assistance resulting in sudden surge of debt level. As of today, the foreign, as well as domestic debt levels are way below the restricted level of 60% of GDP set by the Law on Economic Freedom. Despite this, it will be a serious challenge to keep the debt levels within the manageable margin.
Possible quick and adverse change in international economic conjuncture can deteriorate economic conditions in Georgia and thus complicate the maneuverability of the state to cope with the massive social obligations incurred in budget. In such an adverse scenario the option is to resort to foreign lenders. In such a case the debt can grow quickly and further deteriorate growth prospects. This phenomenon of debt overhang was widely observed in Latin American countries in 70-s of the past century.

The achievement of a “genuine” positive fiscal balance remains a problem for all the Georgian governments since the collapse of the Soviet Union. Genuinely positive fiscal balance is the excess of budgetary revenues over expenditures not taking into consideration the privatization proceeds. Only in 3 years post Rose Revolution managed the Georgian government to maintain overall positive fiscal balance even taking into consideration the privatization proceeds. Currently, the potential for privatization of the state owned enterprises is much more limited than it used to be. Thus, subsequently, if the negative shock to the economy occurs, it will be very hard to the Government to maintain positive fiscal balance without incurring more of the domestic and foreign debt.
Chart #13 depicting some key variables dynamics indicates clearly that the budget is getting more and more burdened by the social obligations. Interestingly, social expense outlays growth rates almost always exceed the growth rates of nominal GDP. Since 2005 there is a very close correlation between the pace of increase of foreign debt and social outlays. This means that that the primary source for the social assistance programs is provided by the foreign debt facility. Plus, increases in social expenses appear to be driven by conjuncture factors and not by the careful planning process. Abrupt swings in this particular category of the budgetary expenditures can create inflationary pressure to the economy and might deteriorate the government’s liquidity position. We fully appreciate the fact that in 2009 sharp increase of social spending was driven by the consequences of the War with Russia and need to meet the requirements of the poor strata of the population. Despite this, bringing more predictability and consistency in this particular area will pose a serious challenge to the GoG and the economy in general.

**Figure 13 Growth Rates of Selected Key Variables (www.geostat.ge)**

![Graph showing growth rates of selected key variables](image)

The table below summarizes major macroeconomic parameters in relation to GDP. It can be said that during the period of 2003-2010 Georgian economic growth was largely consumption driven and was fuelled by FDI and relatively cheap consumption credit. We do not think this is a major problem, since the private sector can react to the adverse external shock by readjustment of its consumption habits by saving more and consuming less. (See above in the topic of the State Consumption).

**Figure 14 Major Economic Parameters against GDP (www.worldbank.org)**

<table>
<thead>
<tr>
<th>GDP</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Household Consumption</td>
<td>71.58%</td>
<td>72.76%</td>
<td>66.43%</td>
<td>78.34%</td>
<td>70.34%</td>
<td>76.45%</td>
<td>81.18%</td>
<td>74.33%</td>
</tr>
<tr>
<td>Final State Consumption</td>
<td>9.76%</td>
<td>14.04%</td>
<td>17.33%</td>
<td>15.34%</td>
<td>21.88%</td>
<td>25.88%</td>
<td>24.46%</td>
<td>21.07%</td>
</tr>
<tr>
<td>Gross Capital Formation</td>
<td>31.32%</td>
<td>31.91%</td>
<td>33.49%</td>
<td>30.86%</td>
<td>32.06%</td>
<td>25.96%</td>
<td>13.03%</td>
<td>21.59%</td>
</tr>
<tr>
<td>Net Exports</td>
<td>-14.58%</td>
<td>-16.63%</td>
<td>-17.82%</td>
<td>-24.15%</td>
<td>-26.74%</td>
<td>-29.78%</td>
<td>-19.19%</td>
<td>-17.81%</td>
</tr>
</tbody>
</table>

Of course, it would be desirable if Georgia relied less on imports and exported more but such a development cannot be accelerated by government policies. In our opinion, an effective measure to induce more savings and export oriented growth would be decrease of external vulnerability of the country stemming from increasing debt.
The figure 15 demonstrates a rather unpleasant development in external debt dynamics. The overall level of the state external debt as compared to GDP is less than limited by the Law on Economic Freedom. This notwithstanding, in the upcoming years it will be a serious challenge for the GoG to stabilize, and in the best case scenario reduce the Debt to GDP level. This will be particularly difficult, if the global economic crisis continues and economic growth rates decelerate both in Georgia and its neighboring countries.

For the upcoming years it will be of crucial importance to limit domestic/external debt levels in accordance with provisions of the Economic Freedom Act. Again, improvement of fiscal discipline and avoidance of unnecessary spending is key to this.

5.3 Unemployment/Underemployment

The puzzling part of Georgian economic performance so far has been stagnant employment. This is rather strange since country attracts investment and wages are growing consistently across the board. This development means that largest portion of Georgian economic growth is induced by investment and capital and not driven by additional employment. This means that over time the relative return on capital decreases resulting in fewer incentives for depositors and investors to invest.
In order to clearly know whether the state sponsored vocational training, job matching and other job creation support services are successful, one should possess advance statistics to match the people employed as a result of vocational training programs to their specialization obtained through the vocational training. Unfortunately, we do not possess such advanced statistics. Moreover, Geostat extracts employment figures, both for hired and self-employed labor, from household surveys. Unfortunately, we think this is not sufficient to clearly know employment tendencies in the country. The information on state governance employment and salaries dynamics, as well as state sector formal employment and salaries dynamics by sectors such as education, health care, and etc should be collected and published regularly. The information on formal employment by sectors of the economy and regions of the country by age and gender should be collected and published regularly. This requires concerted efforts of Geostat and the Ministry of Finance.

The figure above demonstrates that Georgian economy has been rather unsuccessful in job creation. Note that even self-employment figures, which in our opinion contain inflated numbers for agricultural employment, are either stagnant or declining. This automatically excludes the possibility of existence of any successful job creation programs in the past.

The reasons of the abovementioned pattern are very hard to establish. The similarly jobless economic growth patterns are currently being experienced in several large and economically successful countries, such as India, for example. The reasons for jobless growth might be peculiar structure of economy, exchange rate arrangements, effects of globalization, and etc. establishment of reasons for persistent underemployment and unemployment in Georgia are beyond the scope of this paper.

Although, Geostat draws the employment calculation methodology from ILO, and in general, deriving to self-employed figures is methodologically correct, we think that better tracker of employment might be the dynamics of formally employed. These are figures for people who are registered and pay taxes. Then the comparison should be made to the so called self-employed figures. In order to have comprehensive information in this regard it is necessary for the Ministry of Finance to organize the relevant database providing more or less exact data on formal employment by state and private sectors, as well as concrete branches of the economy such as services, industry, and agriculture. In addition, such information can precisely show which regions of the country and more successful in creation of formal jobs.

Due to extreme complexity of the problem it is rather hard to suggest a concrete measure for change of the situation. We think it might be reasonable for the government to try a temporary employment subsidy measure of sorts. The employment subsidy that takes the form of tax relief can be denoted by the following formula: $W_0 \frac{(E_1-E_0)}{\Delta VA}$

Here $W_0$ is the level of wages in a company in a base year

$E_1$ and $E_0$ denote employment figures for year one and the base year

$\Delta VA$ is the incremental value added generated by the company over two years under consideration.

If the above measure works, companies will be more interested to hire extra labor and get tax relief based on formula above.

Of course, the employment subsidy scheme is not a panacea but it might be a good starting point to at least establish the reasons for stagnant employment in the economy. Such a scheme might provide incentives for on-job training and skills improvement for small indigenous businesses. The reason for such a measure is to induce businesses to hire labor instead of installing capital equipment with the same productive capacity. Of course, care should be taken not to allow businesses avoid taxes by means of hiring idle labor but such a subsidy should be only temporary and subject to value added creation. Some employment subsidization schemes have recently been successfully tried in rural areas of Romania.

### 5.4 Education

We indeed agree that education system modernization is a real problem to the country. In light of the widespread underemployment in the country, in our opinion, particular attention should be paid to the primary and secondary schooling, as well as vocational training support.
It is often argued recently, that Georgia lacks the quality cadre the business demands. It is also often said that lack of quality higher education, especially lack of people with advanced technical skills is one of the deterrents to development of modern industries in Georgia. We think that such an argumentation might be flawed. It might be very possible that the economy and business itself cannot utilize the qualities of the available workforce and is engaged in unsustainable activities. The business should utilize the available workforce to its benefit. It can be that Georgian managers and businesses are not qualified and creative enough to use most efficiently what is available. Currently, Georgia is not producing sophisticated machinery and electric devices. To move forward basic improvements of basic technologies are needed in services, agriculture, and other sectors of the economy. We think that relatively cheap labor force that is abundantly available in nowadays Georgia, if provided with adequate on-job training is fully capable to be productive. Thus, accents should be placed not on sophisticated cadre but on supply of literate and diligent workforce with skills to learn on job.

We think that primary driver of the economic growth is primary and secondary education. Substantial amount of economic literature demonstrates rather rigorous correlation between economic growth and primary schooling. The correlation between higher and tertiary education with the economic growth is less clear cut. This is evidently demonstrated in East Asian countries.

Unfortunately, according to the World Bank statistics, Georgia spends much less in relative terms on public primary education than former Soviet Union countries such as Ukraine, and Armenia. In addition, given the very low level of salaries, the profession of a teacher remains to be rather non-prestigious. Quality of public schooling in the country leaves better to desire. The widespread anecdotal evidence indicates that parents in addition to providing formal schooling to their children hire private tutors to supplement school education. The reasons for this might be lack of qualification of teachers, lack of remuneration, lack of physical capacity of schools, and etc. Problem probably lies in the fact that primary education is not linked to the requirements of higher education and market. The improvement of financing of the primary schooling system should be focused on improvement of quality of numeracy and literacy skills of the pupils. Namely good literacy and numeracy skills are necessary for quality work force for the country that is transiting from the resources based to efficiency based growth model.

Figure 17 Wages in Different Sectors of the Economy (www.geostat.ge)

<table>
<thead>
<tr>
<th>Wages in State and Private Sectors in GEL</th>
<th>State</th>
<th>Private</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sector</strong></td>
<td>2009</td>
<td>2010</td>
</tr>
<tr>
<td>Agriculture, Hunting, and Forestry</td>
<td>270.7</td>
<td>293.2</td>
</tr>
<tr>
<td>Fishery</td>
<td>129.2</td>
<td>119.6</td>
</tr>
<tr>
<td>Mining</td>
<td>2438.1</td>
<td>2615.2</td>
</tr>
<tr>
<td>Processing Industry</td>
<td>303.8</td>
<td>526.9</td>
</tr>
<tr>
<td>Production and Distribution of Water and Gas</td>
<td>634.3</td>
<td>688.9</td>
</tr>
<tr>
<td>Construction</td>
<td>279.4</td>
<td>323.6</td>
</tr>
<tr>
<td>Trade, repair of cars, equipment and subjects of personal consumption</td>
<td>985.8</td>
<td>1014.1</td>
</tr>
<tr>
<td>Hotels and Restaurants</td>
<td>571.2</td>
<td>204.2</td>
</tr>
<tr>
<td>Transport and Communication</td>
<td>605.3</td>
<td>619.2</td>
</tr>
<tr>
<td>Financial Intermediation</td>
<td>2258.9</td>
<td>2633.6</td>
</tr>
<tr>
<td>Operations with Real Property, Leasing and Services to Customers</td>
<td>363.5</td>
<td>348.5</td>
</tr>
<tr>
<td>State Governance</td>
<td>888.8</td>
<td>973.0</td>
</tr>
<tr>
<td>Education</td>
<td><strong>265.6</strong></td>
<td><strong>299.5</strong></td>
</tr>
<tr>
<td>Health Care and Social protection</td>
<td>336.2</td>
<td>398.4</td>
</tr>
<tr>
<td>Communal, Social, and Personal Services</td>
<td>350.4</td>
<td>373.8</td>
</tr>
</tbody>
</table>
As it can be seen from the table above, remuneration of the education sector employee is among the lowest in all the sectors of the economy. Of course, this trend is to be changed if we are to attract the best cadre in the sphere of education. We appreciate various incentive schemes being developed by the GoG in primary education, but still think that given the levels of wages in education, achievement of serious results will be extremely difficult. We also suggest that at least 4% of GDP should be secure for education to guarantee consistent and quality economic growth, as demonstrated by empirical evidence from many countries. **In addition, to schooling, a particular emphasis should be placed on training programs and vocational education as prerequisites to improvement of employment situation in medium to long term. It should be understood that such a policy measure is lengthy in time and cannot generate quick results.**

### 5.5 Health

Health, in our opinion is the most important area, which, if not addressed properly can possess the serious threats to the development of the country. Despite the undergoing health care sector reform, we think that the situation with regard to some chronic diseases is worrisome in Georgia. It is often indicated by the official sources, including Geostat, that increase in number of diseases is largely related to increasing number of recorded applications to doctors. We reviewed the growth number of applications to the doctor and draw the conclusion that the increase rates of certain chronic diseases, especially among children is increasing at a faster rate.

**Figure 18 Morbidity of Children (0-14 years old) with acute and chronic diseases by main disease group (www.geostat.ge)**

<table>
<thead>
<tr>
<th>Disease Category</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009**</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of registered cases diagnosed for the first time, thsd. cases</td>
<td>144.9</td>
<td>154.2</td>
<td>190.2</td>
<td>221.1</td>
<td>237.3</td>
<td>258.3</td>
<td>276.2</td>
<td>273.0</td>
<td>276.9</td>
<td>394.1</td>
<td>387.1</td>
</tr>
<tr>
<td>- Specific diseases</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Certain infectious and parasitic diseases</td>
<td>15.3</td>
<td>22.6</td>
<td>23.2</td>
<td>24.1</td>
<td>32.6</td>
<td>31.3</td>
<td>22.2</td>
<td>25.1</td>
<td>25.1</td>
<td>34.6</td>
<td>39.3</td>
</tr>
<tr>
<td>Neoplasms</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
<td>0.2</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td>Diseases of the blood and blood-forming organs and certain disorders involving the immune system</td>
<td>2.9</td>
<td>3.8</td>
<td>4.0</td>
<td>3.7</td>
<td>4.8</td>
<td>5.0</td>
<td>4.4</td>
<td>4.9</td>
<td>5.7</td>
<td>10.3</td>
<td>10.1</td>
</tr>
<tr>
<td>Endocrine, nutritional and metabolic diseases</td>
<td>11.9</td>
<td>9.5</td>
<td>9.5</td>
<td>8.0</td>
<td>6.6</td>
<td>7.9</td>
<td>6.4</td>
<td>5.6</td>
<td>5.3</td>
<td>8.0</td>
<td>6.4</td>
</tr>
<tr>
<td>Mental and behavioural disorders</td>
<td>0.6</td>
<td>0.6</td>
<td>1.0</td>
<td>1.0</td>
<td>1.3</td>
<td>1.6</td>
<td>1.3</td>
<td>1.4</td>
<td>1.5</td>
<td>1.3</td>
<td>0.4</td>
</tr>
<tr>
<td>Diseases of the nervous system and sense organs</td>
<td>11.0</td>
<td>10.6</td>
<td>12.7</td>
<td>13.6</td>
<td>15.7</td>
<td>18.5</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Diseases of the nervous system*</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>8.1</td>
<td>6.6</td>
<td>6.3</td>
<td>13.1</td>
<td>11.4</td>
<td>...</td>
</tr>
<tr>
<td>Diseases of the eye and adnexa*</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>7.4</td>
<td>7.5</td>
<td>8.6</td>
<td>10.4</td>
<td>9.7</td>
<td>...</td>
</tr>
<tr>
<td>Diseases of the ear and mastoid process*</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>5.9</td>
<td>6.6</td>
<td>6.9</td>
<td>11.6</td>
<td>10.6</td>
<td>...</td>
</tr>
<tr>
<td>Diseases of the circulatory system</td>
<td>1.2</td>
<td>1.2</td>
<td>1.3</td>
<td>1.7</td>
<td>1.6</td>
<td>1.6</td>
<td>1.7</td>
<td>1.2</td>
<td>1.3</td>
<td>1.4</td>
<td>1.1</td>
</tr>
<tr>
<td>Diseases of the respiratory system</td>
<td>76.5</td>
<td>80.0</td>
<td>105.7</td>
<td>137.1</td>
<td>139.3</td>
<td>151.5</td>
<td>182.8</td>
<td>169.8</td>
<td>169.8</td>
<td>246.6</td>
<td>244.4</td>
</tr>
<tr>
<td>Diseases of the digestive system</td>
<td>6.0</td>
<td>7.1</td>
<td>10.2</td>
<td>6.8</td>
<td>8.1</td>
<td>12.6</td>
<td>9.6</td>
<td>17.9</td>
<td>16.9</td>
<td>19.0</td>
<td>17.3</td>
</tr>
<tr>
<td>Diseases of the skin and subcutaneous tissue</td>
<td>7.0</td>
<td>5.6</td>
<td>6.8</td>
<td>9.7</td>
<td>10.0</td>
<td>10.7</td>
<td>9.7</td>
<td>10.7</td>
<td>10.5</td>
<td>14.7</td>
<td>14</td>
</tr>
<tr>
<td>Diseases of the musculoskeletal system and connective tissue</td>
<td>0.6</td>
<td>0.6</td>
<td>0.6</td>
<td>0.7</td>
<td>0.8</td>
<td>1.1</td>
<td>0.7</td>
<td>1.7</td>
<td>2.2</td>
<td>2.4</td>
<td>1.9</td>
</tr>
<tr>
<td>Diseases of the genitourinary system</td>
<td>3.2</td>
<td>3.2</td>
<td>3.9</td>
<td>4.1</td>
<td>4.7</td>
<td>4.9</td>
<td>4.1</td>
<td>3.6</td>
<td>3.9</td>
<td>6.2</td>
<td>5.6</td>
</tr>
<tr>
<td>Pregnancy, childbirth and the puerperium</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Certain conditions originating in the perinatal period</td>
<td>2.1</td>
<td>2.1</td>
<td>2.1</td>
<td>2.3</td>
<td>2.5</td>
<td>2.5</td>
<td>2.0</td>
<td>1.9</td>
<td>2.1</td>
<td>1.9</td>
<td>2.2</td>
</tr>
<tr>
<td>Congenital malformations, deformations and chromosomal abnormalities</td>
<td>1.0</td>
<td>0.9</td>
<td>1.0</td>
<td>0.9</td>
<td>1.0</td>
<td>0.9</td>
<td>1.1</td>
<td>1.1</td>
<td>1.3</td>
<td>1.4</td>
<td>1.9</td>
</tr>
<tr>
<td>Symptoms, signs and abnormal clinical and laboratory findings, not elsewhere classified</td>
<td>1.1</td>
<td>1.3</td>
<td>1.2</td>
<td>1.2</td>
<td>1.3</td>
<td>1.3</td>
<td>1.2</td>
<td>1.3</td>
<td>1.3</td>
<td>2.4</td>
<td>3.8</td>
</tr>
<tr>
<td>Injury, poisoning and certain other consequences of external causes</td>
<td>4.4</td>
<td>5.0</td>
<td>6.9</td>
<td>6.1</td>
<td>6.9</td>
<td>6.8</td>
<td>6.8</td>
<td>6.3</td>
<td>7.0</td>
<td>7.2</td>
<td>7.3</td>
</tr>
</tbody>
</table>
From the tables above it appears that the diseases are steadily growing for almost all the categories presented in the tables. The incidence of diseases above has very negative implications on health of the work force, and hence to medium and long term growth prospects of a country.

In this regard we propose substantial reallocation of budgetary expenditures to basic health protection in the areas as indicated above. Do not spend on state programs to “stimulate” the economy. Plus, it can be worthwhile to think of spending more on basic health care instead of cash transfers to vulnerable. Cash transfers can be made conditional on examination for say dangerous basic diseases.

5.6 Monetary policy related challenges

Monetary policy has been rather consistent and strong in Georgia since introduction of the National currency. Only in a few episodes coinciding with the global financial crisis, the exchange rate experienced substantial loss in value. Georgian banking sector still remains somewhat underdeveloped but, in general, the trend is rather positive and financial sector is gradually improving both in terms of attracting new deposits and enhancing its loan coverage of the general economy.

It is often said that interest rates are so high in Georgia that businesses can not afford them. We think that access to finance is not that acute of a problem. Yes, it would be desirable to have somewhat lower interest rates on loans but interest rates on loans reflect true social scarcity of capital in Georgia and over time they develop a rather healthy declining trend.

Georgian economic growth did not suffer from perceived high interest rates. The problem in our opinion is somewhat sluggish trend in growth of deposit volumes, which might be related to inflation and negative government savings. Usually, the latter proves to be the biggest disincentive to save in developing countries. It is interesting to note that though still high, the interest rate spread declines rather consistently over time.

The permanent inflationary pressure seriously reduces incentives of population to save. As it can be seen from the chart below, in three episodes during 2003-2010 the real interest rate on deposits was negative, in such circumstances it is rather hard to hope for little spread. The banks are forced to supplement the lack of deposit base from abroad (so called on lending) and take into consideration the risks associated with the small deposit rates into the rates on loans.
Georgia's economy is rather small and number of large scale firms is very limited. Thus, the banks cannot always lend to big scale firms. This, in relative terms, substantially increases their costs of obtaining information and monitoring the loan performance. In addition, incomes of Georgians are not so high as to allow having large deposits in the banking sector. The customer loans also happen to be small resulting in relatively high monitoring costs. Last but not the list, the Georgian market size is still small and banking sector is forced to account for this factor in determining the interest rates on loans. Thus, Georgia is suffering from triple inefficiency related to small market size, small customer base, and small size of loans. These problems can be solved gradually along with maturation of Georgian economy.

Had the interest rates been inadequately high, the ratio of bank loans to GDP would not have grown faster than ratio of total deposits to GDP. It was only in 2009-10 period when Georgian banking sector suffered a major setback caused by global contraction. Otherwise, the banking sector grows at a satisfactory rate. Having said this, it should be born in mind than subsequent marginal growth in loans and deposits might be more difficult to achieve. In developing countries, loans to the general economy might represent 100% and more of GDP. Georgia still has covered a considerable distance to become deeply liquid market allowing the economy to finance large scale projects. This notwithstanding, we think that current monetary policy should continue in the future and contribute to gradual deepening of Georgia financial market.
Figure 22 Monetary Policy Variables and GDP (www.nbg.ge)

<table>
<thead>
<tr>
<th>Date</th>
<th>Currency in Circulation GEL</th>
<th>Reserve Money GEL</th>
<th>M3 GEL</th>
<th>M2 GEL</th>
<th>M1 GEL</th>
<th>Cash outside the banking sector (M0) GEL</th>
<th>GDP GEL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan-00</td>
<td>245.43</td>
<td>298.00</td>
<td>426.89</td>
<td>268.68</td>
<td>261.44</td>
<td>227.52</td>
<td>5,669</td>
</tr>
<tr>
<td>Jan-01</td>
<td>306.33</td>
<td>368.77</td>
<td>591.00</td>
<td>345.77</td>
<td>339.56</td>
<td>290.25</td>
<td>6,043</td>
</tr>
<tr>
<td>Jan-02</td>
<td>361.84</td>
<td>433.01</td>
<td>741.06</td>
<td>401.13</td>
<td>392.04</td>
<td>344.64</td>
<td>6,674</td>
</tr>
<tr>
<td>Jan-03</td>
<td>394.83</td>
<td>495.63</td>
<td>885.18</td>
<td>449.56</td>
<td>439.15</td>
<td>365.06</td>
<td>7,456</td>
</tr>
<tr>
<td>Jan-04</td>
<td>443.54</td>
<td>562.83</td>
<td>1092.70</td>
<td>513.56</td>
<td>501.91</td>
<td>416.33</td>
<td>8,564</td>
</tr>
<tr>
<td>Jan-05</td>
<td>634.17</td>
<td>802.54</td>
<td>1443.56</td>
<td>787.58</td>
<td>759.22</td>
<td>577.77</td>
<td>9,824</td>
</tr>
<tr>
<td>Jan-06</td>
<td>752.83</td>
<td>989.15</td>
<td>1956.06</td>
<td>1055.54</td>
<td>976.37</td>
<td>685.80</td>
<td>11,621</td>
</tr>
<tr>
<td>Jan-07</td>
<td>838.39</td>
<td>1236.05</td>
<td>2613.99</td>
<td>1304.14</td>
<td>1211.05</td>
<td>743.86</td>
<td>13,790</td>
</tr>
<tr>
<td>Jan-08</td>
<td>1191.85</td>
<td>1628.39</td>
<td>4056.92</td>
<td>2047.75</td>
<td>1784.31</td>
<td>1045.93</td>
<td>16,994</td>
</tr>
<tr>
<td>Jan-09</td>
<td>1170.74</td>
<td>1509.85</td>
<td>4045.25</td>
<td>1721.40</td>
<td>1510.31</td>
<td>996.27</td>
<td>19,075</td>
</tr>
<tr>
<td>Jan-10</td>
<td>1357.69</td>
<td>1713.54</td>
<td>4635.12</td>
<td>2026.74</td>
<td>1753.12</td>
<td>1132.68</td>
<td>17,986</td>
</tr>
<tr>
<td>Jan-11</td>
<td>1474.97</td>
<td>2226.10</td>
<td>6074.71</td>
<td>2568.90</td>
<td>2151.10</td>
<td>1248.36</td>
<td>20,743</td>
</tr>
<tr>
<td>Jan-12</td>
<td>1565.83</td>
<td>2780.44</td>
<td>6808.39</td>
<td>3646.71</td>
<td>3027.89</td>
<td>1308.17</td>
<td>24,229</td>
</tr>
</tbody>
</table>

The emissions represented by currency in circulation increase gradually over time slightly surpassing the GDP growth rate. This is a fairly normal trend and demonstrates gradual growth of trust in national currency. Even during the crisis years of 2008-09 the monetary policy remained sound, which is demonstrated by ratio of M1, M2, and M3 parameters to nominal GDP. The latter indicators experienced substantial decrease as a percentage of GDP in 2009 but rebounded strongly along with stabilization of the situation.

Another important indicator of soundness of the monetary policy and strengthening of quality of Georgian institutions is favorable dynamics of so called contract intensive money. In economic literature this is defined as the ratio of difference between M2 and cash outside banking sector to M2 itself ((M2-cash)/M2). It is claimed that in unstable environment with unsound monetary policies and low trust to institutions such as government agencies and judiciary, large amount of economic transactions are undertaken by means of cash. In Georgia of late relatively less and less transactions are undertaken in cash and economic agents trust formal banking sector more and more. The chart below clearly demonstrates this pattern for both of M2 and M3 monetary aggregates.

Figure 23 Contract Intensive Money Dynamics in 2000-2010 (www.nbg.ge)
Georgia’s contract intensive money dynamics are quite favorable and demonstrate a healthy increase of trust in monetary and enforcing institutions of the government. Taking into consideration the above, we think that monetary policy and banking is not a constraint to development of Georgian economy. This notwithstanding, we think that the government and banking sector can do something to increase the deposit base and reduce reliance on international sources of financing, which of late prove to be rather volatile.

In order to encourage savings, the major economic player, the government must demonstrate that it could consistently end the fiscal year with a positive balance. Unfortunately, this is an unresolved challenge still.

Georgia receives around 1 billion USD from abroad by means of remittances. These sums serve a vital function of smoothing out the consumption for the socially vulnerable groups of population but unfortunately, they rarely reach the banking system to supplement the deposits. Encouraging remittance recipients to save shall be a great opportunity to help Georgian banks mobilize more savings and expand loans. According to the study by EBRD majority of remittance recipients, 46% are aged 35 to 49 therefore they are participants of active labor force with the potential of starting up a new business, plus they have positive opinion on the Georgian banking sector.

The government can try raising capital through various public-private partnership schemes by issuing so-called Diaspora bonds. A number of developing countries have done so and have succeeded. The system works as follows: government issues bonds in various denominations (starting from small amount like 100 USD) and markets them to emigrants in more developed countries, they should yield higher earns than bank deposits in their countries of residence. The money raised through these bonds is used to finance important infrastructure, social or economic aspects in developing countries to increase standards of living of the local population. The programs have been successful in many countries (Israel and India). This scheme can substantially enhance the saving stimuli for the general population and engage the banking sector.

Since remittances are only private funds measures taken to enhance their development potential should be only in the form of incentives, such as for example making transfer process less costly, more accessible and safe. Since informal channels are cheaper, easier to use and provide anonymity, promoting usage of formal channels is of importance. Incentives could be in the forms of enjoying financial products savings accounts, loans, mortgages, and credit lines. It is important to increase financial literacy, promote financial services, make them appealing for remittance receivers, enhancing modern technologies in the forms of mobile banking, and penetrating financial institutions in the regions.

5.7 Food Price Inflation and Food Security

There is a considerable debate among economists as to whether the recent global food crisis was caused by fuel price inflation, speculation or fundamental mismatches between global food supply and demand. There is no consensus on the issue but nevertheless, it captures the policy debate spotlight. Along with acute spikes in food prices, their link with major social instability is being discussed among the policymakers. Preoccupation of any country with abruptly rising food prices is fully understandable but it should be noted that there are many countries globally, which rely almost exclusively reliant on imports of basic foodstuffs and yet do not face either economic or political complications.
The chart above demonstrates that Georgia becomes more and more reliant on food imports. At the first glance this might seem worrisome, but in our opinion, Georgian food external trade situation reflects the country’s openness and gradual integration into the world economy. Major part of the food deficit falls on cereals and meat product. Definitely, if would be very desirable to produce the mentioned products in enough quantities domestically but the theory of international trade demonstrates that it is neither always possible nor desirable. From 2010 onwards Georgian food imports, in our opinion, will acquire the stabilization trend. We think that the physical volume of staple food imports cannot grow indefinitely. Plus, current high prices on staple food are already increasing interest in agriculture, which eventually will lead to more production and hence, lower prices. In general, the prices on staple foodstuffs will remain high but not as high as in peak 2008-2009 years. Given that recent sharp increase in import is largely due to price increases, we assume that food import trends will acquire more stable trend. Along the way of economic development, Georgia will gradually produce more meat and cereals but hardly in quantities that would fully satisfy the country’s needs. On the other hand, the exports of high value added agriculture goods such as herbs, nuts, and niche products will go up to counterbalance the deficit in trade of basic foodstuffs.

If food security is understood as full or almost full availability of staple foodstuffs for Georgian citizen within the country, it can be said outright that it is neither practically achievable nor economically desirable. According to internationally accepted definition, food security is availability of food and one’s access to it. Thus, it is not necessary for every country to produce all the foodstuffs. Rather, the focus is on political and legal framework that allows citizens of the country to have access to foodstuffs be they imported and locally produced. The Nobel Prize winner economist, Amartya Sen observes that “there is no such thing as apolitical food problem.” Luckily, Georgia does not have problems of dictatorship and kleptocracy, massive eviction of people from land, and other forms of oppression.

In European Union countries after the Second World War the problem of provision of enough food was acute. This problem led to establishment of complex system of food subsidization that is currently undertaken within the auspices of Common Agricultural Policy. In our opinion, this particular mechanism and other subsidization policies applied elsewhere in developed world is inefficient and unsustainable resulting in global distortion of price signals, resource allocation, and hence consumption patterns. Georgia should by all means avoid this policy, which in addition to its theoretical weakness, is not practically implementable in Georgian context.

Georgia simply does not have competitive advantage in producing wheat, meat or even maize. According to the World Bank International Development Indicators database for 2011, Georgia stands at 154th place among 234 countries and territories in terms of availability of arable land per capita. Availability of arable land is absolutely necessary, although not sufficient, precondition for having competitive edge at producing of basic foodstuffs. Georgia has 0.11 hectares per capita, almost half of the global 0.21. Not surprisingly, we have to rely on imports of basic foodstuffs.
In general, food security rests on three pillars of availability, accessibility, and affordability. Interestingly, according to the Special Report of the Economist on Agriculture in 2011, currently, approximately 1 billion people are suffering from obesity globally and approximately the same number of people is suffering from famine and malnutrition. From the Second World War onwards, food security has almost never been the issue of availability and production volumes; it had always been the issue of accessibility and affordability. Interestingly, the most acute spans of severe famine in Bangladesh in 1970-s occurred precisely when the food stocks were at their highest following the bad year when harvest was low. The problem was the holders hid their stocks of food from potential buyers hoping to gain high price later. In principle, the problem of food security is more a problem of inefficiency or regulations rather than market incentives. Despite the fact that Georgia imports staple food, its accessibility and affordability has never been a problem of the recently, since it is rich enough to afford it and concentrate on production of goods and services with higher unit value added. Georgia does not face a problem of accessibility to food or a large threat of famine. Even in early 90-s of the past century, Georgia was able to avoid this despite massive collapse of the economy and civil war. As to the concrete measures to improve affordability of staple foodstuffs we would recommend to completely abandon import tariffs on them. Currently, Georgia retains 5% and 12% tariffs on imported food. We think that removal of these tariffs will somewhat alleviate the problem of high prices and the relevant loss from the fiscal side will be less than that. Allocation of food vouchers to people is not an efficient measure, since it is impossible to certainly know exact consumption preference of each individual recipient of food vouchers. If the government still decides to undertake compensatory policy actions, it is much more desirable to allocate to socially vulnerable strata of population direct cash payments that are equal to or are slightly less than a face value of food vouchers.

In Georgia, the market is rather liberalized and there is no need in artificially controlling the food prices. In only very rare circumstances should the government deliver some food vouchers to vulnerable for a very limited time till prices goes down. It should be remembered that globally there is a large amount of underutilized food production capacity caused by inefficient and irrational regulations related to subsidization of production and artificial tariff and non tariff barriers in international trade. If the food prices get high enough, the response from the global suppliers will be rather quick and the prices get back to their normal course. Of course, in the near future the humankind has probably to accept the higher prices on food but this serve as additional impetus for using underutilized global production capacity. In fact, somewhat higher staple food prices can stimulate domestic production in Georgia and flow of capital into the sector.

As a direct illustration you can see the below chart that demonstrates the monthly food price inflation for each of 2008, 2009, 2010, and 2011. January 2008 is taken as a baseline. In 2008-09 periods the food prices were relatively stable. They experienced a major spike in September-December 2010 but returned to a stable, even somewhat declining trend from August 2011 onwards. We think this is a very natural development and there is no need for cardinal intervention form the side of the government.

Figure 25 Monthly Food price inflation in Georgia for 2008-11 (www.geostat.ge)
In the below chart on ratio of unit value of Georgian food exports to imports it can easily be seen that Georgia has very sharply visible comparative advantage in production of fruits and higher value vegetables. Despite the fact that Georgia imports almost four times as much agriculture produce as it exports, the chart below is very suggestive as to what policy measures are to and are not be undertaken to maximize the benefits to the Georgian economy. Namely, in order to boost production in areas of competitive advantages the government should be doing the following:

1. Support to agriculture research and technology development and transfer to producers;
2. Securing property rights and undertaking measures to help access to finance;
3. Improve overall standards of education and extension services in agriculture sector;

![Figure 26 Unit Values of Georgian Agricultural Exports/Imports (www.geostat.ge)](image)

As to what the government should not be doing, can be traced in the following tables depicting Georgia’s corn import and exports in 2000-2011. We think that the current governmental programs promoting wheat and corn production are also fruitless at best. Costs of wheat production are much higher in Georgia than global average and corn production costs only rarely drop slightly below global average. Simply, in the country, in our opinion, there is no need to produce more corn since there is no large scale domestic food industry capacity to absorb it. Export is also problematic since Georgia simply cannot produce corn at a cheaper cost than land abundant countries, in which almost no farm pursues maize on plots of less than 50 hectares. Such large plots are extremely rare in Georgia.

The figure 23 demonstrates that precisely when the government decided to “help” production of corn, the situation became dramatically worse. In 2011 Georgia imported record amount of corn seed only because to record the worst net export figures for 12 years under consideration.
In the figure 24 it is sharply visible that not only monetary volume corn net exports worsened but also physical volume of production suffered substantially.

Figure 28 clearly indicates that Georgia might have only marginally competitive position in corn production, only in exceptionally good years. Thus, attempts to artificially boost production of selective crops are bound to failure and only result in dilution of scarce resources.
We do not think that development of import substitution measures is either practical or desirable in conjunction to food security. Georgia is committed to WTO rules and pursues very low tariff policy on foodstuffs. Increase of bind tariffs would be a violation of the WTO rules. Another macroeconomic measure targeted at reduction of foreign trade deficit might be the devaluation of currency. This is not an option since it is potentially related to severe complications related to inflation, erosion of banking sector, real wages and incomes of people, and etc.

Neither do we agree with the government approach to bring more tractors to the country and subsidize the agricultural operations by means of vouchers and fuel price subsidies undertaken at various times. The stagnant level of agricultural production demonstrates that these measures are fruitless, if not harmful, at best. In our opinion, however harsh it might sound, a farmer who cannot accept 30 Lari to plough its plot, is not to be given a voucher. Instead, social strata like this should be a subject to social assistance.

According to the WB data, in 2007 in Georgia much more tractors were available per 100 square miles of arable land than in Armenia, Azerbaijan, Belarus, Bulgaria, Romania, Turkey, and Ukraine. Yet, value added per agricultural worker was much less as in Armenia, Bulgaria, Belarus, Turkey, and Ukraine. Thus, availability of cheap equipment and agricultural inputs are not always related to growth of productivity.

Georgian agricultural sector has a serious problem stemming from rather chaotic land privatization process started in 1992. That measure saved the country from social unrest, but on the other hand land became available to all categories of population not quite interested in agriculture. On average, a holding in Georgia rarely exceeds 1.5 hectares. In such circumstances, especially for annual plots, it is nearly impossible to think of serious increase of agricultural production. In addition, the quality of land ownership is largely poor. Namely, the land certificates given to people during the land registration programs funded by donors are not accepted by the current legislation. The landholders have to anew register their holdings, which results in costs that might sometimes be equal to market value of the holding. Disperse and small size of plots results in lack of interest from banking sector and serious capital almost never flows to the sectors. In 2010 only approximately 1% of bank loans went to agriculture. This is absolutely insufficient for the development of the sector.
It should also be noted that despite the fact that formally employment and self employment in agriculture is measures correctly by Geostat, Georgian agriculture simply does not give jobs to half of the workforce. It is simply impossible that approximately 750-800 thousand people accept stagnant or declining incomes throughout many years, when other sectors of the economy are booming. The government policies should be concentrated not on subsidizing fuel, inputs and equipment, but rather finding ways to create off-farm employment for people who are regarded as agriculture employees by the official statistics. We think that without serious support improvement of property rights on land, land consolidation rehabilitation of infrastructure agriculture sector will continue to be stagnant. In order to support the long-term development of agriculture the GoG should undertake the following measures: stop undertaking equipment, fuel, inputs, and production subsidization measures; conduct a serious, deep study on competitive advantages of Georgian agriculture to see the sub sectors in which country has perspectives; conduct the comprehensive agricultural census that will demonstrate major trends in sector since 2004; Assess the quality of land property rights, assess the quality of state and donor sponsored land privatization programs and design action plan for improvement of property rights quality and land consolidation; Link the above with the regional development plans comprising irrigation, drainage, and major infrastructure rehabilitation plans.

In the upcoming years the government should avoid unnecessary involvement in production process. Rather, further liberalization of external trade barriers combined with support to land market development and access to finance should be used as tools to growth of food output in the country.

5.8 Regional disparities

The charts #30, 31, and 32 present the picture of economic activity level dynamics in Tbilisi and other regions of Georgia. The foundations for economic growth indeed vary across the board and disparity in relative level of development is indeed present. During the period of 2007-09 available capital stock increased in Tbilisi considerably faster than in all the other regions of the country.

Figure 30 Fixed Capital per Capita in Thousand Gel (www.geostat.ge)

Currently, Tbilisi, with approximately $\frac{1}{4}$ of the total population contributes to approximately 70% of value added generated by the enterprises.
Interestingly, the 2008-2009 crisis was overcome rather easily by the economy in the capital city of the country. The rest of it experienced sharp decline with a one year lag. A major tourism region of the country, Adjara experienced considerable decline in 2010. It appears from the regional data that Tbilisi more and more dominates the economic landscape of Georgia. This might be a consequence of a natural, evolutionary change in structure of the economy but also it might pose a serious challenge for the country in case if the capital city can not generate enough job places to accommodate workforce from the regions. In such a case large number of population might live the country. Having said this it must be assessed whether the government’s fiscal policy adequately deals with the problem given very scarce resources at its disposal. Especially the productivity of so called equilising transfers from the central budget should be studied carefully. It can be recommended to consider the possibility of raisin finance at the municipalities level. Large cities of Georgia such as Tbilisi, Kutaisi, Rustavi, and Batumi, in our opinion, have enough property taxable base to raise capital for local needs. Such a measure can naturally draw idle rural population to urban centers and create new economic activities.

Interestingly, comparison of regional GDP figures gives somewhat equal figures among the region. This indicates that the central government sponsored policy of transfer of budgetary funds alleviates the problems somewhat.

The charts on disparities of relative levels of economic development among the regions clearly indicate that these can not be overcome in the short and medium term. The best government can do is continue basic infrastructure rehabilitation programs more specifically targeted at the regional needs. In this regard, we propose to examine the regional infrastructure projects currently underway in the country and provide recommendations on their adequate size and efficiency.
It should also be said that regional development policy in Georgia is rather situational and places disproportionately bigger attention on particular regions as compared to others. For example, up until recently the big cities of Rustavi and Kutaisi deserved considerable less attention from the state than say Signaghi and Batumi. In general, we think the role of tourism in Georgia’s economic development is overemphasized. Tourism, as such, is rather import intensive, and volatile source of income for the country to rely upon. The recent example of Greece would suffice.

We think that the government can think of schemes to encourage local governments in the regions to raise their own sources to local infrastructure development rather than to rely on sources from the center. In former socialists countries the municipalities can already issue their bonds for financing of infrastructure projects. We think that the property tax base to back such a measure is enough in big cities of the country.

In addition, we think that urgent conduct of the full scale population census is of extreme importance. It is visible that since 2002 many major characteristics of the country have changed and mobility of population reached levels that makes it impossible to continue successful economic and social policy relying on obsolete data.

5.9 On Coherence of the Government Policy

Georgia lacks coherent economic policy framework. Previously, EPRC wrote extensively about the Government policy initiatives such as creation of extra budgetary funds to support economic development, creation of financial center in Georgia, 100 enterprises and cheap credit. None of these, in our opinion, proved to be successful, since the results simply are not there. The newly introduced 10 point plan of Georgian government also suffers from serious conceptual flaws.

First of all, the government’s anticipation of GDP growth is much overestimated. Neither World Bank nor IMF predict the growth rates for Georgia that allow for increase of GDP per capita by 60-90% percent by 2015, even in PPP terms. The government declares that in case of exacerbation of the global crisis, the growth rates are anticipated to drop to 0-3% for 2012-2014. In such a case, the whole concept of rapid modernization loses its appeal and the role of the government becomes rather vague.

Unfortunately, the government still places high hopes on obsolete idea of free economic zones. We wrote previously that such a measure does not make much sense in already liberalized economy and we cannot anticipate much of the impact from it. The wording justifying creation of a partnership fund accentuates on necessity for state participation in projects that cannot be managed by private sector due to starting conditions and risks. This is a strange statement for a country that enjoys rather favorable investment climate. Georgian government has to simply continue the course of support to FDI and maintain liberal taxation regime. Georgia is a part of integrated world and it has to compete with other countries to attract capital. To be more attractive, Georgia should be working more on improvement of vocational and primary education standards to make its labor force more productive and interesting to local and international investors.

The government places a due accent on development of a transit and transportation corridor function of the country. Role of the state in this area is rather hard to overestimate. When it relates to agriculture though, the position of the government appears not so well grounded. It is not clear why the government thinks that it is necessary to increase the exports of certain crops and not others. Very little attention is devoted to land market development and role of the government as a supporter of physical and market infrastructure in agriculture. The concept of rural development is missing altogether.

Instead, the focus must be placed on measures to allow capital access rural production areas. By this we mean improvement of physical rural infrastructure, such as roads, irrigation, and drainage and development of land market by means of land parcel registration in conjunction with support to voluntary consolidation of plots. In today’s Georgia too much people are recorded as employed in agriculture. In modern days it is not simply sustainable to have around 50% of the workforce producing some 8% of GDP. Consolidation of land and access of capital to the underproductive land resources will allow creation of off-farm job places and creation of value added in food processing industry, which is almost non
existent in Georgia. As a result of improvement of efficiency in agriculture, people will gradually move to other sectors of the economy and new activities will be created. It should be understood that this is a relatively slow process but natural and allows indigenous rural economy to develop.

In the area, in which government can truly play a major role, namely education, the accents are also not quite well-placed in our opinion. There is the encouragement schemes for pupils, teachers, and directors mentioned, but in our opinion, what is offered is by no means sufficient. The average remuneration of a person employed in either privately run or state educational institution is among the lowest for the formal economy. The government should devote much more resources to school education both in absolute and per capita terms than it is today. Little is mentioned on improvement of level of mathematics and technical subjects at the school level. Without cardinal improvement in the mentioned areas, establishment of technological university in Batumi can hardly be justified. We did not find the establishment of the latter as beneficial to the Georgian economy, especially since the modernization of existing high education institutions can generate similar results at lower costs.

In general, the government places accents correctly on the areas of infrastructure and business support, but the 10 point modernization plan lacks focus and vision. Largely, plans are not quite visible in individual sections of the document.

It must be said that development of long term broad economic strategies are not obligatory in countries with established democratic governance. The government should have core principles to adhere to and follow them consistently. In this regard, adherence to the principles of Law on Economic Freedom is much more important to GoG and Georgian economy than other strategic documents developed so far.

6. Concluding remarks

In this paper we reviewed some macroeconomic and other challenges and presented our approach to them. We believe that maintenance of high economic growth rate is the highest priority area for the country’s authorities to concentrate on. We also believe that careful reconsideration of government operations and accent on basic infrastructure, health and education are much more important that sporadic measures to induce more production of selected sectors of the economy.

We also think that long term economic success of the country relies on the quality institution, including the quality of property rights. This particular topic will be the concentration of our subsequent paper.

1. Executive Summary

The process of state owned land privatization was initiated in 1992 in Georgia. In pursuit of a goal to maintain social stability, the Government of Georgia attempted at granting land property rights virtually to all citizens of country. The initial privatization process was undertaken in a rather chaotic and hectic manner. In those turbulent times rapid alienation of majority of agricultural land to private holders truly softened severe economic and social problems related to consequences of demise of economy and a civil war. Subsequently, especially from late nineties, various government and donor efforts have been directed at formalization of recognition of land property rights and creation of a functioning land market. These efforts continued through early 2000s and resulted in strengthening of institutional foundation. Despite the above efforts, we believe that due to various reasons, land property rights remain tenuous in the country and Georgia lacks functional and transparent land markets. Lack of transparency of right to property might create high risks of disputes and hamper development of the rural economy. This opinion paper attempt to overview the current issues with land ownership and land market and provide recommendations for their solutions.
II CURRENT STANCE OF LAND MARKET IN GEORGIA

1. An overview of Georgian land reform

As a result of large scale privatization of formerly state owned agricultural land in 1992 approximately 763 thousand hectares were distributed to the Georgian citizens. Due to that fact the country was suffering with instability and civil war, the government decided to use land reform as a tool to alleviate social problems and give people access to productive resources to feed themselves. Pursuant to the abovementioned goals, long term implications of quick alienation of state owned land were not taken into consideration. The government attempted to give equal amount of land to as many people as it was possible. As a result, all the households of the country got access to not more than 1.25 hectares of arable and not more than 5 hectares of pastureland. Rural citizens who were in the past the members of the collective farms got more than their urban compatriots. In addition, to extreme degree of land fragmentation created outright, the households acquired multiple parcels, which sometimes were not even located within the vicinity to each other. For example, according to the 2004 Agricultural Census by Geostat, the maximum degree of land fragmentation can reach 9 parcels per holding of 1.25 hectare.

All in all, some 763 000 hectares of land comprising 437 000 hectares of annual cropland, 181 000 hectares of orchards and other perennial crops, 42 000 hectares of hay lands, and 84,000 in permanent pasture were distributed to the people of Georgia. By the time this represented somewhat more than 60 percent of all the cropland and more than 4 percent of the meadows and pastures.

The government essentially retained in its possession other lands, largely through the system of leases. In addition, the pasturelands retained by the state could have been accessed by private holders as grazing lands. These are largely communal pasturelands essentially available to everyone. Given the fact that cattle breeding as an economic activity in nowadays Georgia are very inefficient, the problem of overgrazing will definitely take its negative toll on productivity and quality of communal pasturelands. However acute, this is a separate issue and will not be discussed in this paper.

Theoretically, back in nineties of the past century, all rural households could lease the lands not distributed by government, although leasing as a tool to have access to land was largely available to and utilized by former collective farm managers, members of a village councils or others with the ability to gain access to farm machinery. Access to farm machinery was the key since larger amounts of land could not be effectively farmed without it. During the restructuring process, where conditions and transactions were often confused and non-transparent, it was those with influence who typically had the ability to assume ownership or control of farm machinery at prices significantly below market and, thus, control of farmland significantly greater than the norm.

It must be said that due to the fact that the whole process of land distribution was initiated and undertaken hectically, the initial stage of land privatization truly lacked a solid legal foundation. In 1993 the Georgian government, who itself lacked legitimacy, tried to fix the situation by establishing the form of an acceptance act/certificate. Interestingly, even today, this document, although not exclusively, can be used by a person to claim lawful possession and get his/her parcel registered in accordance with the current legal and registration framework. The legal strength of this decree was further strengthened in 1996 when Parliament passed the Law on Private Ownership of Agricultural Land, which validated all governmental resolutions granting agricultural land ownership rights. This law limited land ownership rights to citizens and legal persons registered in Georgia.

One of the shortcomings of the original privatization initiative is that the ownership of all lands was not shifted to the private sector. While individuals were still able to lease most of the lands not transferred, since they did not have ownership, the land was not quite ‘secured’ in a sense that a farmer had no certainty a lease could be kept for its full term (new membership on councils which supervised the leases could sometimes mean that leases were cancelled and the land then leased to someone with ties to the new council members). This led to limited efforts towards maintaining the land's
productivity or to investing in capital improvements with a positive yield increase potential. It might be possible that quick
dilapidation of extensive irrigation and drainage network is precisely caused by this.

As a consequence and in keeping with the government’s stated policy to privatize all public assets possible, in 2005, the
Law on State-Owned Agricultural Land Privatization was passed, whose intent was to complete the privatization process.
Subsequent to the passage of this law, the Ministry of Economic Development (the lead government entity for privatization)
adopted the Rule on Privatization, which provided comprehensive procedures for this final privatization process. This
new legal framework maintained the principle of limiting land ownership rights to Georgian citizens and those legally
registered in Georgia. With these measures, a second phase of privatization effectively started in Georgia.

The new regulations envisaged a three step privatization process for these last government agricultural lands:

a. For lands already leased, the current lessee had the opportunity to purchase this land directly from the
government.

b. For lands not leased or for any lands leased which the current lessee did not wish to purchase, a special
auction would be held whose participation would be limited to the physical and legal entities registered in
the community in which the auctioned land is situated.

c. For lands which were not sold during this special auction, an additional auction would be held open to every
citizen and legal entity registered in Georgia.

The initial price of all lands to be sold directly to the current lessee was set at 10 times the current tax rate for that parcel.
The tax rate varied based roughly on the quality and location of the land itself. Once the land went to auction, in order to
encourage bids, the minimum bid amount was only twice the land tax. Nonetheless, there was a catch in trying to purchase
the land too cheaply or for the current lessee not to purchase initially hoping that it could have been cheaper at auction.
Each bidder was only allowed one bid, which would be presented in an open forum in full view of all participants.

Those who purchased the land must have paid 20 percent down and 10 percent installments in subsequent years. No
interest was charged. Thus, the purchaser was essentially receiving a long term (up to 9 year) interest free mortgage.
Once payment of the initial 20 percent was made, the buyer received full title to the land. Current lessees could purchase
their land at any time within the period of their existing lease provided it was not greater than 10 years. Thus, a lessee
choosing to wait to purchase the land until the end of the lease might receive an interest free loan for up to 19 years with no
purchase (only lease) payments at all during the early years when the lease was still in effect. However, the lease payments
were approximately equal to the purchase payment. Therefore, the reasons to defer purchase were unlikely be related to
the interest free nature of the situation so much as waiting to see if the market for land, the availability of credit or the
profitability of production made purchase more attractive in the future than it might have been by the time.

In part to incentivize lessees to make a decision sooner and to move this second phase of privatization ahead more quickly,
if full payment was made within one year, the price of the land was reduced by 50 percent. With full payment made within
three years, the price was reduced by 25 percent. However, due to high cost of money, even with these incentives, as long
as the land was not needed as collateral, deferring payments at no interest was often the wiser financial course of action.

Upon completion of phase two, some 464,000 hectares should have been moved into private hands. Of this, 299,000
hectares were leased to farmers and the remaining 165,000 hectares were not leased or farmed. Due to the many issues
associated with the administration of the program, its implementation did not begin immediately after the passage of the
law. It was felt that several years would be required for most transactions to have been concluded but given the option
of delaying a decision for up to 10 years on leased land, it led to considerably longer period of time to complete all sales.

The second phase of land privatization generated an additional positive aspect of moving this remaining land into private
hands by means of inducing the development of the market for farmland (which, in turn, might have incentivized banks to
take land as collateral since it is not difficult to find a purchaser after a foreclosure). Due to the fact that the average size of a parcel within the land pool retained by the government was considerably larger than that of distributed from 1992, one might consider that the second phase of privatization had an excellent chance to kick-start the land market development. For a serious investor willing to accumulate at least some 10 hectares, it might be necessary to deal with dozens of separate owners, any of whom could choose not to sell or to raise their price because they were situated between other parcels already secured.

It appears that the incentives described above did not quite help acceleration of the land market development. Unfortunately, we were not able to directly verify this proposition. Indirectly though, one can argue that the second phase of privatization did not generate economically feasible operations in agriculture. This might be corroborated by pervasive, puzzlingly low productivity levels in almost all the sectors of agriculture and very insignificant bank capital and investment flows to the sector up until today. One of the reasons of this development might be potentially poor quality of land retained by the government at the time it was given to the lessees. Another reason might be that the lessees were just trying to “hoard” land hoping to resell it at profit subsequently without caring much of its value generation capacity. It might also be the case that the lessees, who as described earlier, had gotten access to land in 1992 due to their being insiders to the old collective farming system and associated with village councils, were afraid of conflicts with smaller neighbors or their own economic situation worsened so much that they were unable/incompetent to utilize the resource at their disposal to the most productive uses.

Probably, due to reasons cited above and by the desire to further accelerate the process of land privatization, the government decided to terminate all leases by May 1, 2011. Lessees retained the option to buy out their leases and maintain ownership of the land. In cases where they opted out of this, the State started auctioning the land, through which Georgian citizens and foreign investors became eligible to bid. The second category consists of those lands that were originally transferred as private holdings during the 1992 process.

2. A review of establishment of institutional framework to the land market

As outline earlier, initial stages of land privatization were rather disorganized and clearly lacked rigorous legal and institutional framework. For the purpose of bringing organization and uniformity to the process, the Government of Georgia with the assistance of donor organizations such as UNDP, USAID, German Bank for Reconstruction (KfW), and the World Bank started facilitating privatization by establishing necessary legal and institutional framework for it.

The first stage started in 1997 with the USAID funded Booz Allen Hamilton (BAH) Project closely collaborating with a newly established local NGO, Association for Protection of Landowners Rights (APLR). As a result of this activity, a comprehensive review of laws and regulations related to land ownership and market was undertaken. Subsequently, in 1999 the process of formal granting of land ownership certificates to Georgian citizens started. The process was accompanied by a large scale public awareness and education campaigns. At the later stages other donor entities such as KfW, WB, and UNDP joined the process.

USAID continued its efforts in the abovementioned direction. As a result, within the period of 1999-2004 approximately 2.5 million ownership certificates were issued. In 2004 a major successful step towards institutional capacity building was undertaken. The Government of Georgia established the National Agency for Public Registry (NAPR) that acquired functions of the cancelled State Department for Land Management (SDLM). This was a big successful state forward since it created a modern, competent, and well equipped and staffed organization that has taken over the technical information previously held by poorly functioning technical bureaus. The Government of Georgia further bolstered the process by adoption/amendment of laws governing land property issues in 2007. In 2008 KfW helped institutionalization of the cadastral system housed with NAPR. As a result of the abovementioned measures, in Georgia several key competent actors, namely NAPR and APLR emerged. In addition, newly enacted legislation brought more clarity to legal aspects of land ownership.
We think that currently, despite having necessary legal and institutional underpinnings for emergence of a functional land market, some key functions are still missing. These are lack of availability of information on land, still questionable legality of land certificates, costs of registering land, and land fragmentation issues. These are discussed below.

3. Issues related to availability of information on land

While working on this opinion paper we asked the Ministry of Economy to provide us the information on aggregate volume of land sold through state auctions both in terms of volume and total price. We also asked for information about total area of land purchased by the international investors. Unfortunately, we could not fully obtain this information from them. Subsequently, we've taken a large sample auctioned land from the web site of the Ministry of Economy. Unfortunately, the latter source does not distinguish local and international purchases.

In addition to the above, we've asked NAPR to provide us the year end aggregate information on number and total area of registered agricultural land plots by regions of Georgia for the period of 2007-2011. Also, we tried to obtain the information on aggregate number of transactions for the end periods comprising countryside number of hectares and total volume of price paid separately for the transactions from private entities to private entities and from the state to the private entities. Lastly, we tried to obtain the information on total hectarage of land leased from the state and total area of land plots mortgaged. Unfortunately, we could not get this information from NAPR despite the fact that it regularly publishes the information on total number and volume of all the transactions. We think that information requested by us is technically very easy to compile, more so when the aggregated information on all the transactions certified by NAPR is available online.

In our opinion, lack of structured information on agricultural land, as described above, seriously complicates decision making process related to acquisition of land and development of the government regional development policies. In the first instance, if an investor decides to find a land parcel(s) of some adequate size in a preferred region, instead of draw on readily available information he/she should go through a lengthy information acquisition process and multiple site visits to establish whether his/her preferences can actually match with the underground reality. Inexistence of adequate information, especially the dynamics of land market development can seriously delay the investment process.

In addition, it seems that even the state entities do not fully possess the information on land market at the central level. If this is the case and if the government decides to undertake public, development or investment promotion projects in regions it face serious complications related to potential conflicts with those who have only land ownership certificates but are not fully registered in accordance with the latest legislation stipulating for creation of a renewed cadastral map registered at NAPR.

As an illustration of the magnitude of the problem below can be seen the difference between two state sources reporting on availability of land in one of the rayons of Georgia.

### Figure 33 Discrepancies in information obtained from official sources

<table>
<thead>
<tr>
<th>Hectares</th>
<th>Sagarejo Rayon, end of 2011</th>
<th>Geostat, 2004</th>
<th>Discrepancy</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Owned Agricultural Land</td>
<td>20,771.92</td>
<td>15,647.00</td>
<td>5,124.92</td>
</tr>
<tr>
<td>Privately Owned Agricultural Land</td>
<td>26,725.79</td>
<td>13,737.00</td>
<td>12,988.79</td>
</tr>
<tr>
<td>Total Agricultural Land</td>
<td>47,497.71</td>
<td>29,384.00</td>
<td>18,113.71</td>
</tr>
</tbody>
</table>

The 2011 information was obtained from the Sagarejo Municipality, whereas 2004 information is derived from the 2004 Agricultural Census of Geostat. Interestingly, the largest source of discrepancy is the total area of privately held land. The discrepancies between categories above could be anticipated but the fact that total area of agricultural land in 2011 is more than 150% of what was available in 2004, is confusing.
The problem is further exacerbated by the fact that there is no established measure of exactly how much land held by smallholders is actually registered in accordance with the current legislation. Opinions extracted from the studies of donors as well interviewees from Regions of Georgia (Shida Kartli and Guria) place it within the range of 10 - 30% with most of the interviewees citing the estimated range of 15-20%. In addition, the issue appears to be that currently the data held at the rayon level cannot be reconciled with the data held at the central level by NAPR. This is because the local registrars have the information on parcels that do not appear at the central level.

4. Issues related to questionable legality of land ownership

We’ve obtained sample certificates from our interviews with small scale land owners in Lanchkhuti Rayon of the Guria Region (the name of then holder is removed for ethical reasons). A typical certificate attached to this document is given not to an individual but to the family of individual. In our opinion, this is already questionable quality of a certificate, since it is not understandable what ‘family’ in legal terms and in this particular juncture means. The fact that the certificate is given to a family can mean additional problem related to the need of transferring it to the individual or to heirs of the individual if he/she has already passed away.

The sample certificate locates a concrete land parcel to a sector and quarter within the rayon and gives a simple sketch of the parcel on the outer page of the certificate. The parcel’s contours are given indicated in bold and are placed among other numbered parcels. Unfortunately, such a certificate cannot be regarded as a full quality proof of the ownership. Essentially, it lacks the necessary coordinates, which in accordance with the current electronic registration procedures disallows it to be regarded as a valid document. Although, some indications (number of a parcel, its location in a quarter and sector) are given, they are of no help, since due to absence of the coordinates the parcel can essentially be ‘located’ in any of the Georgian regions.

In addition to absence of coordinated, there is no indication of easements neighboring the parcel, as well as other information related to existence of other infrastructure around it, such as access roads, canals, and etc. Undefined boundaries might also raise the issue of potential conflicts with holders of neighboring parcels, since the boundaries are not clearly demarcated. Unclearly defined boundaries create problems of disrespect to boundaries, especially in areas in which only a minor faction of holders has a valid electronic registration. For example, one of our interviewees in Gori rayon stated that in his area one neighbor ploughed the road belonging to the state and penetrated to his parcel. He had to undergo costly and time consuming disputes to solve the problem with the neighbor.

Unclear demarcation problems can create problems in light of undergoing aggressive state campaign for privatization of land. In conjunction with the problem of availability of information at the central level, the government might decide to privatize a large chunk of land without even knowing that either within the area to be privatized or around it there might be a number of small holders with all certificates, information on which is not visible at the central cadastral level. This might lead to loss of land to small private holders and potential conflicts in the future. In addition, according to the current institutional framework, the claim of ownership is established on a first serve basis, which is additional factor for conflicts.

It might be argued that subsequently, when people with questionable quality certificates realize that the value of land goes up, they register at their cost. This might not be case for the reasons cited below: a) we’ve interviewed a relatively large number of individuals (15) the fact is that Georgia lacks long standing ownership culture, especially among older generation individuals. Majority of our interviewees have higher education but without a clue as to what the proper registration was. They just said that they were given certificates by the previous president’s administration and they are the owners; b) we think that inasmuch as in substantial number of occasions individual parcels are neighboring parcels or infrastructure belonging to the state, it must have been the state itself who must have given very clearly demarcated rights to property at the outset to delineate itself from the private sector holdings. The latter was not done at the earlier stages of the land privatization and can become problem if the state has development plans related to the concrete areas under consideration. In this light it is necessary to pay attention to increasing cases of infringement of property rights by the state in its attempt to promote tourism in certain regions of Georgia as reported by the Georgian NGO-s (see the review of literature and sources).
5. Issues related to costs of registration

According to the current land registration framework that stipulates for obtaining the electronic registration, the costs comprise of the following two categories: cost of surveying one hectare is estimated as 250 GEL, on average; a onetime registration cost for a parcel is 51 GEL.

In the figure 2 below the average costs of registering land assets available to a holding are estimated. According to the information from Geostat in 2004, an average holding had 1.22 hectares divided in 2.33 parcels. Of course, no one has 2.33 parcels and we estimate cost of registration below based on average holding having 2 parcels.

Figure 34 Fragmentation of parcels and registration costs. Source: Geostat; our estimates

| Average area of a holding in hectares | 1.22 |
| Average number of parcels per holding | 2.33 |
| Average area of a parcel in hectares | 0.52 |
| Estimated average cost of registration for a holding in GEL | 407 |

A simple summation exercise demonstrates that proper registration of the land might be exorbitantly costly given the average incomes in rural areas of the country.

Figure 35 Average sizes of land sold through state auction and average price payable per hectare, Source: MoE

<table>
<thead>
<tr>
<th>Size in Ha</th>
<th>Number</th>
<th>Frequency</th>
<th>Selling Price per Ha in GEL</th>
<th>Number</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 1</td>
<td>39</td>
<td>23.64%</td>
<td>Less than 360</td>
<td>12</td>
<td>7.27%</td>
</tr>
<tr>
<td>From 1 to 2</td>
<td>36</td>
<td>21.82%</td>
<td>From 360 to 720</td>
<td>31</td>
<td>18.79%</td>
</tr>
<tr>
<td>From 2 to 3</td>
<td>19</td>
<td>11.52%</td>
<td>From 720 to 1080</td>
<td>51</td>
<td>30.91%</td>
</tr>
<tr>
<td>From 3 to 4</td>
<td>24</td>
<td>14.55%</td>
<td>From 1080 to 1334</td>
<td>38</td>
<td>23.03%</td>
</tr>
<tr>
<td>From 4 to 5</td>
<td>7</td>
<td>4.24%</td>
<td>From 1334 to 1440</td>
<td>0</td>
<td>0.00%</td>
</tr>
<tr>
<td>From 5 and above</td>
<td>40</td>
<td>24.24%</td>
<td>Above 1440</td>
<td>33</td>
<td>20.00%</td>
</tr>
<tr>
<td>Average</td>
<td>9.12</td>
<td></td>
<td>Average</td>
<td>1334.00</td>
<td></td>
</tr>
</tbody>
</table>

The figure 3 shows the average size of agricultural land plots and their average selling price for hectare. This table is extracted from 165 transactions presented at the web page of the Privatization Department of the MoE. As it can be seen, the average sizes of plots privatized by the government are not particularly high. Neither is the average selling price per hectares. The average calculated registration costs could have been a problem for some categories of lands privatized. For example, the average per hectare selling price of lands in 80% of cases is less than 1080 GEL, which is only 3 times higher than the selling price.

In case of private small land plots, which are characterized by much higher fragmentation and probably quality, the registration costs occasionally might even exceed the imputed selling price. This seriously disincentivizes the holders to register their parcels voluntarily, especially in case of existence of a very weak land market.

6. Issues related to land fragmentation, externalities, and lack of capital

As a result of land privatization started in 1992, the land parcels became extremely fragmented in Georgia. Unfortunately, up until recently there is only one document from which the information on this particular problem can be obtained. According to the Agricultural Census of 2004 by Geostat, 98% of plots are less than 5 hectares irrespective of use.
One can question validity of the above, especially in light of substantial time since the exercise was undertaken. Unfortunately, a new agricultural census has not been conducted in Georgia since then, which makes it impossible to have updated information on current situation. On the other hand, entities that are technically and organizationally competent enough to provide such information could not provide it at our request.

Figure 4 shows the fragmentation of land parcels by categories of use. Given the very nature of perennial orchard operations and less need to have larger parcels as compared to annual crop production, the relative frequencies of the two do not appear particularly surprising. On the other hand, the fact that relative frequency of pasture land plots with a size of less than five hectares is a conspicuous demonstration of inefficiency of scale of farming in our country.

Figure 37 Relative frequencies of less than 5 hectare plots by categories of use; Source: Geostat
The above tables, however, potentially not fully reflecting the existence of larger ‘leased’ plots, demonstrate that development of meaningful, commercial farming operations on small plots distributed to all the citizens of Georgia in early nineties is hardly possible in the foreseeable future. In general, parcels are so small that they do not have a chance to exceed the subsistence or even backyard orchard size. According to the World Bank Development Indicators database, Georgia is far ahead of countries with more advanced agriculture (Bulgaria, Belarus, Romania, and Ukraine) in terms of availability of tractors per 100 square kilometers of arable land. Georgia has enough quality soil, enough quantity of water and sunlight to produce more than 2000 USD value added per agricultural worker.

Figure 38 Value Added per Worker in Agriculture; Source: World Bank

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>6819</td>
<td>6839</td>
<td>7701</td>
<td>8180</td>
<td>8820</td>
<td>8536</td>
<td>8702</td>
<td>6806</td>
<td>9018</td>
</tr>
<tr>
<td>Greece</td>
<td>8881</td>
<td>9174</td>
<td>8987</td>
<td>8655</td>
<td>9202</td>
<td>9638</td>
<td>8100</td>
<td>7411</td>
<td>8027</td>
</tr>
<tr>
<td>Romania</td>
<td>2365</td>
<td>3230</td>
<td>3429</td>
<td>3854</td>
<td>5092</td>
<td>5611</td>
<td>5973</td>
<td>6952</td>
<td>7991</td>
</tr>
<tr>
<td>Armenia</td>
<td>2550</td>
<td>2916</td>
<td>3081</td>
<td>3247</td>
<td>3776</td>
<td>4278</td>
<td>4384</td>
<td>4869</td>
<td>5000</td>
</tr>
<tr>
<td>Belarus</td>
<td>2426</td>
<td>2549</td>
<td>2721</td>
<td>3034</td>
<td>3568</td>
<td>3639</td>
<td>4029</td>
<td>4383</td>
<td>4984</td>
</tr>
<tr>
<td>Turkey</td>
<td>2820</td>
<td>2588</td>
<td>2803</td>
<td>2846</td>
<td>2961</td>
<td>3224</td>
<td>3299</td>
<td>3146</td>
<td>3326</td>
</tr>
<tr>
<td>Poland</td>
<td>2001</td>
<td>2176</td>
<td>2274</td>
<td>2392</td>
<td>2608</td>
<td>2624</td>
<td>2643</td>
<td>2620</td>
<td>2754</td>
</tr>
<tr>
<td>Ukraine</td>
<td>1375</td>
<td>1558</td>
<td>1646</td>
<td>1538</td>
<td>1904</td>
<td>1948</td>
<td>2062</td>
<td>2019</td>
<td>2394</td>
</tr>
<tr>
<td>Georgia</td>
<td>1335</td>
<td>1441</td>
<td>1516</td>
<td>1696</td>
<td>1650</td>
<td>1913</td>
<td>1746</td>
<td>1955</td>
<td>2258</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>871</td>
<td>960</td>
<td>1011</td>
<td>1059</td>
<td>1103</td>
<td>1183</td>
<td>1200</td>
<td>1212</td>
<td>1274</td>
</tr>
</tbody>
</table>

Most farms, even very small ones, are not at a single location. They are often comprised of multiple parcels separate from one another. This occurred, in part, because during the first phase of privatization, land was distributed based on its quality and location. So that one farmer did not get all high quality land in the best location and another all low or medium quality in less desirable locations, a household might receive multiple parcels of each. Since quality is a function of soil, slope, and drainage characteristics, this meant that the parcels would seldom, if ever, be next to one another. Fragmentation means inherent inefficiencies for a farmer, either in lost time moving between parcels or in the ability to use equipment and other production factors efficiently. Fragmentation in general leads to additional complication, which is the need to have additional access roads to each of the newly emerged parcels at a site that was previously much larger and had more efficient access roads and irrigation/drainage infrastructure around it. This factor leads to considerable loss of land area immediately useful for agricultural operations.

It can be said that availability of and access to virtually everyone to land is a positive factor providing safety valve to large chunks of population at the transition stage. One can encounter opinions stating that the fragmentation issue will sort out itself over time as consolidation naturally happens. The empirical evidence states the contrary – according to annual reports by Geostat every year at least some 30-40% of the useful land remains unprocessed. We think that domination of small parcels makes it very hard to pursue serious scale agriculture for young more skillful generation of Georgians, who in virtual absence of agricultural credit are moving in urban areas to exploit other economic opportunities.

An interesting aspect of massive land privatization in Georgia was the fact that among others, it was distributed to category of people, who had very little, if any attachment to agriculture and rural life. Even people living in rural areas were not exclusively farmers. Rather, they worked for collective farms not necessarily farming. Geographic separation from the parcels naturally leads to diminished sense of attachment to them, and less care over its maintenance. Poor agricultural
practices, lack of incentives to invest in quality of land, and inertia might gradually lead to cropping practices that continually withdraw nutrients from the ground without replenishing them. There is no compelling evidence that the issue of land degradation led to dangerous scale. Nevertheless, with current practices and land holding patterns it is very much possible to face this problem in the nearest future. Given the problems of potential widespread decrease of soil fertility and degradation of access roads and infrastructure, even if the commercial farming develops on larger chunks of land retained by state in 1992, the attractiveness of the sector to investment will eventually suffer due to negative externalities generated by dominance of subsistence farming.

It is interesting to note that in US a widespread collapse of the family farm system during the 1920s and 30s was addressed not by the market only but by creation of a comprehensive national strategic commercial farm development policy initiative. The effort was put in creation of a farm cooperative credit program. The credit network utilized the expertise of public sector employees to make short and long term credits available to farmers. Variety of incentives was put in place to induce farmers taking care of quality of their plots and improve its nutritional characteristics. We think that similar measures can be very beneficial to Georgia.

Fragmentation creates problems in obtaining credit. Many lenders are unwilling to loan money to farmers even if proof of ownership of a parcel exists. The problem lies in the small size of a parcel that may be used for collateral. If the lender has to foreclose on an operationally miniscule parcel, there will be an extremely limited number of individuals who might be interested in purchasing it from the lender. These would essentially only be those farmers with parcels immediately adjacent, or at least very close, to the parcel in question. As a consequence, few loans will be made to farmers with such small parcels of land. According to the information on the web site of the National Bank of Georgia, agricultural loans constitute to no more than 1.08% of the total bank portfolio in 2011, despite agriculture providing some 9% of GDP. This number probably contains short term loans to large enterprises. So far, Georgian agriculture does not look very attractive to FDI-s either even given a potential to make large parcels available for foreigners. According to Geostat, agriculture received 22.3, 8.6, and 13.6 million USD FDI in 2009, 2010, and 2011 respectively. Correspondingly, these represent only 3.4%, 1.1%, and 1.4% of total FDI to the country in the mentioned years.

All in all, extreme fragmentation, breakdown into small parcels, and lack of incentives to maintain quality of land seriously hampers development of a viable land market in Georgia.

7. Broad recommendations

We think that despite huge efforts from the government organizations and success to date, the formation of land market is somewhat incomplete in Georgia. The rights to property of small holders are not well defined and there is a potential for conflicts between private holders and state, as well as between private holders themselves. We think that voluntary registration process by the small holders will not take place by itself. Even if it does take place it will take several decades and is related to much more costs to the society than a managed program for addressing the problem, even if the latter is time and resources consuming. We think that a number of additional steps should be undertaken to bring the process of land market development to its ultimate land. This might be best achieved by strengthening the legal and institutional framework in parallel with introduction of mechanisms for market based consolidation of small parcels.

This might be undertaken into the following steps:

1. The information on existence and legal ownership on agricultural land should be established centrally and reconciled with the data available at the local level. For this purpose, the reasons for the discrepancies thoroughly established.

2. Subsequently, when the information on land ownership at the local and central levels are reconciled, measures have to be undertaken to ensure that all the holders with lawfully possessing land are fully protected in cases of unintentional or intentional infringement of their rights. This pertains to purchase and sale of land and boundaries enforcement problems;
3. A comprehensive review of land ownership should be undertaken in order to identify potential problems and inefficiencies associated with legal, institutional and regulatory practices (if any) and set measures for improvements if problems are established;

4. A serious scale information campaign involving government, donors, local NGO-s and other actors should be undertaken to clarify to the small holders the whereabouts of land privatization process and encourage them to register;

8. An instrument of Market Driven Registration and Consolidation

We think that within the legal, institutional, and economic context of nowadays Georgia, the best way to tackle the problem of tenuous land ownership and fragmentation can be introduction of incentives driven, and market oriented schemes.

In ideal circumstances, the initial titling has to be undertaken from top down rather than from bottom up. This is based on the premise that by titling land parcels not belonging to the state, the state itself identifies “empty” areas that belongs to itself. Plus, this means that the Government (potentially by means of employing donor funds and relying on public-private partnership schemes) must provide guaranteed and well demarcated titles so that subsequently individuals can freely use land as a fungible asset. In nowadays reality, we think that this approach can be successfully supported by the schemes referred to above.

The schemes mentioned above have recently been successfully tried in Kosovo and Moldova. Namely, relying on very careful selection of targeted areas (based on extensive preparatory work) people with multiple holdings was asked whether they would voluntarily participate in a program for consolidation. People with multiple holdings could also voluntarily engage in exchange process with their neighbors to bring their own plots to more meaningful size. In so doing they could gain substantially by economizing on scale as well as new registration transaction fees. The results of such a program varied considerably throughout the regions of the mentioned countries, although the rate of participation was almost 50% and the degree of fragmentation was on average reduced by some 30%.

As opposed to the mentioned countries, the titling and consolidation problems can be tackled simultaneously in Georgia given the fact that family holdings are largely not titled and very fragmented. Namely, in targeted regions titling should be done for everyone but some incentives offered to those willing to participate voluntarily in consolidation schemes. Given the average per hectare price of surveying (approximately 250 GEL) and a registration fee of 51 GEL per plot, those who engage in voluntary scheme can economize at least some 400 GEL just by combining their own plots. In so doing they can acquire other plots, gains can be considerably higher. For those who do not participate in the scheme, it must be conveyed at the outset that they will still get their registration but in the future, if they want to consolidate, they themselves should bear the new surveying costs and registration fees. It should be mentioned that this scheme can be modified further to make it more attractive to participants and implementers so that total costs can be brought down considerably.

The general methodological approach for Georgia is in line with the strategic approach of market driven consolidation presented above. Plus, we think, the scheme itself fits within the concept of introducing albeit small but still meaningful “sticks and carrots.” By participating in the scheme people gain considerably, while opting out they forego some future income. We think that efficiency of incentives can be further enhanced by bringing some extra positive signals. This might be explaining benefits of participation to people. These benefits might be articulated by the local business community, MFI-s, local bank affiliates, land arrangers and other locals with trust and experience. People can get convinced that consolidation is positively associated with land price and prospects of access to finance.

As it was referred to earlier, average per hectare surveying costs amount to approximately 300 GEL (both surveying and one time registration fee). Part of such a high price can definitely be explained by very small number of surveying transactions. For a surveyor it is rather costly to get to the site and survey some 0.3 hectare plot. In case of bulk work, total costs to the surveyor can be brought down by some 50%. In such a case, incentive scheme creates more opportunities
for the voluntary participants. Assuming that 30% of parcels are registered, the country wide program could cover some 550,000-600,000 hectares. The total costs without the incentive scheme is a multiple of hectarage by some 250 GEL plus a multiple of approximately 1.6 million plots involved by 50 GEL registration fee. In such a case the program might cost some 210-230 million GEL. With the incentive scheme (if successful) and bulk work approach the costs can be brought down to some 100-100 million GEL.

If successfully undertaken, the effects to the country might be rather positive. First, the property rights will be clearly demarcated. This is beneficial both for the state and private sector players since the necessary, although maybe not sufficient, prerequisites for functioning land market will be established. The state will also gain by creating a full and comprehensive inventory of land and immovable assets. The degree of fragmentation will be substantially reduced. Titling might have very sizeable positive effects on land values. Flows of financial resources to the sector will be enhanced. Interestingly, based on findings of numerous studies, titling induces switch from annual crops to perennial crops, which is an indication of increased interest from the owner in land as an asset. Plus, perennial crops are competitive edge of Georgia. The synergy and positive impact on property market of Georgia also must not be neglected. The voluntary scheme allows for identification of market-oriented individuals within the individual communities, who, however slowly, can and will continue market driven consolidation by their own means.

It must be understood that however elegantly the conceptual framework might be formulated, the actual results might not be ideal. Plus, serious challenges might emerge along the way. The difficulties might be related to bad institutional memory of people (Soviet inheritance), unwillingness to participate, cultural rigidities, demographic and inheritance problems, potential conflicts within the community, zoning problems, other legal and institutional difficulties. The lack of precise information, institutional capacity, and potential need for legal/regulatory upgrade can also be regarded as constraints. It must also be understood that huge boost of commercial finance to agriculture must not be anticipated. Rather, the process will go on slowly, although given the policy choices available (as referred to above), probably slow and steady addressing of the problem is optimal.

Similar programs in Moldova and Kosovo were based on "learning by doing" approach. This means parallel comparison of achieved results in various communities so that necessary changes are being introduced timely. Plus, continuous monitoring of the outcomes enables the process to be able to modify incentives and introduce additional positive signals.

9. Conclusive remarks

In our opinion, despite achieved success in building institutional and legal framework to property rights and land market development in Georgia, the process remains incomplete. The rights to property lack clear definition and transparency, the information on land market is not readily available, and there is a potential for conflicts between the actors pursuing access to land pursuing different economic interests. In addition, the lack of proper registration of land and high degree of its fragmentation impedes flow of capital to agriculture and hampers productivity growth. We think that these problems can be resolved by concerted efforts from the government, donors, NGO-s, and public society by means of employing transparent, market driven schemes for establishment of fully functioning land property market in Georgia.
III HEALTH CARE AS A COMPONENT OF NATIONAL SECURITY STRATEGY OF GEORGIA

1. Introduction

The aim of the document is to outline the national health security component of the overall national security strategy of Georgia, including the definition of the goals, strategic objectives, and capabilities needed to address and respond to the health needs of the country's population. The document attempts to frame the obligation to ensure the highest attainable standard of health as one of the primary objectives of national security strategy, and provides recommendations on reaching this objective. The approach is forward-looking, but at the same time grounded on the analysis of the present situation in the country's health care system.

The philosophy that undergirds the document is in line with the declared commitment of the Georgian government to liberal economic policies that promote limited government intervention of the state in economic affairs, the value of individual choice and relying as much as possible on competitive forces and incentives arising from free market transactions. At the same time, the document takes into account well corroborated evidence that health care, due to the nature of the associated goods and services, is fundamentally different from other spheres of economy and requires robust regulatory, policy and legal framework to avoid multitude of inefficiencies and market failures that have plagued health care systems without such controls in many part of the world, even in highly developed countries.

The starting point of the analysis is the acknowledgement that the available data points to a poor overall health status of Georgia's population. This is evidenced by a number of health indicators that have not yielded to significant improvements despite recent efforts of the government. We also recognize substantial efforts exerted by the Georgian authorities to ameliorate the situation. Namely, we note the increasing financial resources in the state budget earmarked for health care purposes, and welcome the adoption by the authorities of the National Health Care Strategy for the 2011-2015 period, which correctly outlines, albeit in general terms, some of the important components of health care reform required for improving the overall system performance.

However, we notice that so far, these positive trends have not sufficiently improved health outcomes for the population. The cause of this counterintuitive phenomenon is the existence of substantial inefficiencies and market failures in Georgian health care system, which we discuss, analyze, and propose to rectify through targeted policy interventions below. Some of the lowest indicators are the high maternal mortality ratio and the under-five mortality rate in Georgia, as compared to the benchmark countries, as well as a very high incidence of non-communicable and infectious diseases, pointing to low access to the necessary health care for the population and the lack of preventive strategies by the health authorities.

The sources of inefficiencies, which should be the targets of government's intervention, include practices that focus on medical inputs rather than outcomes, fragmented and poorly regulated health care finance system, and inadequate focus on disease prevention and promotion of healthy lifestyles. The proposed solutions are compatible with both the free market approach championed by the Georgian authorities, and with the government's “stewardship” function of the health sector promoted by the leading health economics schools, as well as the World Health Organization.¹

2. Health as a component of National Security Strategy

Achieving the highest attainable standard of health for its population is one of the core components of national security strategy of any state, and Georgia should be no exception. Like anywhere else, the health of the Georgian population has a direct impact on the security of the country. For Georgia – a lower middle income country with formidable socio-economic challenges, the meaning of health as a component of national security goes far beyond the emergency context related to natural and man-made disasters, and is closely related to its strategic goals such as fast-track integration into the European political and economic space. Georgia’s unacceptably low health indicators and prohibitively high overall disease burden impede economic growth of the country, drive up health care spending, and keep large proportion of working-age population from partaking in the economic activity.

2.1 Health in the context of emergency response and disaster preparedness

A wide range of potential large scale incidents can put the health and well-being of Georgia's population at risk and compromise a society’s economic productivity. Unfortunately, the likelihood of such events, whether it is an instance of bio-terrorism, natural disaster or an outbreak of an infectious disease pandemic, is increasing with the global political and environmental trends, and are especially relevant for Georgia, which confronts complex security threats and challenges.

Therefore, how well-prepared and resilient Georgian population is for health contingencies is an important measure of the nation's overall security. Accordingly, deriving from the definition formulated in the US National Health Security Strategy, national health security for Georgia is a state in which the country and its population are well prepared for, protected against, and resilient in the face of various health contingencies.

Georgia needs to develop and publicize the strategy for emergency response and disaster preparedness. This need is acknowledged in the National Health Care Strategy document for 2011-2015, which states that: “The emergence of biological and other man-made or natural hazards poses high economic and social risks to Georgia. To mitigate these risks and reduce the potential damage, the Government will ensure early detection and expedient coordinated response measures.” The first step towards this aim is to elaborate a coordinated action plan.

2.2 Adequate healthcare standards as strategic objective in the context of European integration

Since the Rose Revolution of 2003, greater integration into the Euro-Atlantic institutions and specifically the European Union has been a priority area for the Government of Georgia. Despite significant advances in other fields, notably in the liberalization of economic market and limiting state intervention in areas best managed by private sector, health remains an area in which indicators have a long way towards reaching European standards.

There are several instruments and related bodies that provide general normative framework for Georgia’s health aspirations within the European context. One example is the Council of Europe’s (CoE) 1950 Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR). The European Social Charter (ESC) complements the Convention in the field of economic and social rights and ensures the compliance by states parties through a supervisory mechanism. The rights enshrined in the Charter concern housing, health, education, employment, social protection, the free movement of persons and non-discrimination.

The European Committee of Social Rights rules on the conformity of the situation in CoE Member States with the European Social Charter, and issues conclusions. Since the ratification of the Charter in July 2005, Georgia, as a member of CoE has submitted its report to the thematic group on health in 2009, and the next report is due towards the end of 2012. In total, within the thematic group on health, the committee did not find a single case of compliance by Georgia and identified six cases of noncompliance, which is a very poor indicator for a country aspiring for European integration.

Besides the instruments enacted within the Council of Europe framework, the members of the European Union are also bound by the Charter of Fundamental Rights that spells out the right to health care in Article 35. Although not a member

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3 The Committee has found that health related situation in Georgia was in serious non-conformity with the acceptable standards. More concretely, the committee issued the following non-conformity “conclusions”:
   • Article 11§1 - Removal of the causes of ill-health
     Conclusion: It has not been established that measures taken to reduce infant and maternal mortality rates, which are significantly higher than in other European countries, are adequate.
   • Article 11§2 - Advisory and educational facilities
     Conclusion: The measures for counseling and screening of pregnant women and children are not adequate.
   • Article 11§3 - Prevention of diseases and accidents
     Conclusion: It has not been demonstrated that adequate measures have been adopted in the field of environmental health, on tobacco consumption, alcohol use, drug abuse, food safety or to prevent accidents.
4 “Everyone has the right of access to preventive health care and the right to benefit from medical treatment under the conditions established by national laws and practices. A high level of human health protection shall be ensured in the definition and implementation of all the Union's policies and activities.”
of the EU, as an aspiring country Georgia needs to adopt good practices and adhere to the same standards of meeting the health rights of citizens that are prevalent in the member countries.

The highlight in EU-Georgia bilateral relations has been the establishment of the European Neighborhoods Policy Action Plan (ENP AP) in 2006, which aims at bringing about an increasingly close bilateral relationship. The ENP AP takes into account the difficult economic and social challenges that Georgia faces as a low middle income country, and considers achieving the Millennium Development Goals (MDGs), and especially the drastic reduction of poverty levels, especially in rural areas, as an urgent priority for the government. Consequently, and in line with the Action Plan, the assistance coming from the EU to Georgia will be structured around building its capacity to meet the commitments under the ENP AP.

A key instrument in this area is the European Neighborhood and Partnership Instrument for 2007-2013 (ENPI), which sets several targets that Georgia is expected to meet or make significant headway towards doing so if funding is to be continued after 2013. Two of these targets are directly related to healthcare under ENP AP Chapter 4.4:

1. Continued reform of the social security system, notably social protection, child care and health care;
2. Prevention and control of communicable diseases, in particular through facilitating the implementation of international treaties in the area of public health.

Since the ENP AP uses the MDGs as indicators for measuring the success of health care system reform in the country, it is important to note where the country stands currently in the attainment of these goals. The relevant goals are:

- Goal 4 – reduce by two-thirds, between 2000 and 2015, the under-five mortality rate; The target rate is 11, while the 2010 indicator was 22.
- Goal 5 – Reduce by three-quarters, between 2000 and 2015, the maternity mortality ratio; The target rate is 8, while the 2010 indicator was 19.
- Goal 6 – Halt and reverse the spread of AIDS, malaria and other major diseases by 2015.

Figure 39 Progress Towards MDGs 4 and 5

5 The Action Plan contains specific priority for action on health sector reform, which tasks the government to: “Continue health sector reform inter alia through enhancing the policy and regulatory framework with a view to notably: improve access and affordability for whole population; improve the organisation, quality, and efficiency of the sector and its institutions, including the Ministry of Labour, Health and Social Affairs; increase the share of primary health care services and of prevention and health promotion activities in the total health care budget; implement a sustainable healthcare finance strategy; improve the quality of and access to information on health statistics, risks and determinants in Georgia; enhance the quality of health workers including through training.” EU/Georgia Action Plan, Chapter 4.7.2. Health sector reform <http://ec.europa.eu/world/enp/pdf/action_plans/georgia_enp_ap_final_en.pdf>
For MDGs on infant mortality and maternal health, Georgia still has a very long way to go before reaching the targets set as indicators of achievement at the long-term impact level in the ENP AP. Strong progress should be made towards these goals by 2015. Considering the ambitions of Georgian government to move the country closely to Europe and to align its standards and policies to those of the EU, the improvement in these basic indicators of health should be a strategic priority that cuts across all the relevant sectors of the government, generates policy discussions and results in their adoption. Reaching adequate levels of health for the population as a strategic national objective calls for an increased funding for health care.

The EU and Georgia agreed to move forward with deepening and broadening EU-Georgia relations within the Eastern Partnership framework. Negotiations on an EU-Georgia Association Agreement were launched in 2010. Furthermore, the EU has given a green light to launch negotiations on the Deep and Comprehensive Free Trade Areas, which will be part of the Association Agreement and aim to closely associate Georgia to EU both in economic and political terms, in line with the Eastern Partnership objectives. Increasing economic activity with the European Union will put additional pressure on the country to improve health conditions of its population to meet the general European standards.

Figure 40 Under Five Mortality Rate

2.3 Good health as a driver of healthy economy

Economic growth, poverty reduction and good health of the population are closely related concepts. Some studies have suggested that foreign direct investment (FDI) is strongly correlated to the recipient countries GDP\(^6\), indicating that an increase in GDP is likely to lead to an increase in FDI. There is also a close link identified in economic literature between life expectancy and GDP, with a 1% rise in life expectancy leading to a 6% rise in GDP\(^7\), demonstrating the important role healthcare has to play in both the economic and national security of the country. It is important to note that the causal relationship between economic growth, poverty reduction and good health can be two-directional, making it important to pursue these objectives simultaneously for the best outcomes.


The Global Competitiveness Index issued every year by the World Economic Forum provides a good illustration of the role of health in determining country’s competitiveness on the global economy. In the 2012 report, Georgia ranks 82 among 142 economies evaluated in terms of overall competitiveness. Out of the 12 pillars used by the report to determine the overall ranking, such as “institutions,” “infrastructure” and “labor market efficiency,” one is dedicated to “Health and Primary Education.” The performance of Georgia under this pillar is far from impressive. With the exception of HIV prevalence, which places Georgia in the rank of 21, all such indicators as TB incidence (92th rank), infant mortality (94) and life expectancy (87) are not contributing to the competitive advantage of the country’s economy.

2.4 Health as a human right: meeting international standards

The accumulated experience shows that a human rights approach to health is necessary in advancing a complex agenda associated with health care reform, because it emphasizes equality, the right to choose and the right to participate, and calls for the participation of the public in the design of the policies, budgets, legislations and other activities. This participation is not simply a requirement of human rights, it has also been shown to increase the effectiveness of any health care reforms.

Georgia, as a member of international community and the signatory of a number of relevant international instruments, is under legal obligation to promote health of its population as a fundamental human right. Meeting these obligations is an important national security prerogative to ensure the country’s good standing as a responsible member of the international community and a healthy and attractive environment for deepening economic relations, especially in trade and investment.

Having first appeared in the Preamble of the World Health Organization (WHO) Constitution in 1946, a right to health was recognized by a number of United Nations human rights documents, including the Universal Declaration of Human Rights (UDHR), which promulgates in Article 25 “the right to a standard of living adequate for health and well-being.”

It should be noted that while the right-holders for health are the citizens, the responsibility to meet this right does not

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11 (1) Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and medical care and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control.
rest solely with the government, but also on all societal segments that play an important role – the private sector, local communities, civil society and international partners included. However, the government has the primary responsibility, and can galvanize the support of the broader societal segments through appropriate policies and correct incentives.

3. The health of the nation: current state, challenges and recommendations

The health care system of Georgia today represents the heritage of the country’s communist past as transformed through several waves of reforms carried out to adjust the system to the new realities, to improve health quality in the country, and to increase the access of the population to health care services. The description and analysis of these reforms are available from various sources, including the Ministry of Labor, Health and Social Affairs (MoLHSA), and is not the subject of this document. Instead, we look at the current situation to assess the state of health of the population, the key systemic challenges, and the present regulatory framework that determines the degree of access to medical goods and services.

Figure 42 Maternal Mortality Ratio

3.1 Health Care Finance System

The health financing system of Georgia must aim to create a policy framework that uses the scarce health care resources more efficiently, improves the quality of health care, and increases access to basic health services by providing individuals and families who use health services with financial risk protection through risk pooling. The existing health policy documents, such as the National Health Care Strategy 2011-2015, do identify these issues, and provide broad recommendations to address them. In implementing these recommendations, the government should be guided by key principles of health financing policy to improve access to basic services with financial risk coverage for all.

The past decade witnessed skyrocketing health care expenditures in the country, reaching 10.1% of the GDP in 2009. However, the lion's share of this spending – estimated at 72% comes directly from households, while merely 18.4% (an extremely low rate compared to other European nations) of health expenditure is from public government sources. The household expenditures on health care have increased dramatically from 15% of disposable income in 2001 to 34% in 2009, most of this increase associated with the outpatient medication.

When a household is forced to expend one third of its disposable income on health care, often unexpectedly and mostly out-of-pocket, it can easily slip below the poverty line, adversely affecting Georgia’s growth potential. Moreover, the costs associated with this pattern of payment vastly reduce the majority of the population’s access to healthcare and pharmaceutical drugs.

In order to alleviate the burden of health care expenditures on households while ensuring access to the needed services and drugs, the government of Georgia undertook reforms during 2007-2008 designed to reduce out-of-pocket expenditures by bringing increasing number of individuals under an insurance coverage. This did result in a three-fold increase in the number of insured persons to 1.5 million in 2011, two thirds of them covered by state-funded medical insurance, including more than 900,000 citizens living below the poverty threshold. Another positive trend has been a steady increase in the government’s health expenditures from the national budget. However, even though the insured persons have used health services with increased frequency, the total health care utilization has not been positively affected. In fact, Georgia has second lowest (after Azerbaijan) rates of hospital and outpatient service utilization. This is hardly surprising considering that more than 2.5 million citizens remain uninsured.

The underutilization of health services leads to low health indicators, which in turn diminish the attractiveness of its domestic market for foreign investment, decrease the competitiveness of its labor market, and push Georgia lower on various socio-economic rankings (which directly feed into the investment decisions concerning the country), such as the Human Development Index (the rank of 75 out of 187 countries in 2011) and the Global Competitiveness Index of the World Economic Forum (the rank of 82 out of 142 countries in 2012).

The picture points to a clear need to increase the number of insured citizens. The government has set as a target raising the number of the insured to at least 2.5 million by 2015, as indicated in the National Health Care Strategy 2011-2015, through the increase of coverage of population under a state funded insurance scheme, and through the development of health insurance market.

The health insurance and medical care markets are text-book examples of markets in which asymmetric information plays an important role – in other words, where one side of the economic transaction is likely to have more information than the other. This asymmetry of information leads to adverse selection, where persons who expect to incur high health care costs are more likely to purchase health insurance. Another characteristic of this market is moral hazard – a situation in which having insurance coverage may encourage patients to disregard the cost of care and use excessively and unnecessarily available health care services. Precisely for these, as well as other market inefficiencies in health care, it is critical for the government to establish robust regulatory, policy and legal framework, which will rectify the imbalances when the market forces alone cannot determine the incentives.

There are number of fundamental principles in health financing policy, in theory and as born out in practice in many countries, which need to be in place for the government to have the legal and regulatory capacity to carry out the main health financing functions of resource generation, pooling, purchasing of benefits and coverage, and providing health care services. These principles underlie the recommendations below for addressing the identified shortcomings.

☐ Recommendation 1: Capture all health care services, whether the sources of finance are public or private, under the same legal, policy and regulatory framework, in order to avoid fragmentation of health sector, but take explicit responsibility for providing access to the set of essential health care services.

Based on health economics theory and the best available empirical evidence, the failure to integrate private health funding and private providers into an overall health financing policy leads to market inefficiencies and health system failures that can easily offset the nominal increase in health expenditures by the government. Only an integrated system in which the government has the regulatory coverage of all funding sources can create the conditions for optimal allocation of all resources in the health system, allowing for a gradual expansion of the coverage of services and populations with public funding, and to promote increased risk-pooling of private health expenditures. A good illustrative case is Greece, where despite consistent rise in government’s health care expenditures (before the current financial crises, which is of course partially caused by the unbalanced growth of expenditures at the expense of mounting budget deficit and external debt),

private expenditures continued to increase in total share of health funding, a phenomenon directly linked to the failure to integrate private funding sources into an overall health financing policy.\textsuperscript{15}

An overhaul of the existing legal and regulatory framework might be necessary to empower the government to formulate and implement policies that ensure access to the entire set of essential services, integrate policies governing private sources of financing into broader health financing policy, and actively regulate the private health insurance market to ensure equitable access to essential services for the privately insured and avoid cream-skimming and dumping practices by private insurance companies. Towards this end, the Law on Health Care of Georgia, which currently limits the role of the government to ensuring “universal and equal access to medical care within the framework of State-funded medical programs,”\textsuperscript{16} must be amended to give the government the legal bases to capture the services outside the state-funded medical programs.

Figure 43 Set of Essential Health Care Services under Government Health Financing Policy Umbrella

Recommendation 2: Set evidence-based priorities in terms of services and populations covered for the allocation of government funding of health care

Once the entire set of essential services are captured by the legal, policy and regulatory frameworks, the government can ensure that the increasing resources available for health care are optimally distributed. The government that has full regulatory control over the medical insurance market can make strategic choices concerning increasing the range of services financed by the state and the population covered. There is an ample room for policy maneuvers within this scheme, such as following the expansion path for government funding vertically, meaning the insurance scheme would


cover an increasing number of medical services, or horizontally, indicating that more groups of vulnerable population will be covered, or in both directions – vertically & horizontally over time in chronological stages of growth.

Once the legal and regulatory framework is in place, the government has the leverage to optimally allocate the resources to ensure the best health outcomes for its population. An essential step is to rank health services from highest to lowest priority, and the population from most vulnerable to least vulnerable segments, based on criteria that are economically sound and reflect real health priorities of the population, as well as the prevailing social values and the political priorities of the government.

3.2 Demographic pressures

Approximately 47,000 deaths occur in Georgia every year, one fourth of which are among the working age population due to preventable conditions: cardiovascular disease, cancer and trauma. This has a direct bearing on the labor force and consequently the economic potential of the country. Moreover, despite slight improvements, Georgia has under-five mortality rate that significantly surpasses the EU average, and compares poorly to the similar indicators in most countries from the post-Soviet space.

In fact, children seem to represent a group that is especially vulnerable to health risks. Preventable infectious diseases account for 56% of the disease burden seen among children up to 15 years old. The overall disease burden among children is three times higher than the European average.

Figure 44 Life Expectancy

The demographic pressure of time should be an important incentive for avoiding delays in health care reform – the prevailing trends will make the health care needs of the population more pressing in the medium-term future. Unless the fertility rates in Georgia, currently at 1.86 per reproductive aged woman, rise above the natural replacement level of 2.15, the proportion of the elderly over the young persons, which increased from 15% to 19% over the past two decades, and is projected to reach 26% by 2050, will inevitably place additional stress on the health care system.

As recognized in the National Health Care Strategy of Georgia, the growing ratio of elderly people over working age individuals, caused by declining fertility, poses significant challenges for health care system in particular, and to the economic growth of the nation in general.

Recommendation 3: increase state resources spent on the public health services in general, and specifically on:

- improvements in the quality of and access to maternal and child health services;
- prevention and control of existing and newly emerging communicable diseases; and
- prevention of non-communicable diseases with an enhanced focus on awareness-raising and promotion of healthy lifestyles.

Public health services have specific economic characteristics that justify, even in the most liberal schools of economic thought, government intervention in the financing or delivery of that good or service. Public health services such as the prevention and control of communicable diseases and disease surveillance benefit everyone in the community in which measures are undertaken, since no one can be realistically excluded from the benefit of not acquiring a disease. Most of the services targeting a healthy environment, such as treatment of water and prevention of air pollution, as well as public information campaigns and health education programs through the public media, fall under the public goods category. Public goods and services can not be allocated by market forces because suppliers would not be able to capture revenue, due to the free riders who have no incentive to pay for the benefits of consuming, without incurring personal costs, the public health goods and services.

We welcome the declaration of the government’s commitment, in the National Health Care Strategy document, to the development of integrated, adequately equipped and well-functioning disease surveillance system, with the required information infrastructure, modern lab network and highly qualified personnel. The expressed intention to increase the effectiveness of the immunization program is also a welcome development, which will contribute to the improvement of some of the most critically low health indicators in the country, such as child morbidity and mortality.

Implementing these commitments will require the allocation of the necessary resources. The next step will therefore be to adequately reflect the required expenditures in the state budget. Within the strategy to reduce maternal and child mortality, increasing public resources should also be allocated to upgrade perinatal services.

Infectious diseases present a high risk factor for Georgian health care. Infectious diseases have been shown to be a major factor in neonatal death in Georgia and an increase in neonatal care and vaccinations needs to become a priority area. The majority of deaths in the population below the age of 60 are preventable. Therefore, in dealing with the high burden from infection and in increasing public education as to the health risks of various actions, the government of Georgia can simultaneously tackle the issue of the ageing population. A greater policy focus that directs financing towards specialized health care for the major illnesses affecting the population, especially health care specialized for children can assist Georgia's population in developing a healthy equilibrium between young and old.

3.3 Building and Renovating the Health Care Infrastructure

The construction of new and rehabilitation of old hospital sector infrastructure is today the most visible and publicized aspect of health care reform in Georgia, and is based on the Hospital Master Plan, called “100 New Hospitals”, approved by the government in 2007. The plan aimed to ensure high-quality and affordable hospital services by transferring full ownership rights from the state to the private sector under certain conditions, such as the requirement to make the necessary investment in renovating and refurbishing the facility, and keep the existing profile of the hospital for at least seven years. Therefore, this is an area where the government cooperates closely with the private sector and donor organizations, primarily for the purpose of obtaining funding for the required upgrades. The plan envisages an investment of 1.2 GEL in hospital sector over the next two years. So far, the government has rehabilitated or built 50 hospitals throughout the country. 150 medical facilities are planned to be built or refurbished by 2013.

According to the National Health Care Strategy, the new multi-profile facilities will be based on the principle of referral network and will offer inpatient, outpatient and ambulance services. The regulatory mechanism to ensure the quality of the new centers will be based on the national permit requirements, established by the Georgian government. The plan is to ensure that every administrative-territorial until has a new medical center that offers high quality medical services that will be accessible both geographically and financially to the entire population of Georgia.
Choosing to transfer the ownership of the deteriorated healthcare infrastructure from the state to the private investors is a pragmatic approach that has a potential to increase competition, attract the needed investment into the sector, and ensure better medical services. However, unless the appropriate health care finance system is in place, guaranteeing the entire population an equal access to certain basic level of services offered by these facilities, the existence of modern care facilities will further exacerbate health inequalities in the country by focusing on serving the rich and excluding the poor. In the privatized hospitals, healthcare costs are likely to increase. Therefore, a modern medical infrastructure – the hospitals, the clinics, the equipment and other physical entities, is a necessary, but not sufficient component of an effective and accessible health care system.

It is important to note that hospital privatization process is currently administered by the Ministry of Economic Development, which, based on its mandate and competences, tends to approach the issue from a purely economic perspective. This raises two major challenges. First, privatized hospitals will fall under the Georgian Entrepreneurial Law, according to which they must meet a number of criteria, including solvency, capacity to pay taxes and operate at a profit. The profit motif, under the conditions of total government non-intervention, can easily compromise the hospital's desired focus on improving quality of and access to healthcare. Considering that many of the new and refurbished hospitals are owned or leased by the few major pharmaceutical companies in Georgia, there is a high risk of collusion, conflict of interest, and other unfavorable conditions for promoting free competition, affordable prices and equitable access to medical goods and services.

Second, the management of hospital privatization by the Ministry of Economic Development leaves out a key stakeholder in the health care delivery – the Ministry of Labor, Health and Social Affairs.

☐ Recommendation 4: coordinate and align closely the hospital sector reform with the health care finance reform in the country. Enforcing the stewardship function of MoLHSA is especially important in regards to the privatization processes managed by other sectors of government. Within this function, MoLHSA can design specific provisions to accompany the hospital privatization process. Such provisions should regulate and monitor different types of services, aimed at discouraging monopolies, price fixing, and other distortions to the market, thereby optimizing the prices for goods and services in the healthcare sector.

Another approach that can be pursued in parallel is making sure that the Company Charter of the hospital explicitly commits the entity to improve access to and quality of health care, and to use any profits generated for the improvement of hospital’s facilities and capacities.

3.4 Focusing on Prevention and Promotion of Healthy Lifestyle

Non-communicable diseases are by far the leading causes of death in the country. 63 percent of all deaths in the last decade (2001-2009) were caused due to the diseases of the circulatory system. And further 11 percent of deaths were due to cases of neoplasm – also a very high rate caused by significant delays in diagnosing the neoplasms. Only between 25% to 30% of neoplasms are detected at early, more treatable stages.18

Unhealthy lifestyles and practices harmful for health, such as tobacco consumption, drug abuse, unhealthy diet and lack of physical activity account for a large share in national disease burden.

Prevention policies targeting the main causes of morbidity and mortality can lead to substantial benefits for the health care system, in terms of improved health indicators, and decreased health expenditures.

☐ Recommendation 5: set up and promote awareness about screening programs to detect neoplasms in early stages.

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Recommendation 6: Promote healthy lifestyles for citizens and communities of Georgia through education, prevention and creation of healthy environment.

3.5 Attaining High Qualification of Health Care Workforce

Achieving and maintaining high national health standards depends on a strong, well-trained workforce operating within supportive policies and legal frameworks.

Medical education in Georgia is facing two major challenges: the first is the quality of education and training in medical schools, the other is the lack of planning and coordination that results in the oversupply of doctors and severe undersupply of nurses on the medical labor market.

The level of education for doctors has largely been tied in the past to simple knowledge assessment. While medical knowledge is an important determinant of a doctor’s performance, clinical problem-solving skills and clinical performance is arguably equally important. As such, education policies emphasizing medical students experience in clinics, hospitals and other centers is essential for improved medical delivery in the future.

According to the latest data, 1200 doctors enter the workforce in Georgia each year, which is 135 more than the European average per 100,000 people. This stands in stark contrast to the 100 nurses that enter the work force in Georgia each year. This is ten times less than the average observed in Europe. This disparity creates a poor allocation of resources, with a hospital physician seeing only 2.6 patients per month and an outpatient physician seeing only 3 patients a day. Current projections indicate 350 doctors and 1400 nurses as optimal yearly numbers of entrants into the medical professions.

Recommendation 6: Shift the focus of certification examinations for doctors from knowledge assessment to the evaluation of clinical competencies and problem solving skills.

The major stakeholders in this process are not only the educational institutions, but also the medical professional associations, and the existing training and clinical facilities, which should be closely integrated into the teaching and training programmes with a view to providing the needed capacities for adequate education and training of future medical personnel.
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