



Gap Analysis of Georgia
August 11, 2009
Companion Narrative for PowerPoint Figures 1-15

Summary

This analysis attempts to take stock of Georgia's progress in its transition to a market-oriented democracy. It is an update of a more comprehensive analysis undertaken in October 2008 that looked in detail at gaps in economic and democratic reform, economic performance and human capital¹. This updated analysis focuses on new data available since then, namely from the EBRD and Freedom House, as well as more up-to-date forecast data from the World Bank, IMF and Economist Intelligence Unit reflecting the economic crisis.

As before, this analysis considers two sets of thresholds, transition progress attained in: (1) Bulgaria and Romania on average in 2002; and (2) Bulgaria, Romania, and Croatia at phase-out in 2006.

The salient finding is that the global economic downturn has halted Georgia's impressive economic growth and may result in negative growth for 2009. The poverty rate is also forecast to increase. The democracy gap continues to widen irrespective of which set of thresholds are employed. Gaps also remain in second stage economic reforms.

Economic and democratic reforms

Figure 1 provides the bird's eye picture of reform progress in Georgia vis-à-vis the rest of the transition countries and vis-à-vis two plausible thresholds. By EBRD measures, Georgia is among the Eurasian economic reform leaders, second only to Armenia. This position places it in the middle of the Southern Tier CEE countries in terms of economic reforms. It is above the Eurasia average in terms of democratic reforms. It is close to the Romania-Bulgaria 2002 thresholds in the economic reform dimension; yet at considerable distance in terms of democratic reforms. When measured by the threshold standards of Bulgaria, Romania, and Croatia in 2006, Georgia has a noticeable gap in terms of economic reforms and a larger gap in terms of democratic reforms.

Economic reforms Georgia's economic reforms (as measured in 2008 by MCP's economic reform index, which draws from EBRD indicators) are slightly below the Romania-Bulgaria 2002 standard (*Figure 2*). Given more recent trends, Georgia may meet the 2002 threshold around 2011. It is difficult to estimate when Georgia will meet the standards of Bulgaria, Romania, and Croatia in 2006. While a very optimistic scenario based on progress since the mid 1990s could result in meeting the more

¹ http://inside.usaid.gov/EE/po/pdfs/mcp_gap_analyses/mpc_gap_analyses-georgia_october_2008.pdf

ambitious threshold around 2013, more recent trends suggest that convergence with the 2006 threshold is over a decade away.

While economic reforms have increased over the past decade in Georgia, there was no change between 2007 and 2008. According to the EBRD data, the economic reform score has moved from 3.19 in 2005 to 3.22 out of 5.00 in 2008. Of the nine indicators that make up the MCP economic reform index, there was movement only on one during this time period- the large scale privatization component increased from 3.67 in 2005 to 4.00 in 2008.

Figures 3-4 show the components of the economic reform index and Georgia's current level of economic reform progress in each component relative to the Bulgaria, Romania, and Croatia 2006 threshold, and relative to its own economic reform progress in 1999. Good progress has been made in first stage reforms; while gaps still remain in the second stage reforms vis-à-vis the Bulgaria, Romania and Croatia threshold. This is evident in *Figure 3* which shows gaps in all five of the second stage indicators relative to this threshold: enterprise restructuring, competition policy, banking reform, non-bank financial reform and infrastructure reform. It is notable that while Georgia is a leader in the Eurasia region when looking at economic reforms, Stages I and II combined; the country is in the middle of the Eurasia group when looking at Stage II reforms alone. Russia (Stage II score of 2.6), Kazakhstan (2.5), Ukraine (2.5) and Armenia (2.3) lead Georgia (2.2) in this regard.

The 2008 EBRD Transition Report narrative, credits the Georgian authorities with having "made good progress with economic reforms in recent years, especially regarding the business environment." Microeconomic reform appears to be moving forward very well, at least by one set of measures. According to the World Bank's *Doing Business* analysis, Georgia has been rising rapidly in rank among 181 countries worldwide in the extent to which its business environment is conducive to enterprise growth² (*Figure 5*). This puts Georgia first among transition countries, including all of Central and Eastern Europe. Georgia has made the most significant progress of all Europe and Eurasia countries in the *Doing Business* index since 2005.

Democratic reforms As noted earlier, *Figure 1* indicates that Georgia, like most of Eurasia, lags considerably in democratic reforms behind all Central and Eastern European countries.³ Georgia's most recently measured level of Democratic Reforms is positive by Eurasian standards - lagging behind only Ukraine among the twelve Eurasian nations. Progress in democracy has been very uneven over time in Georgia; characterized by volatility in the early 1990s, followed by two prominent periods of backsliding, beginning in 1999 and again in 2007. (*Figure 6*)

² Scores are based on progress in ten areas, constraints towards starting a business, dealing with licenses, hiring and firing workers, registering a property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and closing a business.

³ The exception is Kosovo, which was under a UN Protectorate at the time the data was reported.

The MCP converts Freedom House data to a 1 to 5 scale, with 5.0 being the best possible score. Georgia's best score was 2.9 in 1999, after which the rating began to decline. According to Freedom House, in 2008 Georgia's score declined to 2.4 out of 5.0. While the Rose Revolution initially ended Georgia's early 2000s democratic backsliding, the modest but positive trend begun after the installation of the Saakashvili government reversed itself sharply with the violent crackdown against demonstrators in 2007. In light of recent trends, it is difficult to predict when Georgia will meet either the Romania-Bulgaria-Croatia 2006, or the Romania-Bulgaria 2002 democratic reform thresholds. Only an extrapolation based on progress made since 1991 places Georgia on a positive trajectory. The presidential and parliamentary elections held in 2008 offer no initial hope for a reversal of this negative trend.

Relative to the Romania, Bulgaria, Croatia 2006 threshold, gaps prevail in all seven areas that make up the Democratic Reforms index; media; anti-corruption; rule of law; national governance; and local governance (*Figure 7*). Scores for electoral process, civil society and national governance worsened for Georgia between 2007 and 2008. Significant backsliding since 1999 is particularly evident in electoral process, national governance and local governance (*Figure 8*). Scores for anti-corruption (2.3) and civil society (3.2) are the same in 2008 as in 1999. No components of the Freedom House democratic reform index for Georgia have improved since 1999.

Post Crisis Developments

Georgia's GDP growth in recent years had been strong, averaging 9.4% from 2003-2007. However, as *Figure 9* shows, this picture has changed dramatically in the past year. Real GDP growth slowed to 2.1% in 2008, with the economy contracting by 3.9% and 2.5% year on year, respectively, in the third and fourth quarters. Overall growth was dragged down by the impact of the global economic crisis and, as the Economist Intelligence Unit estimates, by the ongoing political conflict between the authorities and the opposition.

Figure 10 offers two alternate forecasts for Georgia's growth in 2009 and 2010. The IMF's estimate (from May 2009) shows Georgia maintaining positive growth of 1% in 2009, increasing to 3% in 2010. The Economist Intelligence Unit's forecast (from June 2009) shows a more pessimistic -3% growth in 2009, followed by a more modest recovery of 1% growth in 2010. If the more optimistic IMF forecast is to be believed, Georgia will be one of only six countries in the transition region, mostly from the Caucasus and Central Asia, which will register positive economic growth in 2009. (*Figure 11*)

The Economist Intelligence Unit estimates Georgia's fiscal deficit at 5.9% of GDP in 2008. Other estimates show it closer 4%. However, the fiscal deficit is forecast to improve. (*Figure 12*) According to a June estimate by the EIU, Georgia's current account deficit will be around 20% of GDP in 2009, although the April IMF estimate shows it at around 16%. (*Figure 13*) Inflation, currently around 10%, is forecast to decline in 2009 and rise again in 2010 (*Figure 14*).

Among the total population, according to the World Bank, 24% of Georgians were found to be poor. While this figure had been declining, the 2008 conflict and financial crisis are expected to increase both the rates of poverty and extreme poverty for 2009 and 2010.
(Figure 15)



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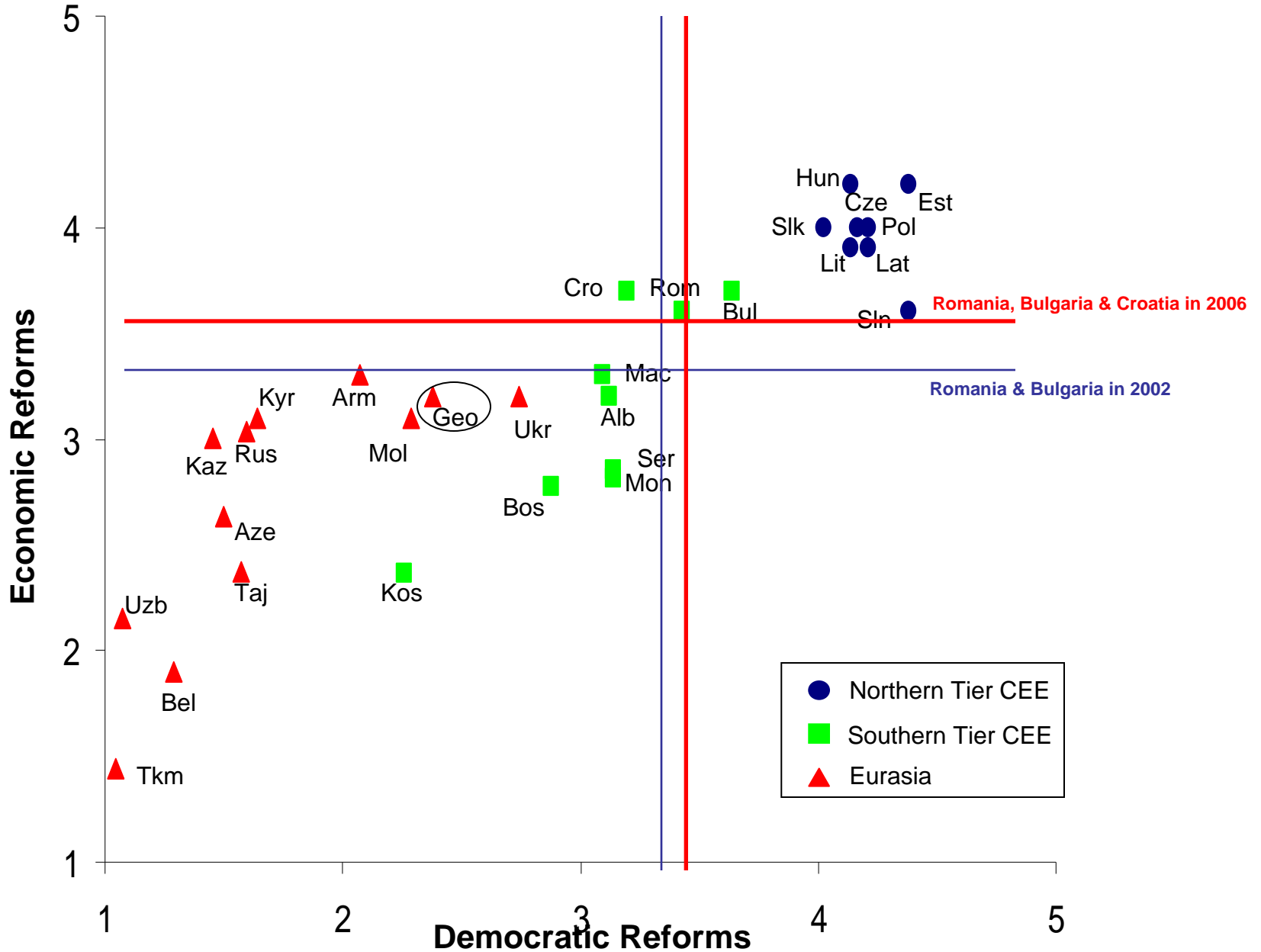
Figures 1 – 15 – Companion Presentation for “Gap Analysis of Georgia”

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Figure 1

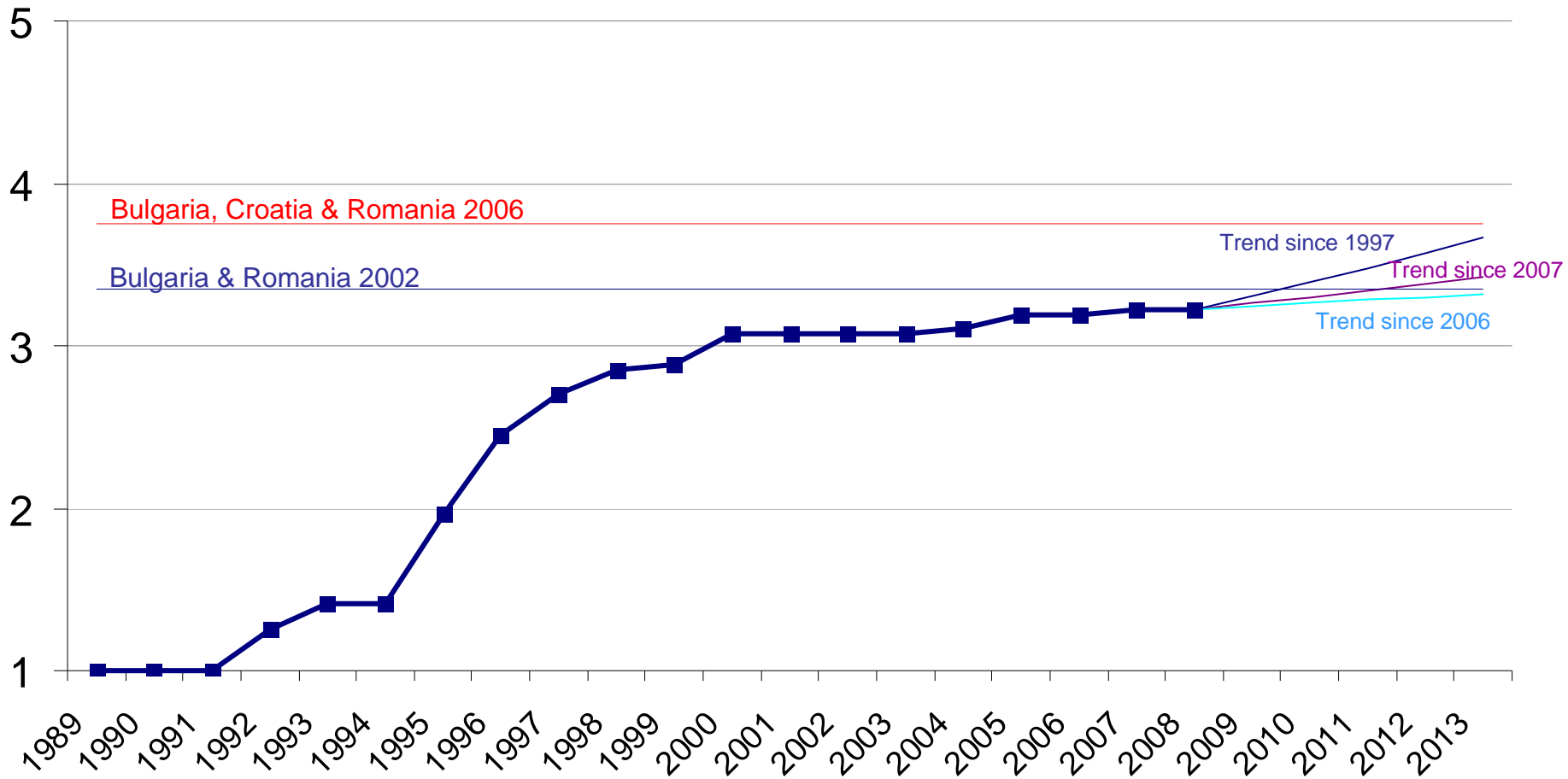
Economic and Democratic Reforms - 2008



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. Freedom House, *Nations in Transit 2009* (2009) and EBRD, *Transition Report 2008* (November 2008).

Figure 2

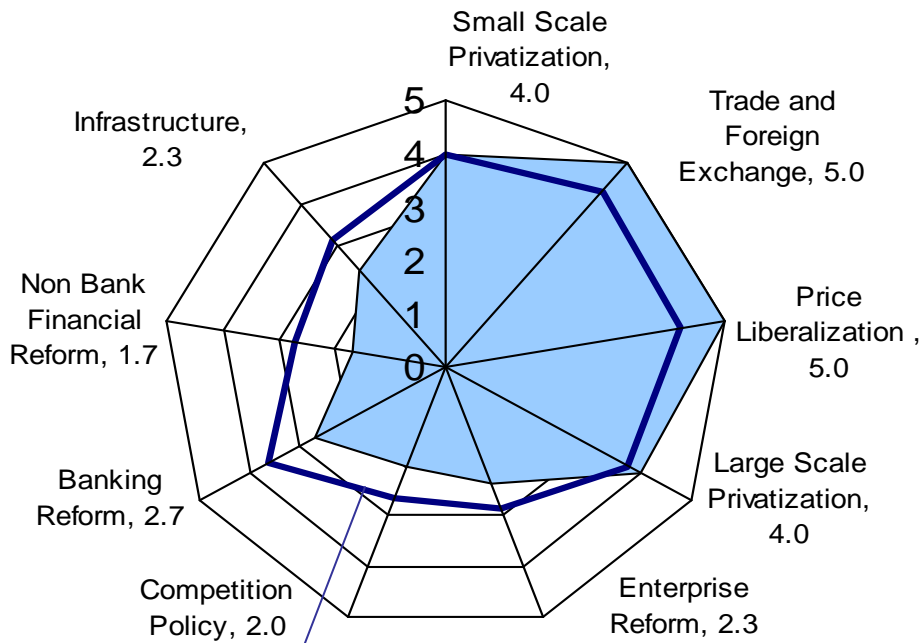
Economic Reforms in Georgia



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. USAID, Monitoring Country Progress in CEE & Eurasia system drawing from EBRD, *Transition Report 2008* (November 2008).

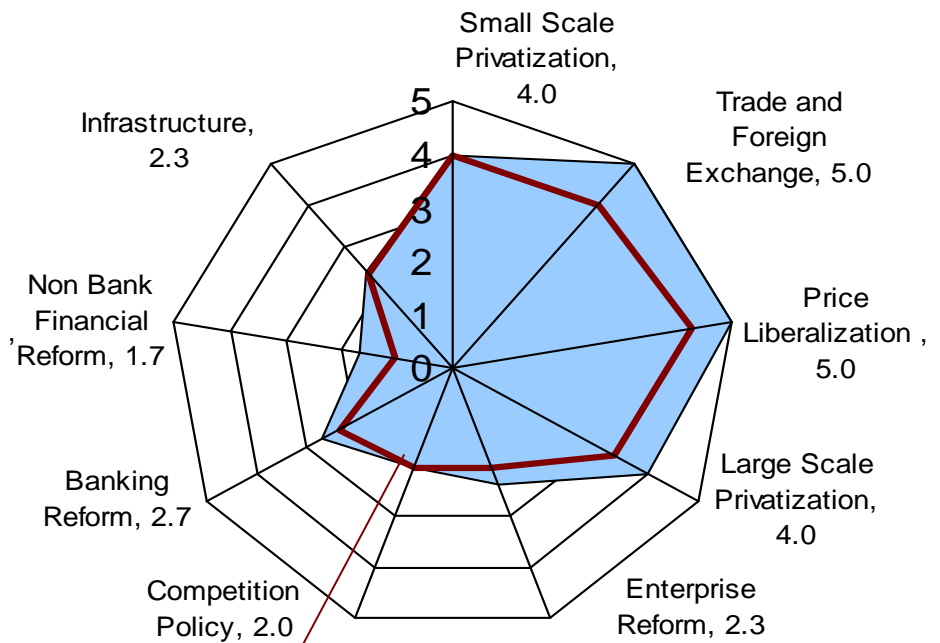
Economic Reforms in Georgia (2008)

Figure 3



Romania, Bulgaria & Croatia, 2006

Figure 4



Georgia, 1999

Figure 5

Business Environment in 2008, Percentile Rank

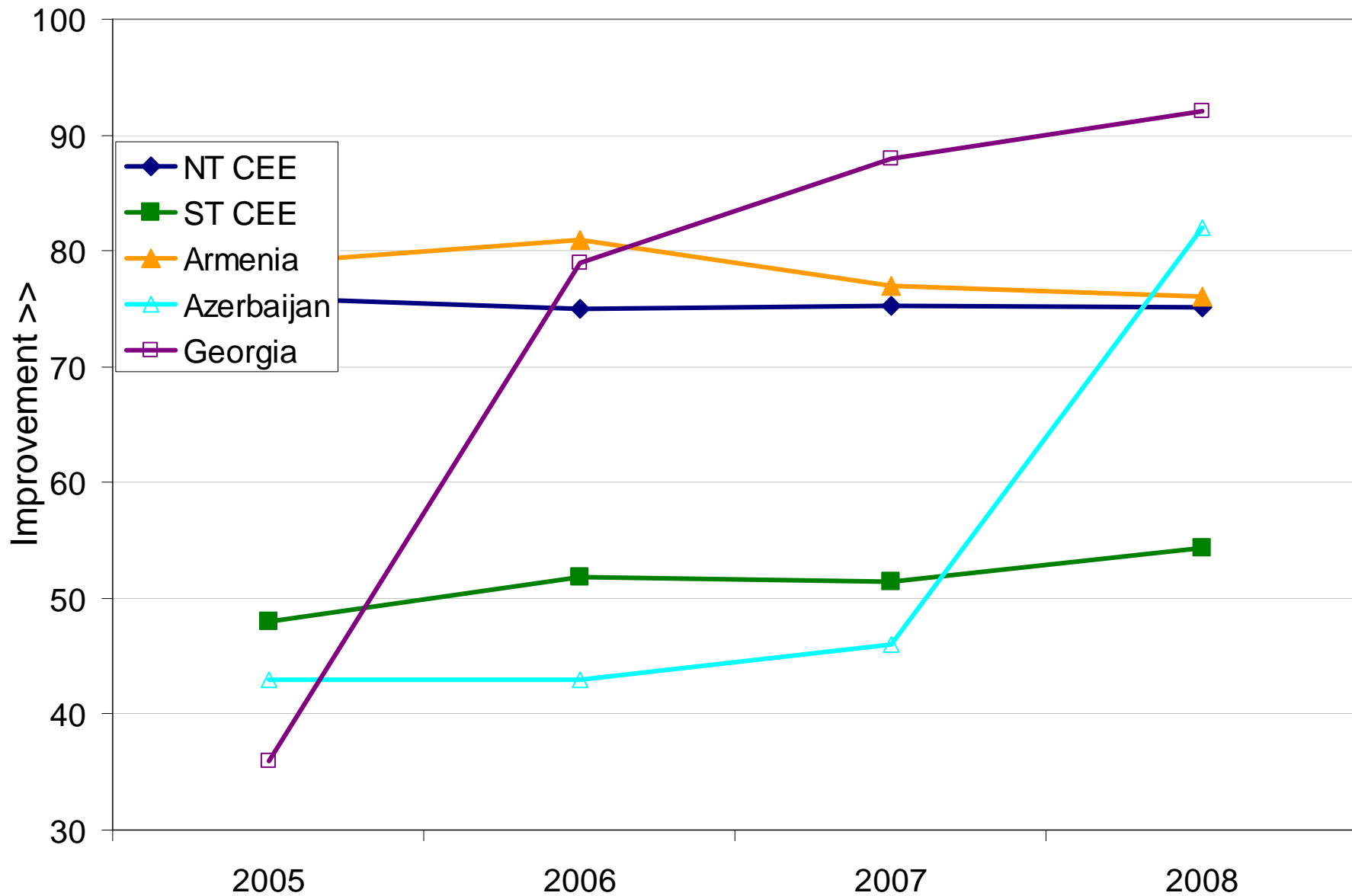
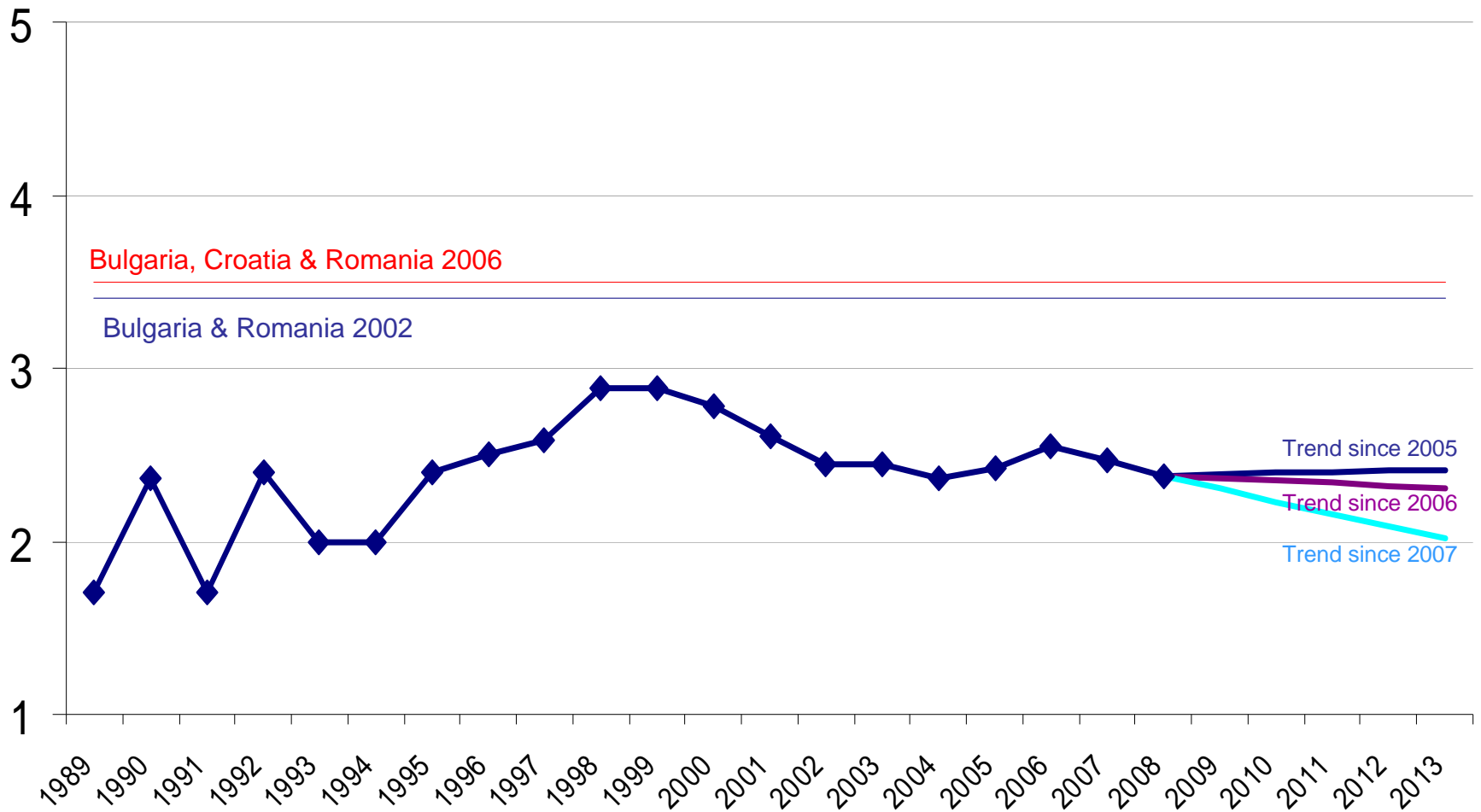


Figure 6

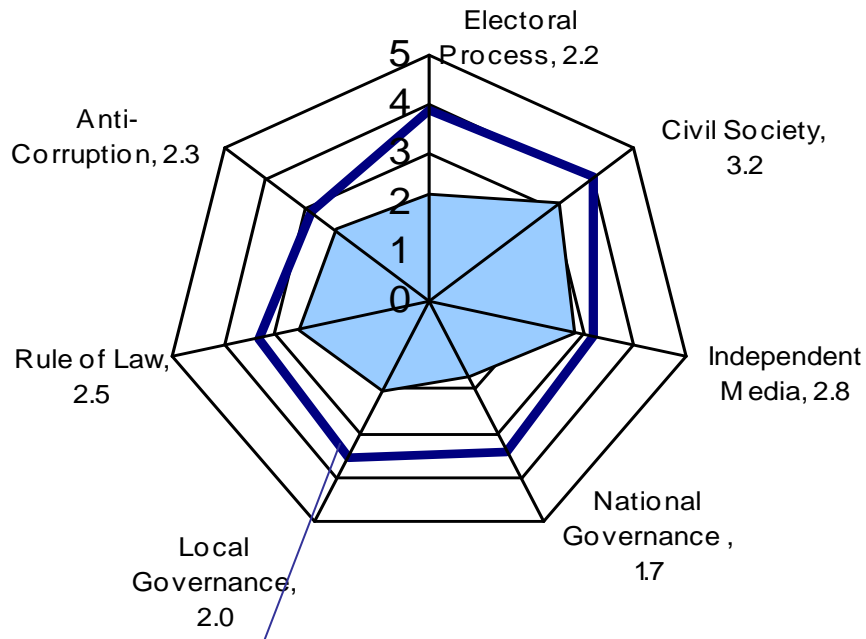
Democratic Reforms in Georgia



Ratings are based on a scale from 1 to 5, with 5 representing the best score. Freedom House, *Nations in Transit* 2009.

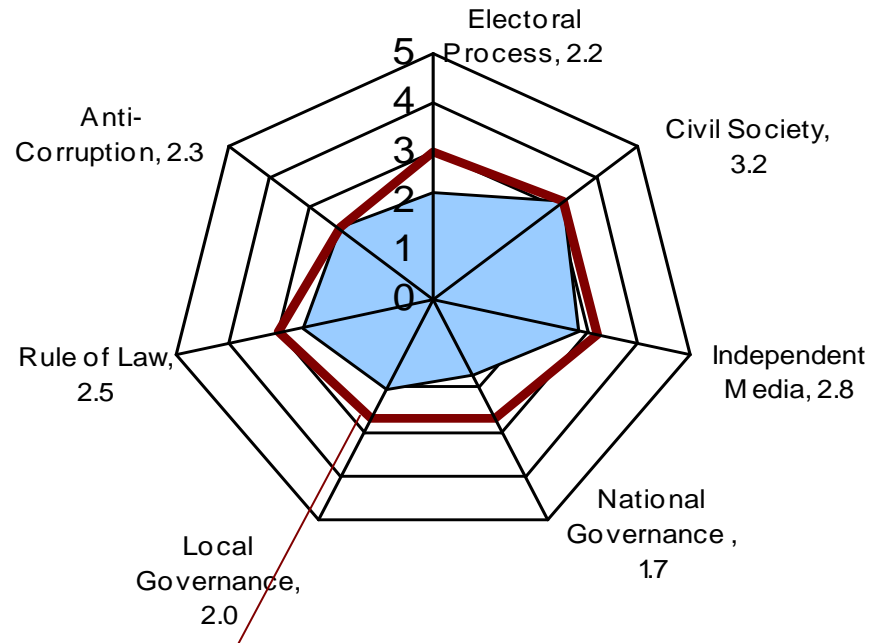
Democratic Reforms in Georgia (2008)

Figure 7



Romania, Bulgaria & Croatia, 2006

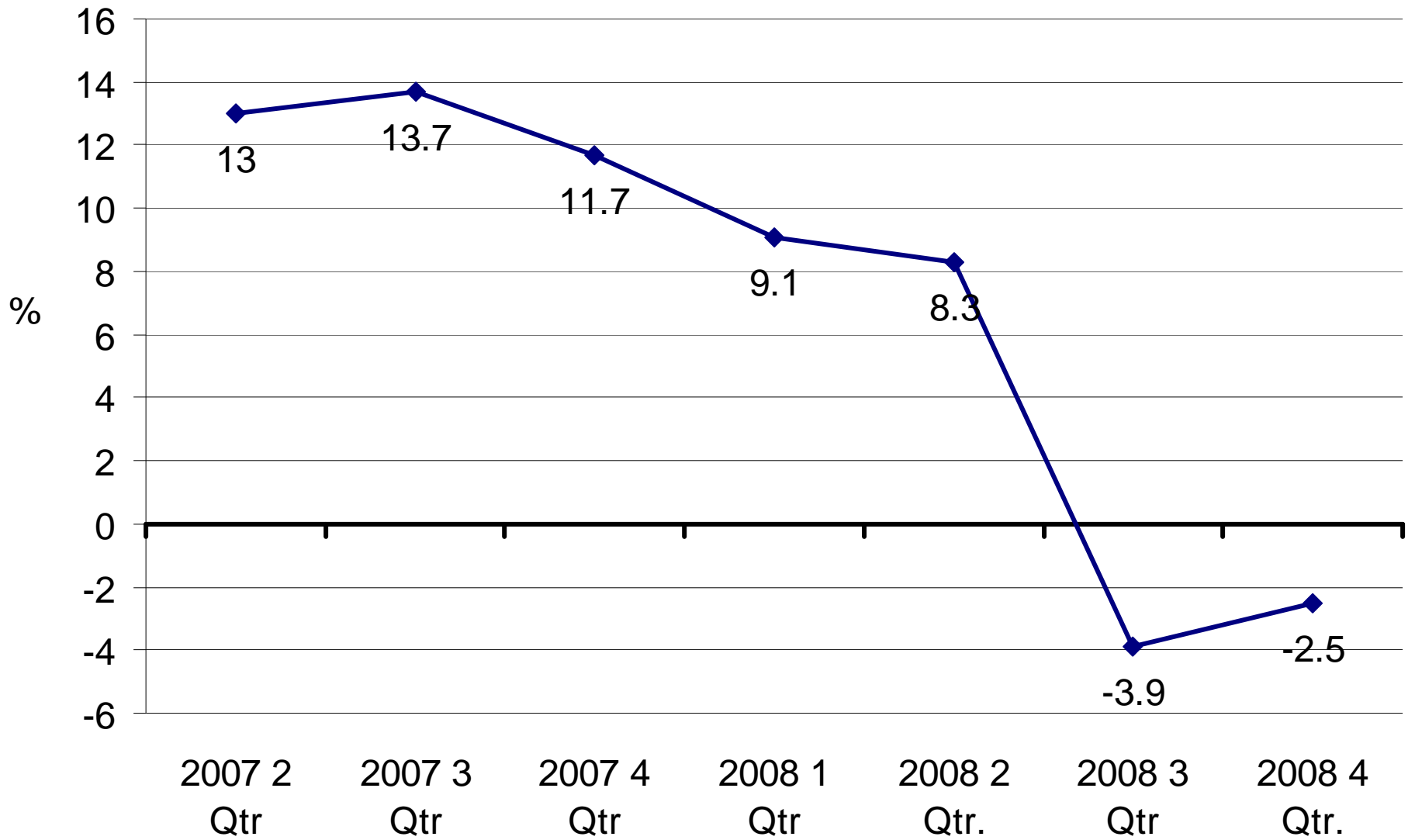
Figure 8



Georgia, 1999

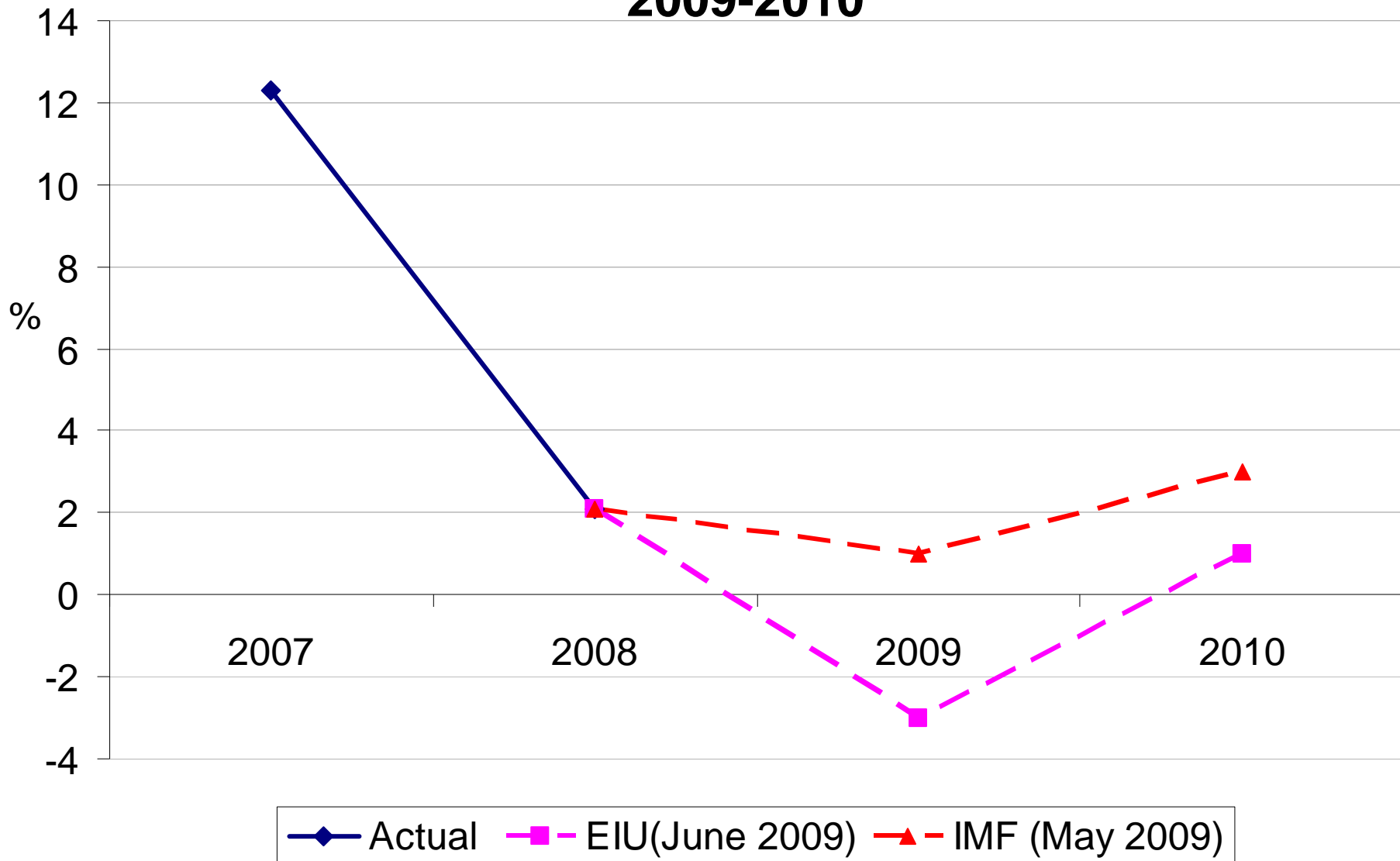
GDP % Change, Year on Year

Figure 9



Growth Rate and Alternative Forecasts for Georgia 2009-2010

Figure 10



Real GDP Growth, 2009 Projections

Figure 11

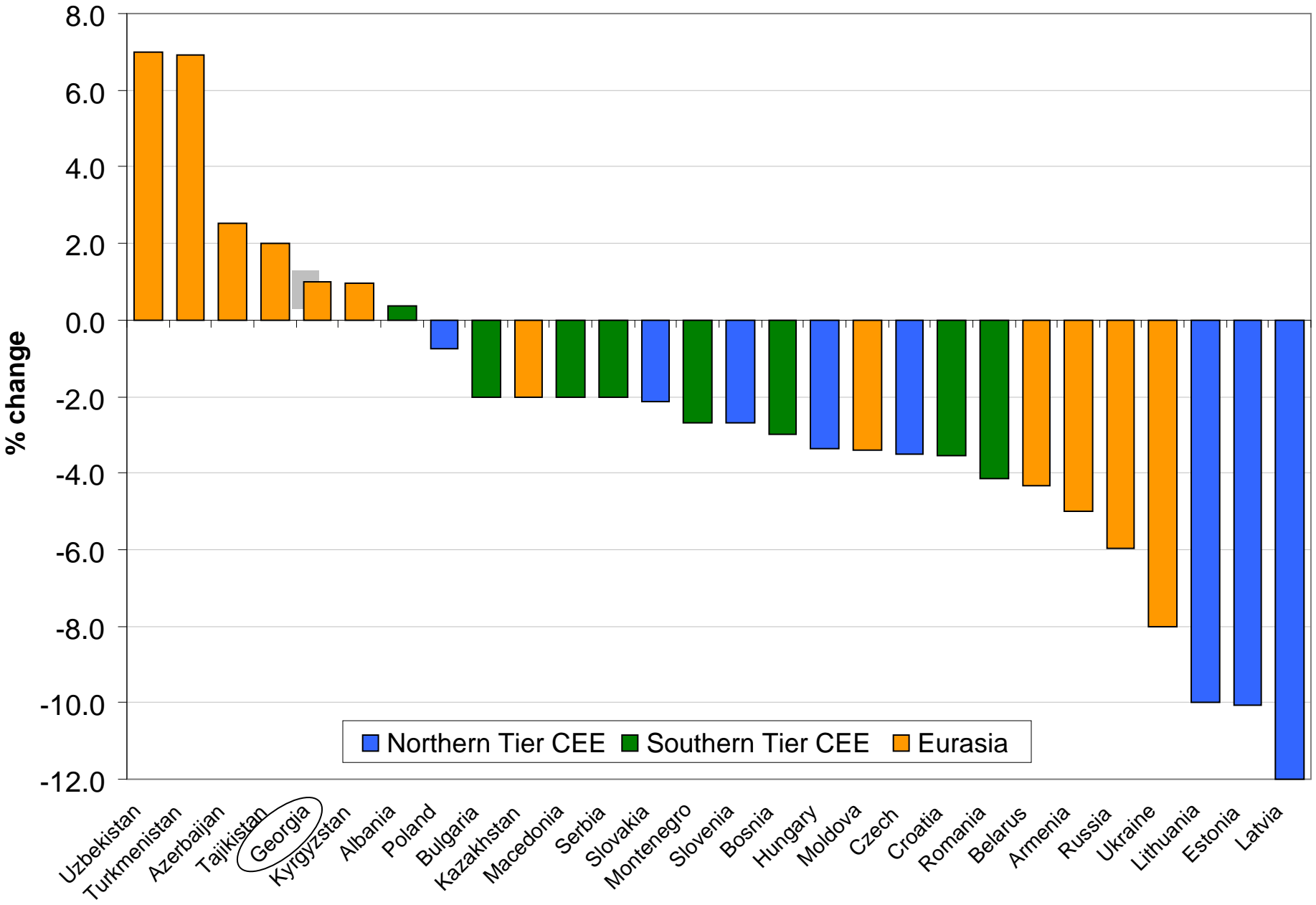


Figure 12

Fiscal Balance in Georgia

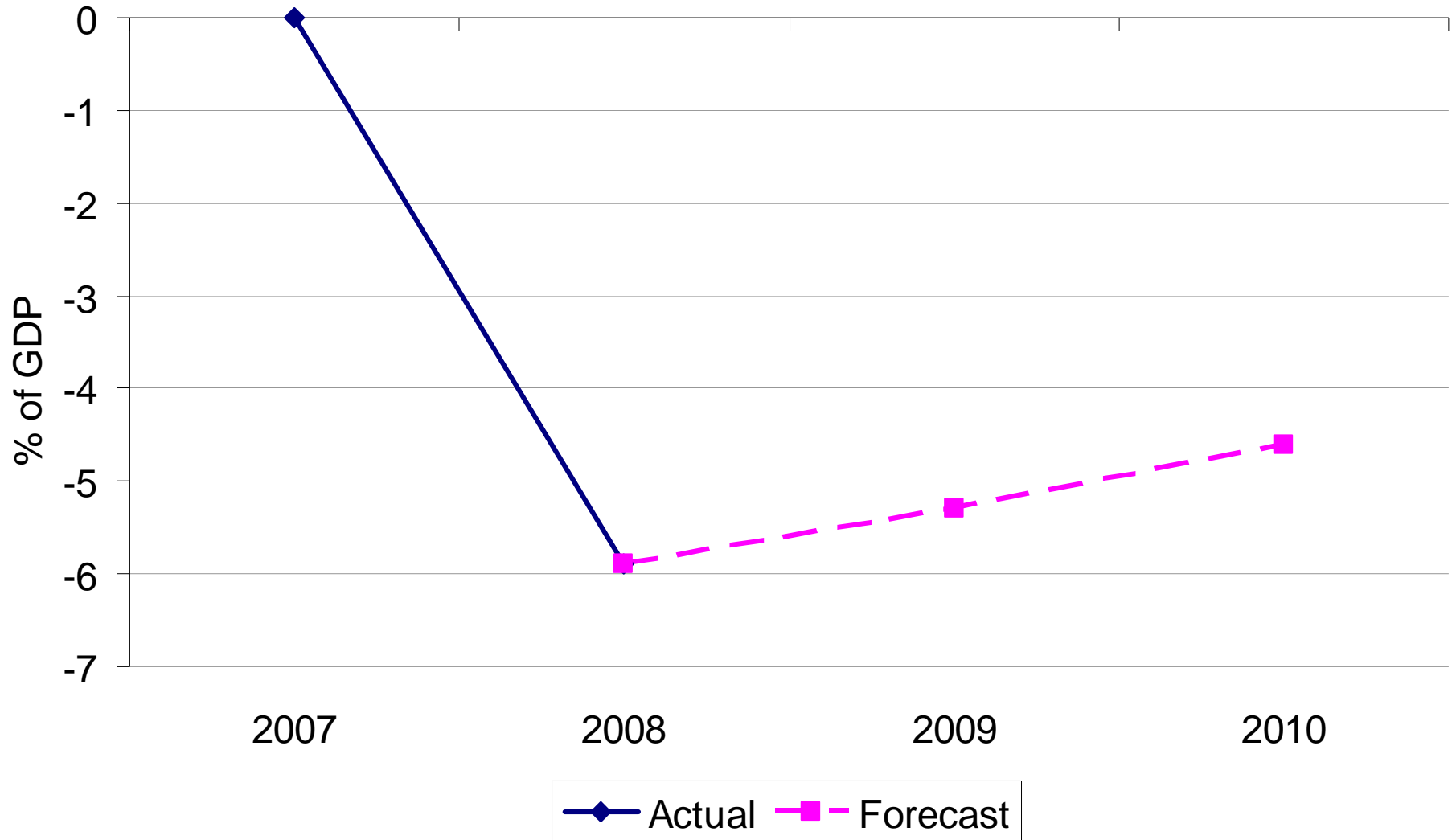


Figure 13

Current Account Balance

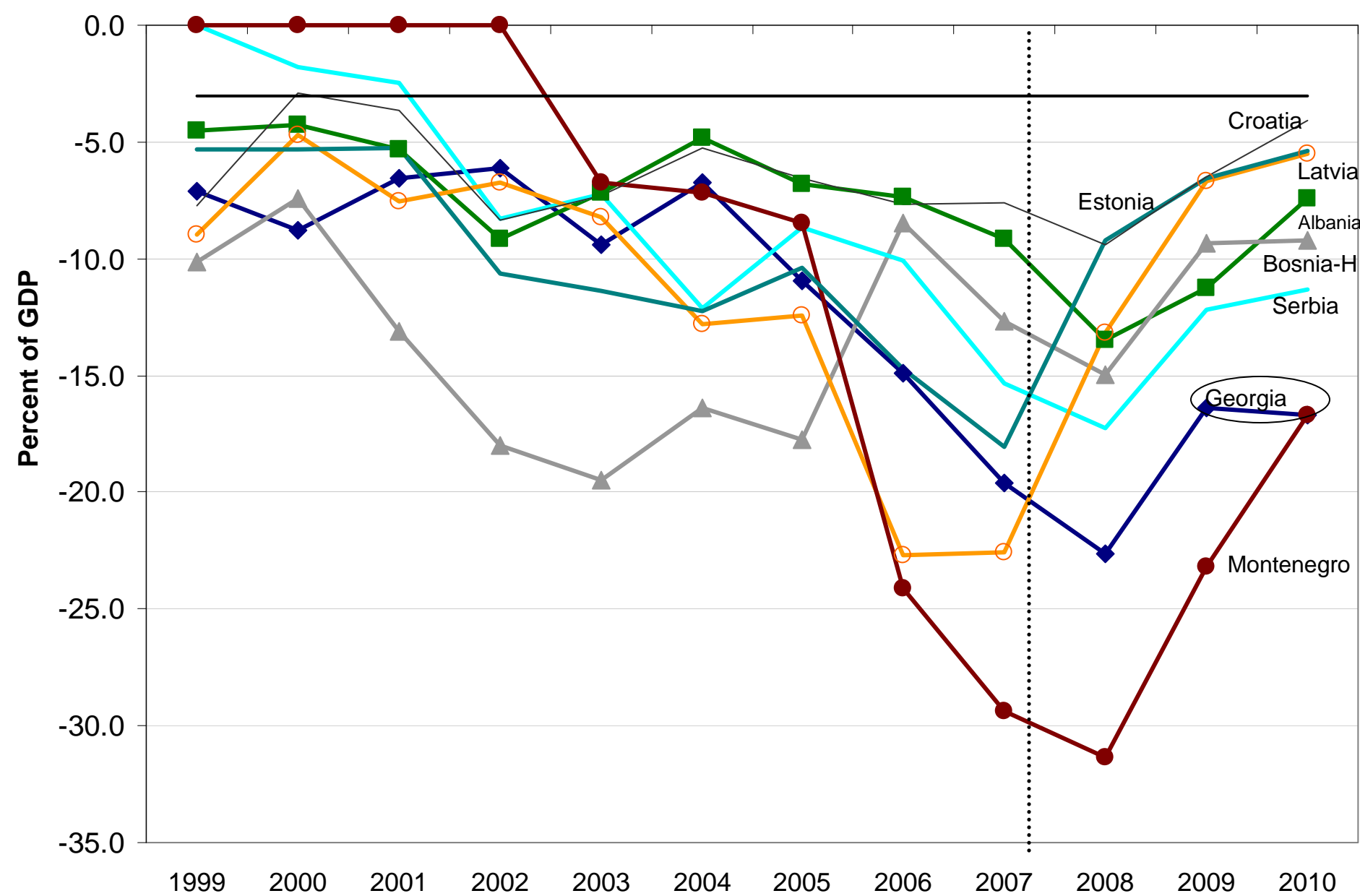


Figure 14

Inflation in Georgia

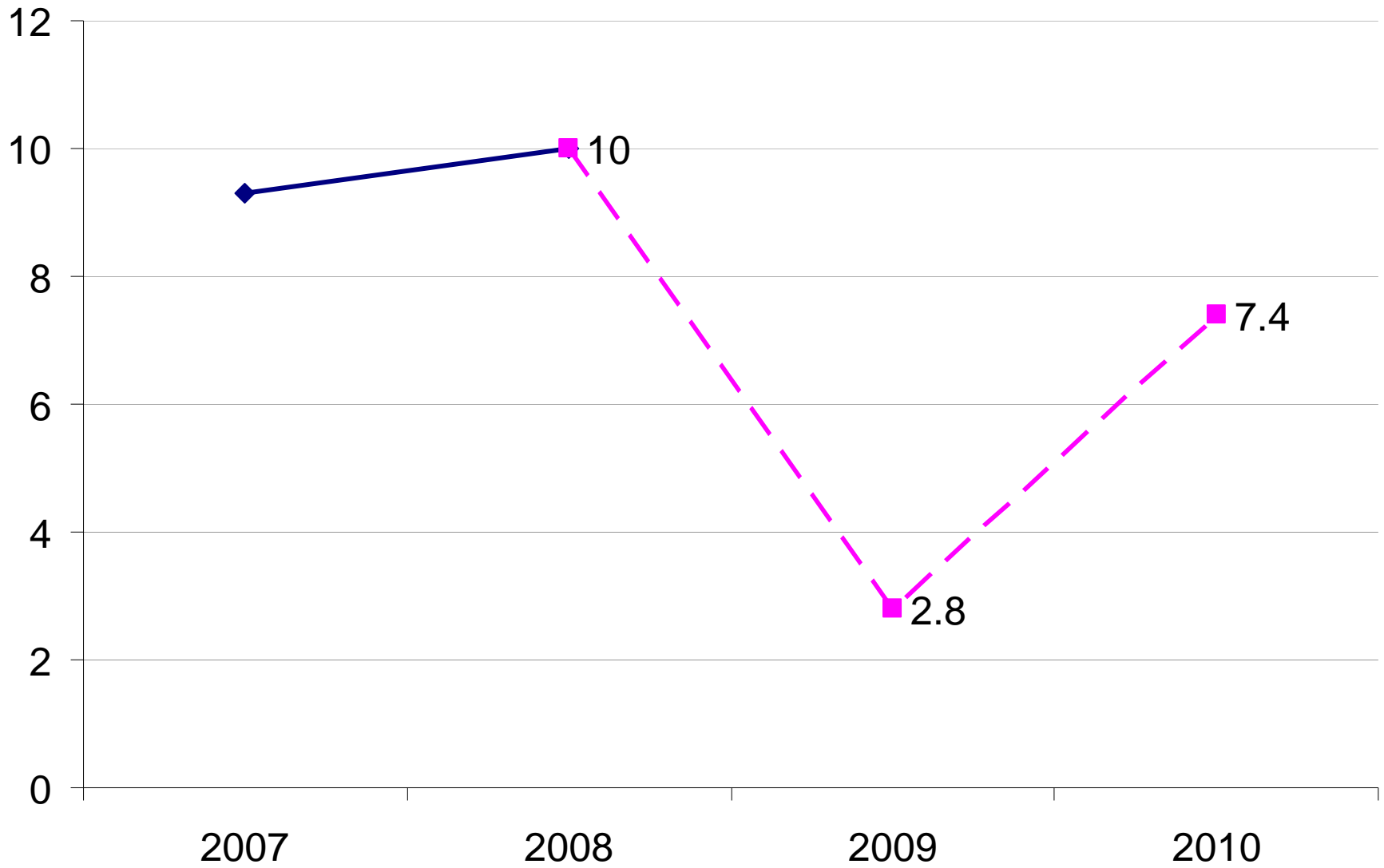
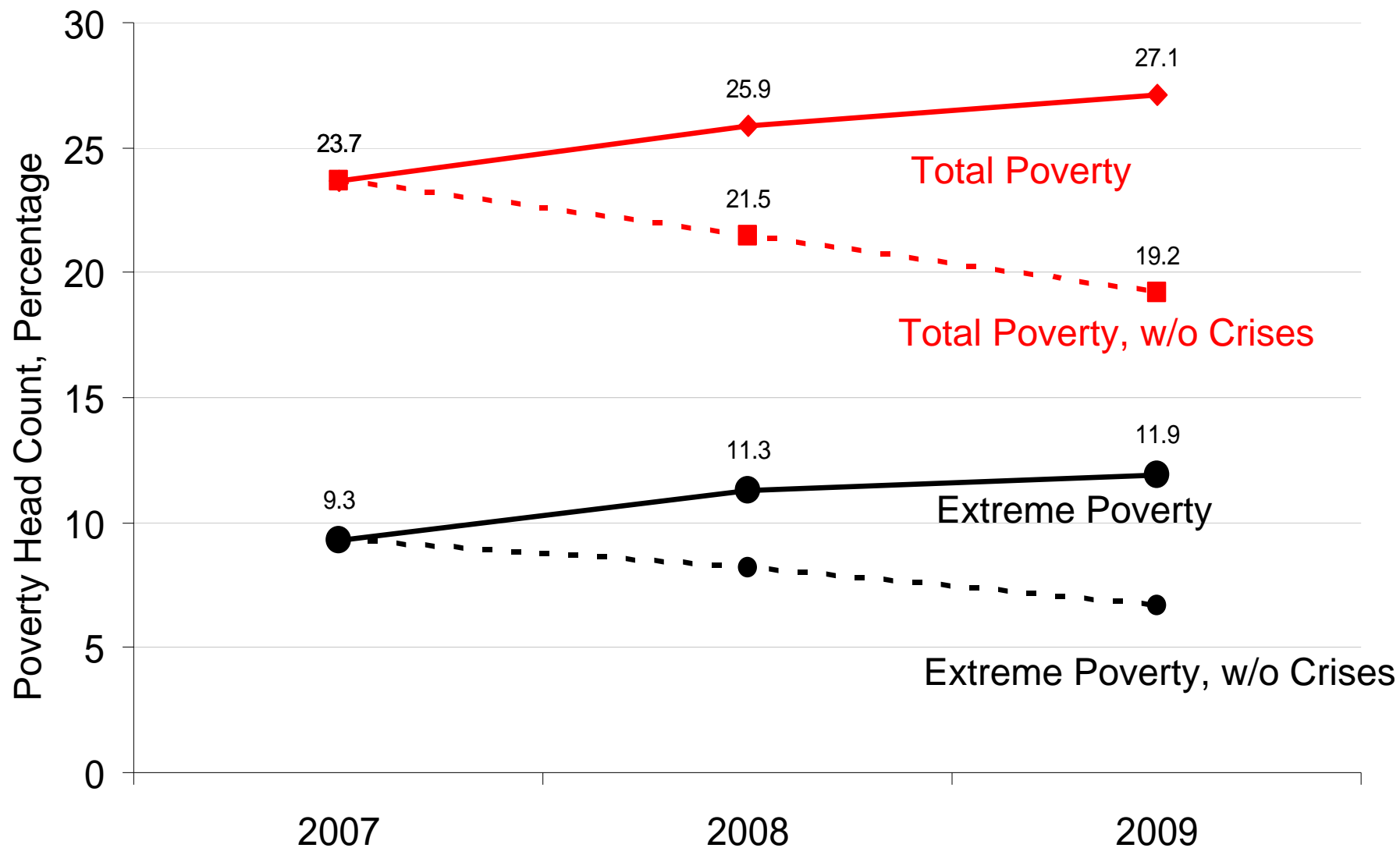


Figure 15

Poverty Forecast - Georgia



World Bank estimates using 2007 LSMS Data; The no-crisis scenario is based on the assumption of the economic growth at an average of 5% per annum during 2008-09. The actual (crisis) scenario is based on the simulated impact of the August 2008 conflict and the projections of the 2.5% decline in per capita consumption in 2009 due to the impact of the financial crisis.