

## Report on research on debt and development issues in Georgia

Georgia became independent in 1991, and like other parts of the former USSR, saw its economy collapse with the sudden transition from a planned to radical free market economy – and like most of post-Soviet countries, went through a period of sharp economic decline with high inflation and large budget-deficits, due to persistent tax evasion. In per person terms, the economy *shrank* by 70 per cent between 1990 and 1994. By 1994, national income was just \$520 per person.<sup>i</sup>

According to the data of the Finance Ministry of Georgia, the foreign debt of Georgia is USD 4,206 billion as of 2011 with USD 3,015 billion making a share of international financial institutions. The diagram below gives the dynamics of Georgia's foreign debt for 1996-2011.

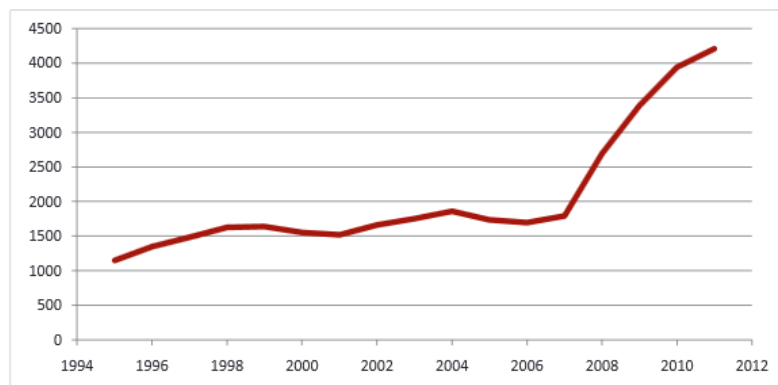


Diagram 1. Dynamics of foreign debt of Georgia for 1996-2011

### Debt levels

Annual government external debt payments:  
7.7% of government revenue, \$250 million  
Net external debt: 60% GDP, \$7 billion  
Gross government external debt: 35% GDP, \$4.1 billion  
Gross private external debt: 27% GDP, \$3.2 billion

### Social indicators

Population: 4 million  
Adult literacy: 99%  
National income per person: £3,500  
Inequality: for every £1 the poorest 10% earn, the richest 10% get: £16  
Life expectancy: 74 years

### Origin of debt crisis

The Georgian government at independence did not owe any foreign debt. But with the economic collapse, public external debt rapidly increased to almost 50 per cent of national income by 1999. Georgia was not considered for the Heavily Indebted Poor Countries initiative because although it had been impoverished, its debt was considered payable by the IMF and World Bank. Foreign debt payments by the government averaged the equivalent of 20 per cent of government revenue between 1997 and 2006. During past 15 years the country's foreign debt increased approximately four times<sup>ix</sup>. But after 2003 these payments and economic growth finally began to significantly reduce the government's foreign debt, from 40 per cent of national income in



2003 to 15 per cent by 2007. Foreign debt payments were down to 5 per cent of government revenue in 2007 and 2008.

In the mid-2000s the economy boomed, growing by an average annual rate of 10 per cent between 2003 and 2007. National income per person reached \$2,300 by 2007. However, inequality increased. Between 1996 and 2008, the poorest 20 per cent saw their share of national income fall from 6 per cent to 5 per cent, whilst the richest 20 per cent increased their share of national income from 44 per cent to 47 per cent.<sup>ii</sup> More dramatically, the percentage of the population living on less than \$1 a day increased from 5 per cent in 1996 to 15 per cent by 2008.<sup>iii</sup>

During this 'boom' a large amount of foreign private finance was lent and bought assets in the country. By 2008, foreign debt owed by the private sector was estimated to be double that of the public sector.<sup>iv</sup>

### **War influence and financial crisis**

In August 2008, Georgia went to war with Russia over the separatist regions of South Ossetia and Abkhazia. Around 500 military and civilians were killed on all sides. At the same time, Georgia was being impacted by the global financial crisis. Net foreign direct investment fell rapidly, whilst profits taken out of the country by multinational companies, and payments on privately owned foreign loans increased. The net private financial flows into Georgia fell from 16 per cent of GDP in 2006 to 7 per cent in 2007, and 2 per cent in 2010; dramatic changes with profound implications. There was a sharp growth of foreign debt starting from 2008 that can be explained by the economic and financial policy of the Georgian government.<sup>ix</sup>

The country re-entered a financial crisis, with the economy growing by only 2 per cent in 2008, then contracting by 4 per cent in 2009. The government's foreign debt again rapidly increased; the IMF and World Bank estimated it would be back to 43 per cent of national income by 2011.<sup>v</sup> Borrowing was low from 2000 to 2007 but has boomed since the war and financial crisis, rising from around \$100 million a year from 2000 to 2007, to \$900 million a year in 2008 to 2010. The large private sector debt has effectively helped to create a financial crisis which has resulted in the government's foreign debt once again reaching high levels.

### **Life and debt in Georgia**

Debt payments for the whole of Georgian society are predicted to average 26 per cent of exports over 2011 to 2015; two-thirds of this is payments by the private sector and one-third by the government. Government foreign debt payments are predicted to be the equivalent of 12 per cent of government revenue from 2011 to 2015.<sup>vi</sup>



Georgia's overall economic performance in 2012 was strong. Growth reached 6.1 percent, driven by manufacturing, construction, tourism, and financial services. As a result, the unemployment rate is expected to have declined further, down from 15.1 percent in 2011. Inflation continued to fall, to -1.4 percent at end-2012 from its peak of almost 15 percent in May 2011, helped by lower food and energy prices and lari appreciation. The external current account deficit remained high, though, at 12 percent of GDP, reflecting an increase in the trade deficit to 26 percent of GDP, which was offset by increases in tourist receipts and investment income.<sup>viii</sup>

Since Georgia's Rose revolution in 2003, the country has increased and deepened its political and economic relations with both the US and EU. However, such developments have provided little in the way of improved human rights. Although there have been a number of positive steps taken, such as combatting petty corruption (ranking 64th among 183 countries in Transparency International's 2011 Corruption perception report) and undertaking reforms in the education and business sectors, Georgia has not made significant progress in strengthening representative institutions or introducing democratic procedures. The state's efforts within the sphere of social and sustainable development policy have been even less successful.<sup>vii</sup>

Unemployment has been a persistent problem in Georgia ever since the country gained independence in 1991. According to National Statistics Office (Georgia) unemployment rate stood at 15,1% in 2011 and it has been decreased from 16.3% in 2010. In 2014 the unemployment rate decreased to 13.7%.<sup>viii</sup>

At the same time there has been a clear tendency to move Georgia's economy towards heavy dependence on the large-scale exploitation of natural resources without assessing the economic, environmental and social consequences of such an approach; in particular, impacts on poor communities that rely heavily on natural resources for subsistence and income have been neglected.<sup>vii</sup>

The Georgian government has introduced liberalisation and deregulation reforms and the minimisation of state control in a number of sectors such as in the food industry, transport and the environment – these measures have put at risk the health and safety of the Georgian population and the quality of the environment.<sup>vii</sup>

60% of rural population stays below poverty line. From 2002 to 2009 the cultivated land area decreased by 43% and in 2010 the government spent less than 1% of the state budget on agrarian sector. Respectively, food supplies in the country mostly depend on imported products.



This, in turn, has much aggravated poverty and inflationary processes in the country. Theoretically, the mission of international financial institutions is to provide the economic, social and sustainable development of the country. But in practice, as it seems, international financial institutions, as well as the Georgian Government, believe that the market will itself regulate everything and will provide the economic and social development of the country. <sup>ix</sup>

### **Problematic Development investments in Georgia (Green Alternative experience)<sup>vii</sup>**

#### **Vaziani-Gombori-Telavi road rehabilitation project**

Donor countries and international financial institutions pledged USD 4.55 billion to help Georgia in post-war recovery following the August 2008 war with Russia. A major part of these funds was earmarked for infrastructure and energy projects. Vaziani-Gombori-Telavi Road Rehabilitation Project was one of those projects, which the Georgian Government submitted for donor funding. According to the Georgian Finance Ministry, it was decided to take a USD 60 million loan from the World Bank to implement the project.

In July 2009 the Georgian Roads Department published Vaziani-Gombori-Telavi Road Rehabilitation Project's draft Environmental and Social Impact Assessment report and announced about the launching the public hearings. According to the project, the road was starting at the Vaziani settlement, running through the villages of Ujarma, Paldo, Otaraant Kari, Sasadilo, Gombori, Kobadze and Tetrtsklebi and ending in the city of Telavi. At a 45 kilometer it was crossing the Gombori Pass at a height of 1620m. The entire length of the road was 66 kilometer. The width of the road corridor was 20 meter, while the road bed – 10.5 meter. The project envisaged the construction of four new bridges with a total length of 348 meter. According to the World Bank project categorization system, the project was granted category A (significant environmental and social impact).

#### **Problematic issues on the project**

Significant social and environmental impacts would be unavoidable in case of the project implementation in its proposed form. In particular, road widening would require involuntary resettlement of several families living near the roadside. At the same time, the compensations offered due to resettlement were extremely scarce and unfair. Furthermore, road widening would also trigger the destruction of a part of forests and other ecosystems, as well as agricultural plots. The proposed project envisaged replacement of the asphalted road by

**Green Alternative** is environmental NGO located in Georgia. The mission of Green Alternative is to protect the environment, biological and cultural heritage of Georgia through promoting economically sound and socially acceptable alternatives, establishing the principles of environmental and social justice and upholding public access to information and decision-making processes.



concrete cover that would require extraction of a great amount of inert materials from the river beds.

Green Alternative studied the project documentation, conducted field visits and studied the project compliance with the World Bank requirements. It was revealed in the process of monitoring that the project was prepared with serious procedural violations (the procedures set for the World Bank's category A projects are meant). Neither was the need of implementing the project in its proposed form justified (road widening, construction of four new bridges, use of concrete technologies).

The project-affected communities had extremely scarce information about the project. They learnt from the representatives of Green Alternative that they had an opportunity to submit their opinions concerning the project. The representatives of Green Alternative met with local population numerously and explained about their rights and the means of protection of these rights. After these meetings locals expressed their willingness to participate in public hearings; although the representatives of local government tried to exert pressure, a part of the local population expressed their opinions and attitude towards the project in written and submitted it in a form of a joint statement to the Georgian Roads Department. Green Alternative submitted a copy of the statement to the World Bank representatives.

Simultaneously, Green Alternative submitted its own project-related comments to the Roads Department and the World Bank. A series of meetings were held with the representatives of the Roads Department and the World Bank.

Green Alternative had the following position: the project would be acceptable only in case if the road would not be widened on the sections running through the villages. This solution had the following positive sides: involuntary resettlement of the rural communities would be avoided; the need and respectively the amount of compensations would be reduced; the scale of environmental impacts and the volume of eco-compensations would be reduced too. As a whole, the project cost would decrease and road safety would increase on rural sections. It should also be taken into consideration that Vaziani-Gombori-Telavi road passes through geologically very sensitive Gombori Pass, which falls under extremely high risk of geological disasters. Because of difficult character and depth of landslides, surface stabilization is actually impossible there. Thus, the wide road constructed through using expensive technologies would be damaged shortly after its construction because of landslides. In the opinion of Green Alternative, it would be expedient to rehabilitate the road by using the simplest technologies to ensure that annual repairs, which would be unavoidable, cost inexpensive.

The World Bank shared the position expressed by Green Alternative and local population. As a result, the Bank refused to finance the project in its proposed form. The Georgian Roads Department withdrew its project documentation submitted to the Service of Permits and Licenses of the Ministry of Environmental Protection and Natural Resources for obtaining a



permit. Later, the Department prepared essentially a new project, under which the road was rehabilitated without widening, through using asphalt technology.

As a result of advocacy campaign, involuntary resettlement of the rural communities was avoided, while the construction had a minimal impact on forest ecosystem. By decision of the World Bank, the amount of a loan for the project was reduced twice compared to the government's proposal and constituted USD 30 million. The quality of the project-related public hearings has to some extent improved.

Thus, duly unveiling of project shortcomings and discrepancies, goal-oriented lobbying and active involvement of the population brought tangible results in terms of improving the project's environmental and social aspects and increasing its cost efficiency.

### **Corruption issues: ENERGY**

#### ***From interview with Transparency International Georgia<sup>viii</sup>:***

One of the declared goals of the Georgian state policy is to ensure energy independence. To achieve this goal, the country is striving for maximum utilization on of the existing energy potential; hydro energy is in the focus of attention. The Georgian government, which came to power as a result of the 2012 parliamentary elections, like its predecessor, is carrying out an intensive campaign to attract investments to hydro energy projects. According to the data of the Georgian Energy Ministry, presently up to 30 hydro energy projects are being implemented in the country (construction of a part of hydropower plants has already been launched, while the other part is at the stage of planning); over 20 memorandums of understanding and/or agreements have been signed between the Georgian Government and Georgian or foreign companies (consortiums) on the projects of construction, operation and ownership of small, medium and large hydro power plants (HPP).

Corruption can be detected in energy sector by different forms and at different levels. It may cover both petty corruption, for example, when paying electricity bills by citizens, or in case of elite corruption, when, for example, special conditions are created for this or that company in exchange of a particular benefit (for example, financing political campaign or simply making certain persons rich). The opportunities for elite corruption are especially high, when the legislation is weak, when the process of signing agreements between public agencies and companies, as well as the process of issuing licenses and permits by competent authorities is closed for the public, or when law enforcement and monitoring is weak. Unfortunately, exactly these conditions are presently observed in Georgia.

#### ***Green Alternative on energy projects:***





### **Dariali hydro power project**

The Dariali hydro power plant (HPP) project envisages the construction of a derivation type hydro power plant with installed capacity of 110 MW on the Tergi River, in Kazbegi municipality, close to the Russian-Georgian border. The HPP will be connected to the national grid via Dariali 110 kW transmission overhead line which connects Georgian and Russian grids. The project is being implemented by the Dariali Energy company.

The construction and operation of the Dariali HPP will cause the degradation of ecological and cultural values of the Dariali Gorge ecosystem and increase risk of natural disasters, in case the project is implemented in the form it was approved. Compared to the harm caused by the project, the economic benefits gained by the country will be quite insignificant.

### **Cultural-ethnographic values and tourism importance of Tergi River and Dariali Gorge**

The Dariali HPP project envisages diversion of the greatest part of the river flow, 90 percent, into the channel first and then to the tunnel; Thus, about eight-kilometer section of the Tergi River will actually remain without water. Landscape will radically change on the eight-kilometer section of the Dariali Gorge with a total length of 11 kilometers; as a result of water diversion, the Gorge will lose historically established cultural-ethnographic values and tourism importance.

Just the Tergi River makes the Dariali Gorge so remarkable. The river was the source of inspiration for Ilia Chavchavadze, Alexander Kazbegi, Grigol Orbeliani and other famous Georgian writers and poets. Just the river and its adjacent landscape were attracting travelers and are still attracting tourists. In case the Dariali HPP project is implemented in its approved form, the Gorge will lose those values, which still attract tourists that will ultimately have adverse effects on the incomes of people engaged in the tourism industry.

### **Unstudied hydrogeological regime of the river**

The Dariali HPP project was planned, approved and is being implemented without studying the hydrogeological regime of the Tergi River and its tributaries. The data about average annual flow of the Tergi River are based on the results of observations conducted in 1928-1940 and 1953-1986 – no data for the past 25 years are available. Moreover, the calculations for suspended solid flow of the Tergi River (solid and bottom sediments) are based on the data of 1928-1940. No data about the tributaries of the Tergi River, as well as average annual flows and suspended solid flows of the Chkheri and Kuro Rivers have been studied or provided at all.

The lack of hydrogeological data, taking into account that under the project only 10 percent of water flow will remain in the river, increases risk of harmful damages to the Dariali Gorge and its biodiversity, as well as occurrence of natural disasters.



## **Negative impact on biological diversity**

The project implementation will have an irreversible and strongly negative impact on the flora and fauna of the Dariali Gorge.

The HPP construction and operation will have a significant negative impact on the species included in the Red List of Georgia such as trout. The measure offered to mitigate the project impact – arrangement of fishways – will fail to improve the habitat of a trout, since 10% of water left in the river will not ensure the conservation of fish habitat in the river and will cause extinction of this population.

In response to the criticism from the non-governmental organizations, in order to mitigate the project impact on trout, the Dariali Energy undertook an additional obligation to conduct monitoring to assess the efficiency of the operation of fishways within five years after beginning the operation of the Dariali HPP. If the efficiency of fishways does not exceed 60-70%, Dariali Energy assumes the responsibility to arrange a trout reproduction facility. We believe that the harm caused to biodiversity by construction and operation of the HPP will not be compensated by arranging the trout reproduction facility. In addition, the inefficiency of fish reproduction facility has already been confirmed by the Geguti Sturgeon Hatchery arranged to mitigate the adverse effects caused by the Vartsikhe HPP in Imereti region.

Due geographic and climatic conditions (Kazbegi (Khevi) is the eastern mountainous region of Georgia, which is characterized by dry, cold winters) small amount of water (10 percent of annual average flow) left in the river will be frozen in winter; as a result the invertebrate species (especially those living in the water) will fully die out and the river will become lifeless. Disappearance of the river will have a strong impact on plant population, as well as on the dynamics of animal populations and migration patterns. Because of the above mentioned impacts, the implementation of the project in its current form contradicts a number of international environmental agreements.

## **Construction without permits**

Dariali Energy launched the construction of the HPP in September 2011 without a relevant clearance documents. Green Alternative has reported to the Ministry of Environmental Protection and the Ministry of Energy and Natural Resources on the construction works, requested to investigate the legality of construction works and to take relevant measures. Initially, the both public agencies responded that they would investigate the case. Only two months later, after the relevant agencies hastily issued permits, the both ministries declared that the company had obtained all the necessary permits for the construction. It should be noted that





launching of the HPP construction without a relevant permits, as well as neglecting of such violation is punishable under the Criminal Code of Georgia.

Since not a single agency reacted on violation, there is a huge probability that the public agencies will again close their eyes on possible violations committed by Dariali Energy in the process of construction and operation in future. Furthermore, tolerance demonstrated by the enforcement authorities is likely to prompt Dariali Energy to commit other violations and to neglect its environmental and social commitments. This assumption is further strengthened by the amendment made to the environmental legislation of Georgia in March 2012. Currently the legislation enables a violator and the Ministry of Energy and Natural Resources to conclude an agreement, according to which the Ministry, in exchange for payment of a certain amount by the violator, will declare the latter's illegal actions as legal.

### **Construction on the territory of the Kazbegi National Park**

The Georgian legislation prohibits the construction of a hydro power plant on the territory of a national park. Nevertheless, the Dariali HPP project was planned so that the project area covered a part of the Kazbegi National Park.

In November 2011 the Dariali Energy submitted to the Ministry of Environmental Protection the ESIA report of the Dariali HPP project – it is compulsory to submit such a report to obtain a conclusion of ecological expertise (i.e. environmental clearance document) from the Ministry. Although the report clearly stated that the HPP project area included 2.64 hectares of the Kazbegi National Park, the Ministry of Environmental Protection still approved the project and hence violated the law.

Later, again through violation of the legal procedures, the Government submitted a draft law to the Parliament envisaging the removal of 8.7737 ha from the Kazbegi National Park for the Dariali HPP project. Green Alternative raised its concerns before the Parliament about procedural violations and illegal actions of the Ministry of Environmental Protection, as well as about unjustified removal of 8.7737 ha from the Kazbegi National Park. However, the Parliament did not take Green Alternative's arguments into consideration and adopted the law on March 13, 2012. Moreover, it appeared after publishing the law that not 8.7737 ha, but much more – 20.3633 ha was removed from the Kazbegi National Park.

Green Alternative still demands the authorities to explain the reasons for neglecting the organization's arguments and removal of 20.3633 ha from the Kazbegi National Park, but in



vain. The Parliamentary Committee for Environmental Protection and Natural Resources has no reaction to the organization's requirements.

The Georgian Government now tries to portray granting of the status of natural monuments to three areas in the Kazbegi district as a compensation of damage caused by the HPP to the environment. We strongly believe that this measure cannot mitigate the environmental damage caused by drying up the river.

It should be noted that construction of the HPP in the Dariali Gorge was a Soviet-old project. The Kazbegi State Reserve was created on initiative of Academician Niko Ketskhoveli just to protect the Dariali Gorge from this project that finally saved the gorge from the Communist Government's encroachment.

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<sup>i</sup> Calculated from World Bank. Global Development Finance database.

<sup>ii</sup> Calculated from World Bank. World Development Indicators database.

<sup>iii</sup> <http://mdgs.un.org/unsd/mdg/SeriesDetail.aspx?srid=580&crd=268>

<sup>iv</sup> Calculated from World Bank. Global Development Finance database.

<sup>v</sup> IMF and World Bank. (2010). Georgia: Public sector debt sustainability framework. IMF and World Bank. Washington DC. 24/06/10. <http://www.imf.org/external/pubs/ft/scr/2010/cr10219.pdf#DSA>

<sup>vi</sup> IMF and World Bank. (2010). Georgia: Public sector debt sustainability framework. IMF and World Bank. Washington DC. 24/06/10. <http://www.imf.org/external/pubs/ft/scr/2010/cr10219.pdf#DSA>

<sup>vii</sup> [http://greenalt.org/wp-content/uploads/2013/04/Georgian\\_energy\\_sector\\_web.pdf](http://greenalt.org/wp-content/uploads/2013/04/Georgian_energy_sector_web.pdf)

<sup>viii</sup> [http://en.wikipedia.org/wiki/Economy\\_of\\_Georgia\\_%28country%29](http://en.wikipedia.org/wiki/Economy_of_Georgia_%28country%29)

<sup>ix</sup> [http://www.greenalt.org/webmill/data/file/publications/Foreign\\_Debt.pdf](http://www.greenalt.org/webmill/data/file/publications/Foreign_Debt.pdf)

<sup>vii</sup> From the visit to Georgia 15-17.April, meeting in Green Altrnative, Natia Ksovreli, Manana Koladze and Dato Chipashvili

<sup>viii</sup> From the visit to Georgia 15-17.April, meeting with Transparency International, Erekle Urushadze

