Emerging Markets

Georgia's Economic Reforms Stumble --- Slowing Tax Collection Is a Major Hindrance

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TBILISI, Georgia -- After several years of economic-reform successes, Georgia is struggling to overcome the fallout from the Russian crisis and put its budget in order.

At stake are the country's relations with multilateral lenders such as the International Monetary Fund and the World Bank.

"Georgia was a success story for the first two to two-and-a-half years (of reforms), but since then, they've stopped producing results," said Hunter Monroe, the departing head of the International Monetary Fund's Tbilisi mission. "If they don't continue to make improvements, then there are some real questions about the viability of the country."

The IMF has held up release of the second tranche of a $74 million loan while Georgia follows a shadow program with the fund in the hope of winning renewed lending. (Under such a program, the IMF provides technical assistance and advice, but no financial assistance, to a country.) The second disbursement could be as large as $47 million if the government "demonstrates a successful track record," Mr. Monroe said.

An IMF mission is scheduled to arrive here at the end of April to evaluate the government's progress before deciding on disbursement.

After four years of civil war and political instability following Georgian independence in 1991, subsequent progress toward reform was nothing short of remarkable, the country's boosters agree.

From 1995 -- when the government introduced its national currency, the lari, and began to accelerate the reform process -- to mid-1998, inflation decreased from around 163% to just 9% a year, and the economy grew by 10.5% in 1996 and 10% 1997.

Since August, however, the Russian economic crisis has hammered Georgian exporters, while inexpensive imports are competing with local producers. This year, the government predicts that the economy will grow 4%, up from 2% growth in 1998, while it expects inflation to be roughly 10%.

With tax collection slowing and wage and pension arrears mounting, the government was compelled to consider floating the lari. The National Bank of Georgia duly stopped intervening in support of the currency in December. As a result, the lari has fallen by about a third against the dollar. A dollar now buys 2.20 laris, compared with around 1.50 laris to 1.60 laris in November.

After a rough 1998, international financial institutions are now more sober in reflecting on Georgia's initial achievements.

"We're trying to get the right balance," a Western diplomatic source said. "Maybe we were overly optimistic a couple of years ago."

A combination of poor tax collection, corruption and the region's economic malaise "certainly has impacted (the government's) ability to move ahead with the bolder, second stage of reforms that are needed," said Joseph Owen, the World Bank's resident representative here.

"I remain cautiously optimistic that they will come around," Mr. Owen said. The government has no alternative to getting its fiscal house in order, he said, adding that the "scenarios in which they don't are scary."

Revenue collection has been the government's greatest headache since crisis struck. From 1995 to mid-1998, the government increased tax collection from 2.5% to 9% of gross domestic product. Since then, however, progress has proved elusive. The government's budget deficit was just under 4% of GDP in 1998, and is forecast at around 3.5% for this year.

Both Western and Georgian officials cite massive tax and customs evasion, particularly by importers of tobacco, alcohol and grain.

The government says it's combating the problem, most recently by imposing strict fines and threats of prison sentences for the sale of cigarettes without excise stamps.

Although the new fines went into effect April 1, the government already has been reaping the benefits of stricter enforcement of customs duties on tobacco, Finance Minister David Onoprishvili said. The ministry has received more than 8.5 million laris in tobacco duties for February and March, compared with 16 million laris for all of 1998, he said.

The government has also abolished a series of tax exemptions and tendered out a contract to run the country's customs service. The winner is to be announced by the end of this month, and is expected to take over the running of customs operations by July 1.