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**Article**

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## **Global Economic Crisis: Is Georgia At Risk?**

**Maka BUGHULASHVILI**

### ***Abstract***

*Most of countries have been badly affected by the tremendous global financial crisis and economic downturn happening recently. It is really difficult to predict the timing and magnitude of events caused by the global economic crises, the effects of the crisis vary from country to country. It has become a serious problem not only for those countries which belong to the world of unprecedented financial globalization, where the financial sector plays a historically large role in economic activity, but it is also an “imported crisis” (G20 Financial Ministers' Meeting, November,2008) for low-income countries (LICs) as well.*

*Although Georgia's economy is quite small, it is not isolated from the recession dilemma facing the world economy. In this article I look at how the global financial crisis may affect the Georgian economic development, export-import structure, investment flows and those sectors of Georgian economy which are regarded as having suffered the most because of the financial crisis spreading around the globe. This paper is kind of attempt to find out what are the optimal measures to recover from the post-August war condition and how to avoid direct influence of the global crisis on Georgian economy.*

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## **Introduction**

Since the Georgian market is not integrated enough with the world market, some may think that the world financial crisis cannot have any serious and direct influence on the Georgian economy, but in fact this country can't be isolated from the recession dilemma facing the world economy. The only way a country would remain untouched by the world financial crisis is if the country is completely closed, which the Georgian economy isn't. Georgia feels the global financial crisis in many different ways and first of all because our neighboring countries are experiencing it.

When speaking about Georgia's current economic troubles the three possible conditions are most often quoted: the global financial crisis, the August war with Russia and the economic policies of the present government. We cannot find just one reason for the woes of the Georgian economy. On one hand the August military operations and occupations and on the other hand the overall global financial crises have caused huge damage and decrease in Georgian economy. The shockwaves of the global crisis, worsened by the war in August, had affected all businesses. The first sign of the beginning of new wave of economic instability was in November, 2008, when exchange rate of the lari against the dollar reduced from 1.45 to 1.65. Georgia has seen a dramatic slump in almost every sector of economy including tourism, construction, services, retail, banking. There has been sharp decline in foreign investment, as investors have been less willing to invest in unstable economic conditions, there are fewer companies who are willing to take up credit in order to invest because they are not sure their businesses are going to develop further. Consumers have become very cautious, customers today rather save than spend money. Property prices have plunged, banks have reduced lending and developed stiffer terms for it, the biggest exporters of the country suffer from the drop in demand on the international market, more people have lost the jobs largely created by the recent growth. The only sector that appears to be relatively unscathed is the communications industry. Highly competitive prior to the crisis, the three major companies operating in Georgia maintain that profit margins are increasing.

This article tries to survey those sectors of Georgian economy which are regarded as having suffered the most because of double blow of

the August war and the world financial crisis. But hereby it has to be mentioned that “in the context of global slowdown, the economic growth was still quite high (9.2 percent in 2008) which helped Georgia to recoup some of the huge economic losses.” (Christophe Cordonnier, 2008)

The paper is organized in the following way. The section I examines those threats which are posed to the prospects of economic development and growth of Georgia by the global financial and economic crisis. The section II provides the analysis changes in investment flows to Georgia during the global financial crisis. Export-import structure and existing trade deficit is discussed in the section III. As for section IV it studies the real estate sector that had been playing very important role in the development of overall Georgian economy till above mentioned worldwide or regional crisis. The goal of section V is to find out how the banking sector, which is the key sources of economic growth that is critical to the country's ongoing campaign to stimulate business climate, reacts to the domestic and foreign economic slowdowns. International aids are regarded as major drivers to keep the economy of such a little country as Georgia from sinking - the section VI is devoted to this issue. Because of global or regional crisis most people have lost their jobs. Section VII surveys very painful problem of unemployment in Georgia. And finally, brief conclusion ends this paper, where the possible long-term solution needed to maintain Georgian economy on normal, stable track is discussed.

### **Economic Development**

In recent years Georgia has achieved a high and dynamic speed of economic growth. The economy has been liberalized substantially. In last five years in average nominal GDP exceeded 20%, provoked mainly by the consumption boom, “by intensive private capital inflows (FDI, bank loans and portfolio investments) and increasing government spending. According to the official data, which is also confirmed by the IMF, these inflows increased by 4.6 times in 2004-2007 and reached USD 2.3 billion (22.5 percent of GDP). The consolidated budget expenditure over the same period grew by 2.5 times and exceeded GEL 6 billion (35.8 percent of GDP).” (Georgian Economic Trends, (GET) 2008)

According to the Ease of Doing Business Survey by World Bank 2008, Georgia is among top reformers in the world. Georgia reformed in six

areas. It strengthened investor protections, including through amendments to its securities law that eliminate loopholes that had allowed corporate insiders to expropriate minority investors. It adopted a new insolvency law that shortens timelines for reorganization of a distressed company or disposition of a debtor's assets. Georgia sped up approvals for construction permits and simplified procedures for registering property. It made starting a business easier by eliminating the paid-in capital requirement. In addition, the country's private credit bureau added payment information from retailers, utilities, and trade creditors to the data it collects and distributes.

**Table 1:** Top ten reformers 2007

| The top 10 reformers in 2006/07 |                     |                       |                   |                      |                |                      |              |                        |                     |                    |
|---------------------------------|---------------------|-----------------------|-------------------|----------------------|----------------|----------------------|--------------|------------------------|---------------------|--------------------|
| Economy                         | Starting a business | Dealing with licenses | Employing workers | Registering property | Getting credit | Protecting investors | Paying taxes | Trading across borders | Enforcing contracts | Closing a business |
| Egypt                           | ✓                   | ✓                     |                   | ✓                    | ✓              |                      |              | ✓                      |                     |                    |
| Croatia                         | ✓                   |                       |                   | ✓                    | ✓              |                      |              |                        |                     | ✓                  |
| Ghana                           | ✓                   |                       |                   | ✓                    | ✓              |                      |              | ✓                      | ✓                   |                    |
| Macedonia, FYR                  | ✓                   | ✓                     |                   |                      |                |                      | ✓            |                        |                     |                    |
| Georgia                         | ✓                   | ✓                     |                   | ✓                    | ✓              | ✓                    |              |                        |                     | ✓                  |
| Colombia                        |                     |                       |                   |                      |                | ✓                    | ✓            | ✓                      |                     |                    |
| Saudi Arabia                    | ✓                   |                       |                   |                      | ✓              |                      |              | ✓                      |                     |                    |
| Kenya                           | ✓                   | ✓                     |                   | ✓                    | ✓              |                      |              |                        |                     |                    |
| China                           |                     | ✓                     |                   |                      | ✓              |                      |              |                        |                     | ✓                  |
| Bulgaria                        |                     | ✓                     |                   |                      |                |                      | ✓            |                        | ✓                   |                    |

Note: Economies are ranked on the number and impact of reforms. First, Doing Business selects the economies that reformed in 3 or more of the Doing Business topics. Second, it ranks these economies on the increase in rank on the ease of doing business from the previous year. The larger the improvement, the higher the ranking as a reformer. Source: Doing Business database.

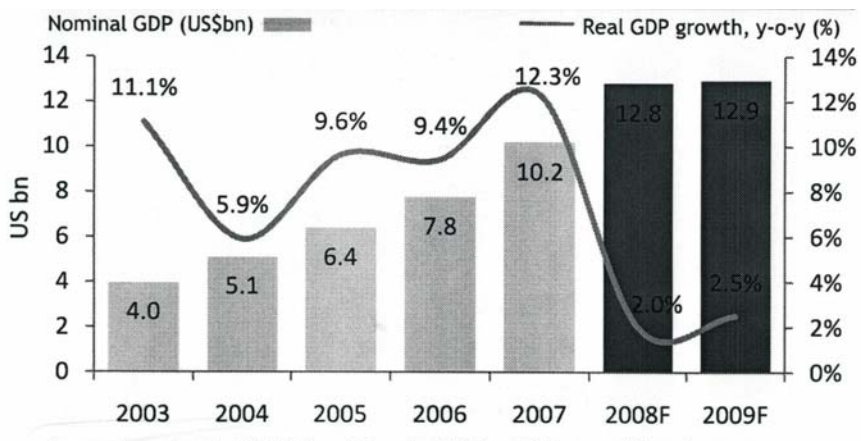
**Source:** <http://www.doingbusiness.org/features/Reform2007.aspx>

So, Georgia is among those countries which has been tracking reforms aimed at simplifying business regulations, strengthening property right, opening up access to credit etc. But ranking on the ease of doing business do not tell the whole story about an economy's business environment. The above given indicators about doing business do not account for all factors important for economic development and growth.

As the World Bank states the global financial crisis will affect all developing countries over the next two years, through contracting export volumes, lower prices, slowing domestic demand, declining remittances and foreign investment, reduced access to financing, and shrinking revenues. “Developing world growth is projected to fall to 1.6 percent in 2009, from an average of 8.1 percent in 2006-07, according to new IMF projections.”

Serious negative macro and micro economic conditions such as global financial crisis as a background and Georgia-Russia armed conflict in August, 2008, caused serious economic slow-down in Georgia, especially those sectors have been damaged which are of central importance to the GDP production. “A sharp weakening of the key factors of the economic growth is a definite threat to slowing down GDP growth rate. Under the most pessimistic scenario, which excludes large-scale international financial assistance, Georgia's GDP would increase by a mere 1 percent in 2008 and fall by 7 percent in the following year. This scenario, however, will never materialize as the donor countries and International Financial Institutions have pledged USD 4.5 billion for the rehabilitation of the Georgian economy. Nevertheless, the recession will still occur even under such a large assistance package. By experts' estimates, used by International Financial Institutions and donor countries, the GDP growth will be 3.5 percent instead of the targeted 9 percent in 2008. According to a more optimistic scenario, the GDP growth will reach at least 5 percent this year given the wide-scale international financial assistance.”(GET, 2008) Table 2 shows the impact of global financial crisis on Georgia's macroeconomic outlook through decreasing exports and other related indicators.

**Table 2:** Real GDP growth – 2009



**Source:** Department of Statistics of Georgia, Ministry of Finance of Georgia

To be more precise, hereby follows a list of those threats which are posed to the prospects of economic development and growth of Georgia by

the global financial and economic crisis. Namely”:

- Threat of slowing down the growth of Georgia's economy
- Threat of termination or reduction of investment flows
- Risks in the leading sectors of economy (tourism, banking, construction..) and dependent on foreign factors
- Threat of reducing the volume of transfer
- Risk associated with increasing foreign debts” (Analysis and recommendations, 2009)

But in the opinion of leading Georgian economic analysts economic situation is not too desperate. They admit the fact that the Georgian economy performed well in the first three months of 2009; indicators like foreign investment and trade turnover were better than 2007 and, in some cases exceeding 2008. However global financial crisis slowed down Georgia's economy, the country has performed better than other countries in the region due to several factors, namely: diversification of trade and investment; diverse energy supplies; diverse donor inflows – going to diverse sectors; the immediate implementation of the International Monetary Fund's economic support program; favorable public debt performance (total public debt as percent of GDP decreased from 56% in 2003 to 29% in 2008); flat, low and easy taxation system; special taxation regimes introduced (international financial company, free industrial zone, free warehouse company); government of Georgia's GEL 2.2 bn fiscal stimulus package for 2009. And one more (GET, 2008): to have a less painful recession scenario materialized, the international assistance, and particularly, its grant component, which goes directly to the budget, should be used as much as possible to stimulate domestic demand, received funds should be strictly targeted not only towards the restoration of destroyed public infrastructure and the resettlement of IDPs, but also to the rehabilitation of the agriculture, transport, energy, tourism and utilities sector.

### **Investment**

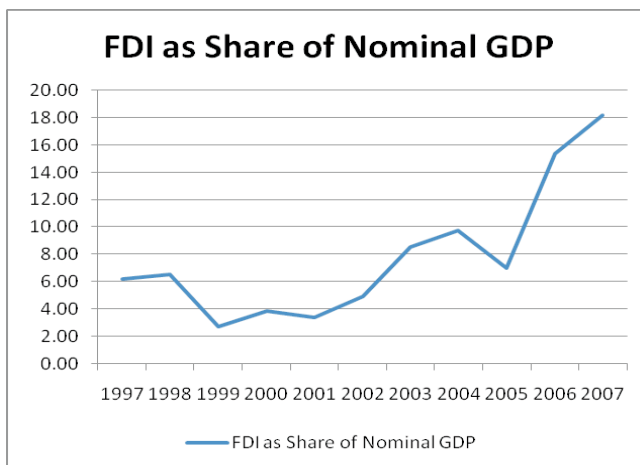
The global financial crisis poses serious pressure on domestic and especially on foreign direct investment (FDI).

Since 2007 year “cheap money” policy had been pursued in leading world economies provided an opportunity to global investors to invest capital in high-risk states, which could have been much more difficult in case of strict monetary policies in the developed states. Apart from this, financial institutes of leading states created an opportunity of investing intense liquidity profitably themselves, by investing in the high-risk assets of developing states.

In conjunction with these two above mentioned factors, it is remarkable that in recent years a volume of foreign, particularly direct investment increased in Georgia. Although a part of investment was provoked by liberalization of economy and successful measures taken with respect to pursuing strict budgetary policy, rapid growth of foreign investments was still provoked by the above mentioned factors. “This opinion is further upheld by the fact that an increase in foreign investments higher than Georgia was established in relatively less developed countries of Asia and Africa.” (Analysis and Recommendations, 2009). 2007 was a record year for FDI to developing countries and for Georgia among them.

In Georgia investment has been one of the driving force over the past five years. Especially, country's diverse foreign investment inflows has been helping Georgia to keep the economy stable. Foreign savings has been playing a key role in the formation of country's gross national product.

**Table 3:** FDI as share of nominal GDP

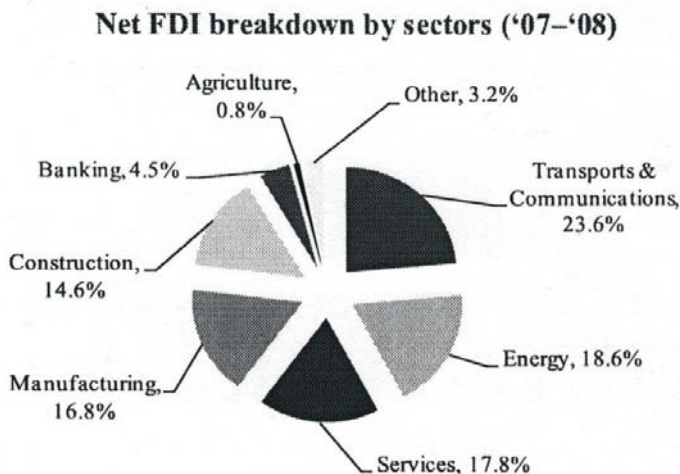


**Source:** Statistics Department of Georgia



Department of Statistics of Georgia reported that in 2008, net FDI in Georgia amounted to US\$ 1,293.7 million, or 10.1% of 2008 GDP. Of this amount approximately US\$318.3 million was received in 2H 2008. FDI remains highly diversified both by origin and by sector.

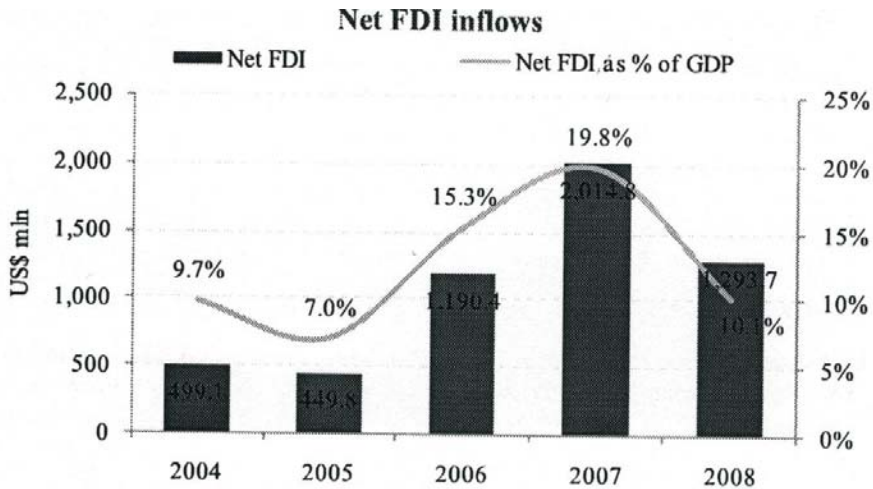
**Table 4:** Net FDI breakdown by sectors ('07-'08)



**Source:** Statistics Department of Georgia

Transport and communications attracted 23.6% of net FDI in 2008, followed by energy – 18.6%, services – 17.8 % and construction – 14.6. Since 2004, the United Kingdom, Turkey, United States and The Netherlands have been the top four investor countries in the Georgian economy, accounting for 10.6%, 9.2%, 9%, and 8.4%, respectively, of cumulative net FDI in 2004-2008. The cumulative STOCK OF NET fdi accumulated in 1996-2008 stood, at year-end 2008, at 53% of 2008 GDP, with the cumulative 2004-2008 net FDI inflows accounting for 43% of 2008 GDP.

Investment is expected to bear much of the direct impact of the financial crisis. There is a risk that investment in developing countries may be headed for a “perfect storm,” with a convergence of slowing world growth, withdrawal of equity and lending from the private sector, and higher interest rates.

**Table 6:** Net FDI inflows

**Source:** Statistics Department of Georgia

On one hand having global financial crisis as a background that significantly restricted international capital flows and on the other hand the fact that for investors, developing countries in general do not represent a portfolio of high-class capital investments, it is time for Georgia to focus problems in domestic and foreign investments and implement investment support policies in order to maintain at least the existing level of in-flow of foreign resources and not to lose one of the chief sources of capital formation in nearest several years. It is necessary to apply extraordinary methods for the attractions of new investors. In this regard it seems reasonable to grant them some of those privileges, including tax breaks which can be enjoyed only by the investors operating under effective legislation in the free industrial zone, for a certain period and throughout the country. Moreover, special benefits should be offered to those investors who would invest their capital into export-oriented industries and create jobs.

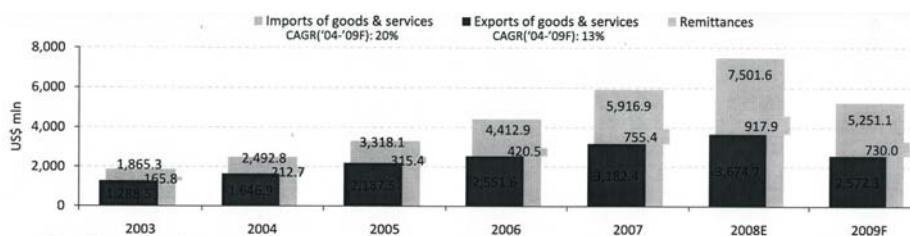
### **Trade**

Georgia is the inseparable part of the global economy, that is why estimates made by World Bank about the influence of global financial crisis on the world trade carry high importance for this country –due to the global financial crisis the IMF expects growth in world trade to decline from 9.4 per cent in 2006 to 2.1 per cent in 2009. The expected declines will come

through a combination of lower commodity prices, a reduction in demand for goods from advanced economies and less tourism. As IMF states there will be dual pressures on developing country trade: reduced demand for their exports and reduced trade credit.

Georgia's trade deficit –once hovering around 20% of the country's Gross Domestic Product – has dropped four points to a financial crisis-induced decrease in demand for imports.

**Table 6:** Export and Import of Goods and Services

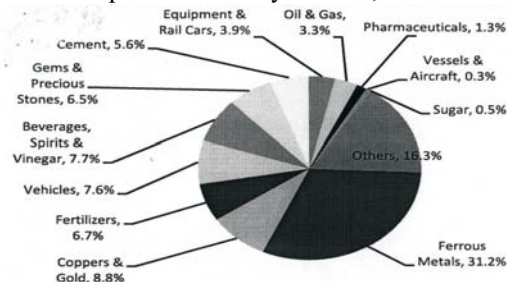


**Source:** National Bank of Georgia

It is really good that country's trade deficit has dropped as the import-addicted Georgian economy grapples with the global financial crisis. Exports, however, have also decreased, leaving the country with the balance to budget – and few of its traditional sources of financing.

The Georgian market does not export much. ”In recent years, structure of Georgia's export witnessed an increase not in the type of exported production, but in the portion of specific good category, thus making the country's export highly dependable on several goods only (ferroalloys, scrap metal, copper mines, fertilizers, hazel nut). (Analysis and Recommendations, 2009)

**Table 7:** Export Structure by Product, 2008

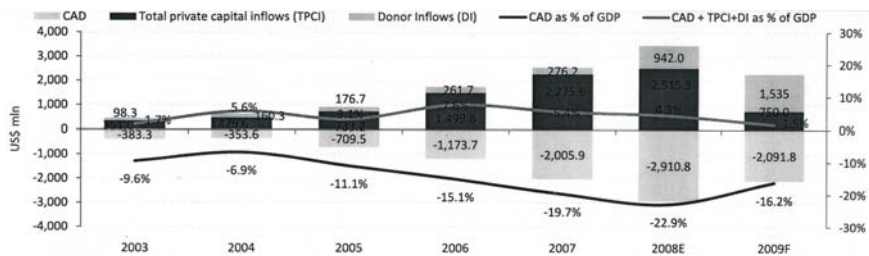


**Source:** Department of Statistics of Georgia

Although exports more or less had started to grow over the past few years, they were out placed and out priced by imports. A permanent change of Georgia's export-import structure in favor of import demonstrates that the terms of Georgia's trade are permanently deteriorating: prices on Georgia's chief export goods are reduced, and a majority of enterprises producing them is either closed down or operates in a slow mode.

In the near future Georgia's main exports are likely to continue to decrease as the crisis unfolds in the world's markets and consequently the problem of trade deficit is most likely to persist. The Ministry of Finance of Georgia calculated the deficit at 16.1% - and estimates imports and exports will remain at the same rate throughout 2009.

**Table 8:** Current Account Deficit



Note: Donor inflows include both public and private sectors

Source: National Bank of Georgia, Minister of Finance of Georgia

The trade deficit of Georgia is significant. Experts on trade policy claim that a trade deficit is not inherently bad. The problem is how to balance it. While economies like the US can always find financing to help off set the debt, Georgia is not in the same position. The deficit itself is not the problem, the problem is how the deficit is financed. Such deficit is sustainable only with sound financing otherwise it can easily lead to a destabilization of the whole economy. If there is only limited finance available, in current conditions this means that the current –account deficit will have to be quite small – and with exports weakening, that means imports must contract. Priority should be given to technological imports and the development of leasing rather than imports of long-term consumer goods. Foreign direct investment (FDI) is regarded as the traditional source of financing but due to the global financial crisis FDI has been declining and the Georgian government is determined to finance trade deficit with

fewer investment dollars and largely with foreign aid. Despite the huge trade deficit, Georgia is still in a comparatively comfortable debt situation.

As I mentioned above the global financial crisis has significantly worsened the problem of the lack of exports in Georgian economy. Since Georgian economy counts upon export as a source of future growth the Georgian government should spare no efforts in order to overcome local and global obstacles by improving the quality, consistency and competitiveness of Georgian products.

**The Real Estate Sector**

The negative events in the global economy and the August war had a serious impact on the leading sectors of Georgian Economy. “Although the real estate crisis affected developing countries to a lesser extent, this does not mean that the risk of financial crisis caused by the real estate sector problem is minimized to a negligible level.”(Financial Stability Report, 2008). After several years of astronomical growth, the real estate sector –dependent on both credit lines and mortgages from banks – has fallen hard over the recent down turn. As a result of the August war 2008 and the world financial crisis the construction activities have almost ceased in Georgia. Developers say problems began when the banks became cautious about financing the sector after real estate markets started to implode globally.

Till above mentioned worldwide or regional crisis the construction industry had been playing very important role in the development of overall Georgian economy. According to the Georgian Department of Statistics, the construction sector accounted for 27 percent of Georgia's Gross Domestic Product; it employed roughly 32 000 people.

**Table 9:** Development of Construction Sector during 2003 - 2008

|                                    | 2003  | 2004  | 2005  | 2006   | 2007   | 2008 Iq | 2008 IIq | 2008 IIIq |
|------------------------------------|-------|-------|-------|--------|--------|---------|----------|-----------|
| Turnover, mln. GEL                 | 309.0 | 387.4 | 778.8 | 1125.3 | 1604.6 | 208.3   | 317.2    | 323.0     |
| Output, mln. GEL                   | 297.9 | 377.1 | 746.1 | 1184.9 | 1717.2 | 214.1   | 321.4    | 328.2     |
| Value added, mln. GEL              | 89.1  | 127.1 | 245.9 | 401.4  | 630.6  | ...     | ...      | ...       |
| Intermediate consumption, mln. GEL | 213.2 | 256.5 | 523.0 | 784.5  | 1087.6 | ...     | ...      | ...       |
| Fixed assets, mln. GEL             | 85.9  | 127.2 | 258.7 | 474.9  | 635.1  | ...     | ...      | ...       |

|  |       |       |       |       |       |       |       |       |
|--|-------|-------|-------|-------|-------|-------|-------|-------|
| Number of employed persons, person                   | 18874 | 21344 | 38560 | 46681 | 52572 | 31944 | 32315 | 32806 |
| Average wages and salaries per employed persons, GEL | 199.5 | 237.9 | 292.3 | 391.0 | 495.1 | 547.6 | 691.8 | 676.5 |

Source: <http://www.statistics.ge/main.php?pform=58&plang=1>

Some experts believe that massive layoffs are inevitable in 2009, unless the government or banks hurry to the aid of this industry. Faced by sagging demand and a credit crunch and in the condition when foreign investors – important sponsors of Georgia's real estate industry – have become increasingly skittish about financing Georgia-based projects the development of the real estate market depends on the purchasing capacity of the population and the stability of banking sector. “The real property prices play an important role in overall financial stability of the country. Due to the fact that investment in real estate is an alternative opportunity of investing in assets, the real estate market combines functions of the financial market. Accordingly, the price variation patterns in the real estate market correlate with variations in prices of other financial assets. This mechanism it is an important factor determining the dynamics of an economic cycle of the country. In case of price drops in the real estate market, loan risks on the balance sheet of the commercial banks increase.”(Financial Stability Report, 2008). Thus, the financial condition of companies in construction sector and their activities has a great impact on changes in market demand. It is strongly believed that without the resumption of lending activities by banks the real estate market will not be able to find optimal solutions to the problem.

In recent years, an increasing number of Georgians have taken loans to start a small business, finance repairs to their houses, buy a new apartment, car, furniture or household appliances. Nowadays, because of credit crunch there are few buyers available and consequently the real estate market has been suffering badly. “Many consumers have either stopped buying property or failed to complete deals. Construction companies, in turn, have accrued significant past-due financial liabilities to banks; many owe consumers unfinished apartments that have already been purchased-so-called “apartments in the sky”. According to several

Ministry of Economic Development sources, any rescue plan is more likely to come in the form of tax cuts and government contracts, rather than as a direct assistance to real estate developers. (Giorgi Lomsadze, January, 2009)

As a way out of the crisis most Georgian construction companies are trying to introduce low price products to improve. For example Iberia company is about to launch the construction of residential complexes in 2009. Iberia and SB Iberia, a subsidiary of Bank of Georgia, have received a financial resource from the Overseas Private Investment Corporation (OPIC) to implement the project. The Bank of Georgia and three construction companies Iberia Real Estate, Bagebi City Group and Kalasi signed a cooperation agreement in February, 2009. The agreement covers 15 different construction project and is worth 28 million dollars. This USD 28m package includes direct loans for companies and 1- year long ipotec loans at a 13 percent monthly rate. The cooperation memorandum concerns 6 separate projects. These are, the living complex Iberia Hills, living quarters by Iberia Real Estate, the living complex Vake Palace by Kalasi and Park Gate by Bagebi City Group. By March 12 million USD of the 28 million total has already been released. After the August war with the background of current worldwide financial crises the quantity of ipotec loans much decreased, which is why it is for sure that the Bank of Georgia's initiative will help leading construction companies to recover and keeping real estate sector afloat. So, banking and construction sectors do depend on each other for survival.

### **The Banking Sector**

Because of the world crisis happening around, most countries financial systems have become demented, most of the leading banks have experienced numerous billion losses, started the selling of their actives and reduction of crediting. Only institutions with more or less infinite resources can hardly survive nowadays.

The depth and breadth of the crisis has impacted not just the surface of the Georgian economy, i.e. an isolated sector or portion of Georgia's gross national product, but the very heart of the global financial sector: the banks. The incredible growth that Georgia has experienced, the boost in buying power and the boom in construction, all depend (or depended) on

financing from the banking sector which has been hit hard by the global crisis worldwide.

The banking sector of Georgia, which had been developing rapidly and regarded as one of the key sources of economic growth that is critical to the country's ongoing campaign to stimulate business climate, has been suffering. Instability resulted from the August war and global financial crisis undoubtedly had negative impact on the Georgian banking system. Access to finance remarkably deteriorated due to a decline in banking lending, along with increased interest rates. By the end of the war in August, most banks were “empty” for clients. “After August war developments Standard and Poor's knocked down Georgia's credit rating from a B to B+, and Fitch from a B+ to a BB-. Both services said that the outlook on the rating is negative.” (Nino Patsuria, December, 2008). The banking sector was not able to reach the projected 70-% growth in 2008, by contrast, Georgian banks lost roughly 10 percent of their deposits in the two weeks since August war. “The value of bank deposits which were worth 4.1 billion laris, shrunk by more than half a billion laris.” (Tamar Khorbaladze, December 2008)

**Table 10:** Financial aggregates of the commercial banks activities from 2008 up to January 2009

| <i>Thous. of GEL</i> |           |           |            |
|----------------------|-----------|-----------|------------|
|                      | Incomes   | Expenses  | Net Profit |
| Jan,08               | 138,543   | 124,162   | 11,978     |
| Jan-Feb,08           | 249,702   | 226,872   | 17,515     |
| Jan-Mar,08           | 366,487   | 314,204   | 42,267     |
| Jan- Apr,08          | 498,809   | 454,843   | 29,403     |
| Jan-May,08           | 638,307   | 568,227   | 51,586     |
| Jan-Jun,08           | 771,525   | 672,505   | 76,145     |
| Jan-Jul,08           | 964,061   | 848,670   | 88,967     |
| Jan-Aug,08           | 1,094,264 | 1,001,238 | 67,462     |
| Jan-Sep,08           | 1,223,938 | 1,255,586 | -37,335    |
| Jan-Oct,08           | 1,361,657 | 1,409,412 | -53,625    |
| Jan-Nov,08           | 1,580,610 | 1,731,633 | -158,348   |
| Jan-Dec,08           | 1,746,585 | 1,954,799 | -215,744   |
| Jan,09               | 380,522   | 385,759   | -6,503     |

This table has been modified based on the information available at: [http://www.nbg.gov.ge/uploads/depozitaricorporeisheniinglisurad/financial\\_aggregates\\_3.4eng.xls](http://www.nbg.gov.ge/uploads/depozitaricorporeisheniinglisurad/financial_aggregates_3.4eng.xls)



Although some local Georgian banks believe that they have no liquidity crisis, Vakhtang Butskhrikidzem, President of one of TBC bank, predicted that the credit squeeze is expected to continue. In case of any increase in the cost of loans small and medium-sized businesses will face the most problems and most of them will go bankruptcy unless banks try to allocate credits to finance this sector. International School of Economics Executive Director Eric Livny agrees that “small companies could undergo reduced access to cash in the short-term, but believes that the government may eventually use outside funding to create special business lending programs to reduce risk for banks.” Banks must have opportunity to allocate credit lines to small and medium enterprises and construction sector which drives economic growth in Georgia, Those enterprises are the main source of creating jobs in the economy.

As for foreign banks entering the Georgian market, bank experts predict that there will be delays in the process since foreign banks are experiencing problems; therefore they will stop themselves from entering new markets.

There are several widely accepted approaches to cleaning up a banking system that is facing a systematic crises: “Government pledges to implement programs aimed at asset purchases (to clarify the balance sheets of financial institutions), recapitalization (to make sure that, if solvent, they could operate and continue to lend), and guarantees (to reassure depositors and some investors that their funds were safe)”. (Olivier Blanchard, 2008). It is thus essential the state to take proper measures in place and to act as the engine of economy. But, in Georgia “no government stimulus or support is planned for the banks, which have suffered blows to both liquidity and consumer confidence.”(Molly Corso, January, 2009). So far, to recover the struggling banking sector and not only this sector, the Georgian government has found the optimal way-out to make deals with international lenders. As economic expert Vladimer Papava said: “objectively there are no economic grounds for a currency crisis in Georgia. The National Bank of Georgia(NBG) still has over 1b USD in its reserves that would allow for a slow devaluation of the lari. And it should also be taken in to account that out of the Brussels donor's conference, 4.5b USD of aid was pledged to Georgia. Given that this money will trickle in over 26 months, there is no objective reason to believe that we are in danger

of a currency crisis in the coming months or next two years.” Georgian banks are still operating; there has not been any nationalization or state bail out program, largely deemed unnecessary by the largesse of financial donor organizations like the International Finance Corporation and the European Reconstruction and Development Bank.

### **International Aid**

As the global economic crisis worsens international attention is focusing on supporting Georgia to overcome its economic slowdowns resulted from double blow of the August war and the world financial crisis. Nowadays, international aids are regarded as major drivers to keep the economy of such a little country as Georgia from sinking. Georgia is getting help in adjusting to the financial crisis by providing this country with liquidity so that it can simply maintain the stable exchange rate in the face of large capital outflows. As Olivier Blanchard, chief economist of IMF, said, “in some cases they (developing countries) can do this on their own, so all that is need is liquidity support to avoid a collapse of the exchange and allow for the adjustment to occur. In other cases, the capital outflows only worsen already difficult situations. These countries need more than liquidity; they need financial help to carry out the necessary adjustments“. Georgia is among those countries that have already obtained financial help (with little or no conditionality ) under IMF program lending.

A donor's conference in Brussels was held in October, 2008. The purpose of the conference was to mobilize external assistance to support the country in the reconstruction of damaged infrastructure, reintegration of internally displaced people and in accelerating Georgia's recovery from the impact of the August 2008 conflict on its economy as well as improving the security of Georgia's energy infrastructure. ([www.europa-eu-un.org](http://www.europa-eu-un.org)). Consequently, after this event Georgia was granted USD 4.5 billion in aid. This decision was based on a Joint Needs Analysis report carried out by the United Nations, World Bank and European Commission. In March, 2008 the IMF board of directors approved USD 750m for the country to help the country deal with difficulties. Of the funds, USD250m has been already used for the strengthening of the country's currency reserves.

The World Bank stressed that commercial banks will also receive part of the funds since they have been particularly hard hit with the fall in investor

confidence as well as the overall international financial environment. “It is expected that banks will receive \$850 million through loans, equity, and guarantees” (Nino Akhmeteli, 2008). On January 20, 2009, the European Bank for Reconstruction and Development (EBRD) and International Finance Corporation, part of the World Bank Group, announced a 200\$ million joint loan for the Bank of Georgia, Georgia's largest commercial bank. A similar package is widely anticipated for TBC Bank, the country's number two retail bank. These funds are intended to allow Georgian banks to continue lending, to reduce the banks' own debts (if any) to creditors and generally to stay in shape.

Some analysts, however, are skeptical that the aid injection to the economy is the right way to cure Georgia's troubled economy. Paata Sheshelidze, the president and founder of the libertarian New Economic School-Georgia, said that while it is hard to say what would be the outcome of the aid injection, the sheer size of the aid package could actually harm the economy. “The government-to-government support means the intervention of the local government in the distribution of resources and it means that there is a threat that these resources will not be used in the most beneficial direction” (Nino Akhmeteli, 2008). But till new ways are found the international assistance package, which is a cash injection that does not require any payback, may be regarded as a timely temporary measure to perform well in the face of adversity, to soften the negative factors caused by the international crisis or at least to maintain domestic confidence and avoid another economic collapse.

But it is worth mentioning that potential unpredictable development of both foreign and domestic conjunction, or hypothetic delay in the donors' aid may create gravest problems to the economic system of Georgia, a number of sectors of which is significantly dependent on the availability of cheap liquid funds and a positive dynamics of consumers' income.

### **Unemployment Rate and Government Stimulus**

The global economic crisis is expected to lead to a dramatic increase in the number of people joining the ranks of the unemployed, working poor and those in vulnerable employment.

More and more people have been losing their jobs in Georgia as

well. “Banking sector eliminated more than 6 000 jobs. The same happened to the construction sector which chopped more then half positions.” (Emma Tukhiashvili, March, 2009). There have been sharp lay offs in wholesale and retail, hotels and restaurants businesses, tourism and service sectors and number of self-employed people has declined as well. The level of unemployment has been increasing and job vacancies offered by different companies has been lessening dramatically.

Based on a Joint needs Analysis Report carried out by the United Nations, World Bank and European Commission ((Nodar KHADURI, December,2008), 100 000 Georgians will lose their jobs over the coming months, poverty levels will rise form 25.9% and those already poor will become poorer, but according to research conducted by Market Research and Consulting team (ACT) ([www.act.ge](http://www.act.ge)) people's expectation about future is not so stringent - one fourth (26 %) of respondents think that in 2009 it will be more difficult to find a job than it was in 2008. One fifth (20 %) of respondents do not agree with the possible threat of global financial crisis aggravation and consider that the situation in this regard will improve. Almost one third (28 %) do not expect any changes. Generally young people have an optimistic mood regarding employment opportunities. At the same time it was found that employed people think it is easier to find a job (25 %) than unemployed respondents. Research was conducted in January, 2009. 1800 adult residents of Tbilisi and other big Georgian cities were interviewed based on representative sampling.

In December, 2008, Georgian Government initiated the plan aiming on saving jobs. The prime minister of Georgia Nick Gilauri vowed to keep unemployment at 14%, which was the official jobless level in 2008. He explained that with nearly half a billion lari going to road and infrastructure projects that construction companies can bid for, there should be enough capital to keep Georgians on the job. Spending on infrastructure is potentially a good way to constrain the extent of the economic downturn. It is not guaranteed savior for jobs. Unemployment has proved stubbornly high even in times of economic boom, underlining the fact that it is structural to a great degree. What's needed is more investment in education and training, but that goes beyond the scope of immediate crisis management. Investment in infrastructure does not automatically mean more jobs – but that does not mean it is a bad policy to

combat the crisis. It is the overall consensus that increased government spending is the better solution at this point.

### **Conclusion**

Of course, full liberalization of economy is the challenge for most progressive countries, but in my opinion when there are threats of serious economic slowdowns, governments should not leave what happens in the economy solely to the market. Far from following the free market nostrums that declare state intervention to be the primary retarding force of economic life, recently the region's business oligarchs have been turning to the state to protect their immense fortunes.

My strong belief is that without having strong policies, it is too easy to think of scary scenarios what the looming global financial crisis may cause in Georgia. "In a climate of profound uncertainty governments are needed, because only they are both big and quick enough to come to the assistance".(Harold James, September, 2008). Since Georgian financial institutions are mid-sized and are not serious global players, most probably they can be rescued by the mid-sized Georgian government. The real challenge for this country in this year ahead should be finding ways to deal with the global financial crisis via setting strong priorities which will reinforce the strength, sustainability and growth of the Georgian economy. And as the President of Georgia Michail Saakashvili emphasized: "The most important for us is to save our country from threats. The economy is the matter of our country survival and we are not going to boast as there are a lot of danger in the future. We must be ready for them. Global financial crises, of course, will damage us, but it must not kill us."

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