Implementing Structural Reforms
The Experience of Georgia

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- General
- Challenges before reforming
- Economic Structure Overview
- Reforms
  - Fiscal Reforms- Tax Policy, Trade Policy, and Import Duties Administration
  - Business Enabling Environment (BEE) regulatory reform
  - Anti-Corruption reforms
- Current challenges, risks, and opportunities
# Georgia - Country overview

<table>
<thead>
<tr>
<th>2015</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Area</td>
<td>69.7 km²</td>
</tr>
<tr>
<td>Population, million</td>
<td>3.7</td>
</tr>
<tr>
<td>Capital</td>
<td>Tbilisi (1.13 mln)</td>
</tr>
<tr>
<td>GDP, current US$ billion</td>
<td>14</td>
</tr>
<tr>
<td>GDP per capita, current US$</td>
<td>3754</td>
</tr>
<tr>
<td>GDP growth rate</td>
<td>2.6%</td>
</tr>
<tr>
<td>Exchange rate, end of the year</td>
<td>2.3949</td>
</tr>
<tr>
<td>Inflation, end of the year</td>
<td>4.90%</td>
</tr>
<tr>
<td>Poverty rate($2.5/day 2005PPP terms)</td>
<td>32.3</td>
</tr>
<tr>
<td>Poverty rate($5/day 2005PPP terms)</td>
<td>69.4</td>
</tr>
<tr>
<td>Gini Coefficient</td>
<td>40.1</td>
</tr>
<tr>
<td>Life Expectancy at birth, years</td>
<td>73.9</td>
</tr>
</tbody>
</table>
Challenges of the Government of Georgia in 2003

- State Default and Insolvency: Huge budget arrears, including in pensions, salaries, social spending, etc.
- Non efficient, non transparent budget and financial management system
- High level of corruption and corrupted system
- High number of government units and employees
- Not motivated, purely remunerated and badly managed government employees
- Duplicated functions between different government units
- Lack of transparency in the government and low level of public credibility
- High level of business regulation from government agencies
- Lack of communication and coordination
Reforms in Georgia

- Property rights
- Liberal fiscal and trade regimes
- Improved budget policy
- Improved public services
- Structural Reforms
- Price liberalization
- Privatization
- Legal Framework
- Fighting corruption
GDP per capita and real GDP growth

Phase 1: Post-Soviet
Phase 2: Rose revolution and reforms
Phase 3: Financial Crisis and Russian Aggression
Phase 4: Recovery; Political Change

Source: National Statistics office of Georgia
Structure of GDP (2015)

The main sectors, which contribute in GDP 2015 are:

- Trade (16.6%);
- Industry (16.5%);
- Transport & Communication (11.9%);
- Public Administration (11.7%);
- Agriculture (8.3%)

Source: National Statistics office of Georgia
External Sector

GEL/USD Real Exchange Rate

Exchange rate depreciated by 38.5% in 2014-2015

Current Account, % GDP

Source: National Bank of Georgia

Source: International Monetary Fund
External Trade

- The value of export decreased (-22.9%) as well as decreased the value of import (-10.1%).
- Trade balance is negative (- $5525 mln.USD).
- Top three trading partner countries by export are Azerbaijan (10.9%), Bulgaria (9.7%) and Turkey (8.5%).
- The highest share in export has copper ores (12.2%), Ferro-alloys (8.8%) and cars (8.1%)
- Top three trading partners by import in 2014 are Turkey (17.2%), Russia (8.0%) and China (7.6%)
- The major imported commodities are medicaments (9.6%), petroleum products (8.5%) and vehicles (6.1%).
Foreign Direct Investments

FDI by sectors, 2015

- Transport and Communication: 44%
- Energy Sector: 7%
- Manufacturing: 7%
- Construction: 9%
- Financial Sector: 14%
- Other Sectors: 19%

FDI by country, 2015

- Azerbaijan: 40%
- United Kingdom: 15%
- Netherlands: 8%
- Luxemburg: 6%
- Turkey: 6%
- Other Countries: 25%

Source: National Statistics office of Georgia
External Sector cont.

Top 5 transferor countries are:
- Russia
- Creek
- Italy
- USA
- Turkey

Top 5 guest countries are:
- Armenia
- Azerbaijan
- Turkey
- Russia
- Ukraine

The Dynamics of Money Transfers

Source: National Bank of Georgia

The Dynamics of International Arrivals

Source: Georgian National Tourism Administration
CPI and Core Inflation

- Import commodity price and exchange rate pressure on inflation

Source: National Bank of Georgia and Geostat

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Economic Activity Rate & Employment Statistics, 2015

- Labor force - 2 mln
- Unemployment in Georgia - 12%

ILO definition: *6.5 working days in a year is counted as an employed (1 hour in a week)*;

- 83% of self employed are peasants;
- 15% of hired employees are in public administration (in EU- 7%);
- According to survey (by Transparency International Georgia), 65% consider themselves unemployed (2016).
- Jobless growth!

Source: National Statistics office of Georgia
Financial Sector

- The banking sector is one of the most dynamic sectors of the economy;
- The financial sector is dominated by banks (more than 95% of assets);
- There are 19 commercial banks in Georgia;
- More than 80% of total banking sector capital is owned by international companies.

Source: National Statistics office of Georgia
Budget/Fiscal Policy

- Based on stated policy, size of the government should not exceed 30% of GDP and is supposed to reduce to 25% for next years.

- Government Investment volume in government spending will be kept more then 5% of GDP (in a range of 6-8%)

- Introduction of the Medium Term Expenditure Framework (MTEF)
  - Better macroeconomic analysis
  - Allocation of the resources according to the priorities
  - Basic Data and Directions (BDD)
  - Defines the balance between current and capital expenditures in the medium term in order to ensure sustainable growth
  - Defines the size of government and allocations to government (25% range)

Source: Ministry of Finance of Georgia
The coefficients of external debt as a % to GDP had decreasing pattern in 2003-2007.

The coefficients of External Debt as a % to GDP increased in the period of 2008-2010.

In 2015, debt ratios to GDP increased to 33%.

External debt portfolio represents 83% of the total national debt.

Sources: Ministry of Finance of Georgia
National Statistics office of Georgia
Tax Reforms in Georgia

- Build Easy and Simple Tax System, with low rates
- Achieve trust of business to Government
- Easy and simple new tax code
- Law on tax type of amnesty
- Low tax rates - only six taxes at low rates (Income Tax, Profit Tax, VAT, Excise Tax, Customs Duty and Property Tax)
- Improving the Filling and Payment Procedures:
  - Easy Filling – e-filling
  - Easy procedures – e-procedures
- Improving the Control and Administration
  - Corruption free
- Appeals Board – Under Ministry of Finance
# Tax Reforms in Georgia

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Income Tax</td>
<td>Diff. 0%, 12%, 17%, 20%</td>
<td>12%</td>
<td>12%</td>
<td>25%</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>Social Tax, paid by employer</td>
<td>31%</td>
<td>20%</td>
<td>20%</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Social Tax, paid by employee</td>
<td>2%</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Profit Tax</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>15%</td>
<td>15%</td>
<td>15%*</td>
</tr>
<tr>
<td>Dividends</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Interests</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>7.5%</td>
<td>5%</td>
</tr>
<tr>
<td>VAT</td>
<td>20%</td>
<td>18%</td>
<td>18%</td>
<td>18%</td>
<td>18%</td>
<td>18%</td>
</tr>
<tr>
<td>Export</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Excise</td>
<td>Differentiated**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property Tax for Enterprises, other that land</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Customs Duties</td>
<td>Differentiated 0-30%, average weighted 7.6</td>
<td>Differentiated 0%, 5%, &amp; 12%. Average Weighted 1.5***</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* From profit tax to distributed profit tax- retained profit tax becomes 0% from 2017
** Excise tax for tobacco and alcohol has increased in January 2015
*** Imported capital goods VAT will be nullified from 2017
Tax Reforms and Tax Revenues

- The Reforms:
  - Only six taxes at low rates
  - Easy e-feeling and e-procedures
  - Tax Appeal Board

- The Outcomes:
  - Corruption free environment
  - Significant improvement in tax control and administration since 2004
  - The ratio of tax revenues to GDP increased from 12% in 2003 to 25.4% in 2015;
  - Tax Revenue - the major source of revenue, 89% of total revenue (2015)
  - Informal Economy has been reduced from around 65% to 10% of GDP

Source: Ministry of Finance of Georgia
Structure of Budget and Tax Revenues

Structure of the Budget, 2015
- Tax revenue 89%
- Grants 4%
- Other revenue 7%

Structure of Tax Revenue, 2015
- VAT 44%
- Income tax 27%
- Profit tax 13%
- Excise tax 11%
- Other 5%

VAT Revenue
- 2002: 0%
- 2003: 0%
- 2004: 0%
- 2005: 2%
- 2006: 4%
- 2007: 6%
- 2008: 8%
- 2009: 10%
- 2010: 12%
- 2011: 14%

Income Tax Revenue
- 2002: 0%
- 2003: 0%
- 2004: 2%
- 2005: 4%
- 2006: 6%
- 2007: 8%
- 2008: 10%
- 2009: 12%
- 2010: 14%
- 2011: 16%
- 2012: 18%
- 2013: 20%
- 2014: 22%
- 2015: 24%

Source: Ministry of Finance of Georgia
Tax Revenues

Revenue from Excise Tax

- Excise tax
- Excise tax to GDP

Revenue from Profit Tax

- Property tax
- to GDP

Revenue from Import Tax

- Import tax
- to GDP

Revenue from Property Tax

- Excise tax
- Excise tax to GDP

Source: Ministry of Finance of Georgia
## Customs & Trade Policy

### Challenges before reform:

- Customs Code had a lot of ambiguous definitions
- Customs tariffs and procedures were scattered in many laws and sub-legislative acts
- Customs procedures were specified by more than 100 acts
- Customs offences were regulated according to the Code of Administrative Offences
- Customs legislation was not harmonized with international law

### Reforms:

- Improving the legal framework
- Simplify customs procedures
- Optimize customs duties
- Increase budget revenues
- Minimize corruption
- Preparation of the new and retraining of the old staff
- Attract additional transit
- Create a comfortable environment for tourists and importers
New Duties

- One of the most liberal import duty systems in the world, with an average weighted import duty rate of 1.5%
- 90% of all imports have 0% duty
- Import duties on agricultural goods and construction materials
- Equal excise tax on imported and local goods
- No export and re-export duties

FTAs with:
- EU (DCFTA) 28 countries
- CIS - 8 countries
- Turkey
- GUAM (Georgia, Ukraine, Azerbaijan, Moldova)

Perspective to CHINA-Georgia FTA in 2016
### Improving not only the Policy but ...

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<tbody>
<tr>
<td><strong>Overall Rank</strong></td>
<td>149</td>
<td>95</td>
<td>64</td>
<td>81</td>
<td>30</td>
<td>33</td>
<td>+116</td>
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<tr>
<td>Documents to Export</td>
<td>9</td>
<td>8</td>
<td>8</td>
<td>8</td>
<td>4</td>
<td>4</td>
<td>-5</td>
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<tr>
<td>Time to Export</td>
<td>54</td>
<td>13</td>
<td>12</td>
<td>12</td>
<td>10</td>
<td>9</td>
<td>-45</td>
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<tr>
<td>Cost to Export</td>
<td>-</td>
<td>1370</td>
<td>1105</td>
<td>1380</td>
<td>1270</td>
<td>1355</td>
<td>-</td>
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<tr>
<td>Documents to Import</td>
<td>15</td>
<td>11</td>
<td>7</td>
<td>7</td>
<td>4</td>
<td>4</td>
<td>-11</td>
</tr>
<tr>
<td>Time to Import</td>
<td>52</td>
<td>15</td>
<td>14</td>
<td>14</td>
<td>13</td>
<td>10</td>
<td>-42</td>
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<tr>
<td>Cost to Import</td>
<td>-</td>
<td>1370</td>
<td>1105</td>
<td>1340</td>
<td>1250</td>
<td>1595</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: The World Bank doing business report
For BEE 2003-2016

- eliminated the requirement for minimum capital, abolished the company seal and the company charter, made the use of notaries optional, and developed an online business registry
- the private credit bureau in Georgia now distributes full information,
- the corporate income tax rate was reduced and the social tax has been abolished.
- simplified process of obtaining confirmation from utilities, risk-based process of approval for building permits, and new time-limits for the occupancy certificate stage.
- implementing a central collateral registry with an electronic database accessible online
- streamlining the procedures for public auctions, introducing private enforcement officers and modernizing its dispute resolution system.
- streamlining the regulation of auction sales.
- broadening the range of assets that can be used as collateral
- simplifying the reporting for value added tax and introducing electronic filing and payment of taxes.
- allowing a security interest to extend to the products, proceeds and replacement of collateral, to secured transactions system
- creating customs clearance zones
- simplifying and speeding up the proceedings for commercial disputes
- establishing or tightening time limits for all insolvency-related procedures, including auctions
- implementing a new law on personal data protection
- Canceling the profit tax on retained profit (from 2017)
Progress Displayed in DBI in Georgia

*Starting Business* takes 2 days and costs 3.5% of income per capita.

*Dealing with Construction Permits* takes 73.5 days and 14.9% of per capita income

*Getting Electricity* takes 71 days and costs 515% of per capita income

*Registering Property* takes 2 days and is free

*Getting Credit* is well-organized as there exists comprehensive database for creditworthiness

*Protection of Investors* is strong (7 out of 10)

*Paying Taxes* requires 5 payments per year and takes 16.4% of profit *(will be changed from 2017)*

*Trading Across Borders* to export takes 9 days and costs 1,355 USD per container, to import – 10 days and 1,595 USD.

*Enforcing Contracts* requires 29.9% of the claim and takes 285 days

*Resolving Insolvency* takes 2 years and costs 10% of the estate

## Business Regulatory Reform and Economic Reforms

<table>
<thead>
<tr>
<th>DB Rank 2016</th>
<th>GNI Per Capita (WB 2014)</th>
<th>Corruption Perception Index (2014)</th>
<th>WB Governance Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Govt Effectiveness</td>
</tr>
<tr>
<td>1-25</td>
<td>$38,799</td>
<td>22</td>
<td>89</td>
</tr>
<tr>
<td>26-50</td>
<td>$23,381</td>
<td>55</td>
<td>73</td>
</tr>
<tr>
<td>51-75</td>
<td>$15,802</td>
<td>71</td>
<td>59</td>
</tr>
<tr>
<td>76-100</td>
<td>$11,739</td>
<td>90</td>
<td>50</td>
</tr>
<tr>
<td>101-125</td>
<td>$8,179</td>
<td>87</td>
<td>45</td>
</tr>
<tr>
<td>126-150</td>
<td>$2,560</td>
<td>116</td>
<td>29</td>
</tr>
<tr>
<td>151-189</td>
<td>$2,672</td>
<td>137</td>
<td>14</td>
</tr>
</tbody>
</table>

Source: The World Bank
Gaps of Comparators

Source: The World Bank doing business report

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Corruption-Free Environment

Reform:
- Number one impediment to reforms - Bureaucracy
  - De-bureaucratization
  - Restructurization of each ministry
  - Staff reorganization
  - Separating policy elaboration and implementation

- The government has also pursued reforms to pro-actively release more public data online and has improved the responsiveness to Freedom of Information requests.

Result:
- Georgia now satisfies the Millennium Challenge Corporation’s indicator regarding "Control of Corruption" and scores above its peer group.

- The percentage of firms that identified corruption as a significant obstacle fell from 60% to 39% from 2002 to 2005.

- 52th place (out of 168 countries) in the ranking of Transparency International’s Corruption Perception Index, 2015

CONTROL OF CORRUPTION PERCENTILE RANK (100=GOOD GOVERNANCE, 0=BAD GOVERNANCE)

Reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.

Georgia in International Rankings

- BB-/BB-/BB – Standard and Poors, 2015
- 80th place (out of 142 countries) in the Legathum Prosperity Index, 2015
- 52th place (out of 177 countries) in the ranking of Transparency International’s Corruption Perception Index, 2015
- 69th place (out of 144 countries) in the ranking in the Global Competitiveness Index of the World Economic Forum, 2014-2015
- 24th place (out of 189 countries) in the ranking of World Bank’s ease of Doing Business, 2015
- 22st place (out of 178 countries) in the ranking of Heritage Foundation’s Economic Freedom Index, 2015
Current Challenges

- Property rights
- Rule of Law and Legal System
- Political Stability
- Unemployment
- Social Vulnerability
- High Trade Deficit
- Foreign Direct Investment
- External Debt

The most problematic factors for doing business

- Inadequately educated workforce
- Access to financing
- Inflation
- Inadequate supply of infrastructure
- Policy instability
- Inefficient government bureaucracy
- Insufficient capacity to innovate
- Complexity of tax regulations
- Poor work ethic in labor force
- Tax rates
- Foreign currency regulations
- Government instability/coups
- Restrictive labor regulations
- Poor public health
- Corruption
- Crime and theft

Note: From the list of factors above, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings.
Source: Global Competitiveness Report 2015-16 (Executive Opinion Survey), World Economic Forum)
Fiscal Risk
- Reluctant to budget adjustment
- Increasing in spending, especially in bureaucracy (manipulating by employment numbers)
- Fiscal sustainability. Elections and political pressure in 2016 will not allow reducing in deficit
- Consolidation of public finances : LEPL, SOEs, Partnership fund, etc.
- Quality and efficiency of spending: Investments, Social, Sectorial, etc.
- Transparency and accountability

Financial Risks
- Due to heavy dollarization, problem remains politically very vulnerable
- Exchange rate risk
- Pressure on currency regulations or exchange rate market restrictions

Structural and Institutional Risks
- Subsidizing politically sensitive sectors (grapes, gas, electricity, transport, etc.), instead of price adjustment
- Business environment and overregulation (new initiatives from different levels of the government)
- New challenges from EU AA-DCFTA requirements
- Size of the public sector (# of hired employees)
Economic Growth

Source: IMF, April 2016

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Looking Ahead

- Facilitate GDP growth
- Further development of business enabling environment
- Increase capacity of public institutions
- Strengthen rule of law and legal system
- Scaling up the economy – further Integration (regional and global)
- Increasing competitiveness
- Increase FDI
- Reduce unemployment
- Maintain fiscal sustainability
- Improve the quality of education
### Progress in Countries with PMCG operations

<table>
<thead>
<tr>
<th>Doing Business Indicators</th>
<th>Mongolia DB2012</th>
<th>Afghanistan DB2012</th>
<th>Kosovo DB2012</th>
<th>Kyrgyzstan DB2012</th>
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</thead>
<tbody>
<tr>
<td>Starting a business</td>
<td>97</td>
<td>36</td>
<td>30</td>
<td>34</td>
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<tr>
<td>Dealing with Construction Permits</td>
<td>119</td>
<td>25</td>
<td>162</td>
<td>185</td>
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<tr>
<td>Getting Electricity</td>
<td>171</td>
<td>134</td>
<td>104</td>
<td>156</td>
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<tr>
<td>Registering Property</td>
<td>26</td>
<td>44</td>
<td>172</td>
<td>184</td>
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<tr>
<td>Getting Credit</td>
<td>67</td>
<td>59</td>
<td>150</td>
<td>97</td>
</tr>
<tr>
<td>Protecting Minority Investors</td>
<td>29</td>
<td>8</td>
<td>183</td>
<td>189</td>
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<tr>
<td>Paying Taxes</td>
<td>57</td>
<td>91</td>
<td>63</td>
<td>89</td>
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<tr>
<td>Trading Across Borders</td>
<td>159</td>
<td>74</td>
<td>179</td>
<td>174</td>
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<tr>
<td>Enforcing Contracts</td>
<td>33</td>
<td>80</td>
<td>161</td>
<td>172</td>
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<tr>
<td>Resolving Insolvency</td>
<td>124</td>
<td>89</td>
<td>105</td>
<td>160</td>
</tr>
</tbody>
</table>
THANK YOU!