# USAID/Georgia

# Annual Report

# FY 2004

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## Georgia

**Performance:**

Background: Since independence Georgia has made impressive strides in laying some of the foundations for a market economy. However, Georgia's political problems have aggravated a difficult economic situation that, in turn, created fertile ground for regime disaffection. President Shevardnadze resigned in November 2003, following mass demonstrations against the certification of fraudulent Parliamentary elections.

Now Georgia has an unanticipated early opportunity to regain lost momentum and make a fresh start in its quest to develop a resilient democracy and market economy. The international community should continue to give strong support and assist Georgia in this endeavor. However, donors must be realistic about the speed with which Georgia can achieve progress. The basic problems have not changed: worsening living standards of the population, most of whom live below the poverty level; unresolved territorial conflicts; difficulties in implementing laws and regulations uniformly throughout the whole country; and a continued tense relationship with Russia over Chechnya and the closing of the two Russian Military Base. The investment climate is complicated by a high level of corruption at all levels, especially in the public sector, which is one of the key reasons for a large shadow economy.

In the absence of structural reforms or improvements in budget revenue collection (the later remains among the lowest in the region), macroeconomic stability has been ensured by the continued tight monetary stance of the National Bank of Georgia and relatively robust real GDP growth at eight percent in 2003 that helped restrain inflation. The high growth rate was helped by the start-up of construction of Baku-Tbilisi-Ceyhan (BTC) oil pipeline. Despite a relatively stable currency and low inflation, investor confidence is extremely low. Most transactions take place in the shadow economy, with estimates ranging from 60 to 70 percent of GDP, and are denominated in hard currency, usually US dollars. The country's foreign debt has stayed roughly constant, at just under 55 percent of GDP owing to the weak fiscal performance, high trade and current account deficits.

Georgia is pinning its hopes for long-term recovery on the development of the international oil and gas transportation corridors to Ceyhan and Erzerum in Turkey, respectively. The construction of the two major pipelines, one for oil and one for gas, over the next two years means that Georgia will soon become an important route for the transportation of Caspian oil and gas to Western markets, and will reduce the country's dependence on energy imports. Oil is presently expected to flow through the pipeline in January 2005

U.S. Interests and Goals: Georgia's development as a stable, democratic country, increasingly integrated into the global economy, remains a key U.S. national interest in the volatile Caucasus and Caspian regions. FY 2003 programs pursued by USAID contributed to the advancement of several strategic goals of the United States Government: democracy and human rights, economic prosperity and security, and social and environmental issues. Georgia's location at the crossroads for east-west energy pipelines makes it a strategic partner and a key ally in the region.

Donor Relations: The International Monetary Fund's (IMF) support for Georgia focuses on economic reform and poverty reduction. Although IMF has suspended its programs in 2003 due to non-performance by the previous government, with a new reform-oriented government and Parliament IMF is expected to re-launch its assistance program. Similarly the World Bank is expected to follow suit. The World Bank has been supporting projects in energy, transportation, municipal infrastructure, and institution-building. These programs are coming to an end and future projects will include poverty reduction programs, water supply and sanitation and further support to the Social Investment Fund. The

EBRD supports programs in banking, SMEs, infrastructure (primarily in the energy sector), and regional projects in energy. The International Finance Corporation (IFC) invests in credit, energy, and industry projects in Georgia. The activities of the United Nations Development Program (UNDP) are focused on poverty reduction, democratic governance and environmental protection. Donor coordination has been satisfactory in the following areas: poverty reduction/economic growth initiative, free-and-fair elections, banking sector reform, energy security, and health care reform.

Challenges: Georgia faces several major challenges on many fronts. Important among these and of immediate concern are: increased generation of revenues, controlling wide spread corruption; improving energy situation in the country; and regaining territorial integrity. These challenges have contributed to deteriorating living standards; difficulties in uniform implementation of laws and regulations; arbitrary application of taxes; and a large shadow economy, which hampers economic growth by depriving the government of much-needed tax revenue; and weak institutions that limit the ability of the state to govern. The new President and members of Parliament slated for election in early 2004 must undertake serious actions to tackle these challenges in order to restore public trust, improve the investment climate, and attract much-needed foreign direct investment. In addition, Georgia's strategic geopolitical location between the Caspian and the Black Seas, provides scope for projects with a regional dimension. Situated on an important transit route for major oil and gas pipelines, roads, railways and communications along the corridor linking Central Asia and the South Caucasus with Europe, the challenge for Georgia is to support and provide security for transport and pipeline projects. Important for the success of these projects will be the cross-border co-operation of the governments in the region.

Key Achievements: Despite the difficult political and economic situation in Georgia during FY2003, overall performance of USAID programs has been satisfactory and program implementation proceeded as planned, except in the energy sector. Four of the five Strategic Objectives met the targets. USAID programs helped lay the legal foundation for private enterprise, strengthened the energy sector's regulatory structures despite GOG's failure to improve the performance of the energy sector, and made great strides in rule of law on the supply-side in an atmosphere where grass-roots, demand-side forces have been increasingly cynical. USAID programs have demonstrated how communities and elected officials can cooperate, even though few citizens are aware of their civic rights/duties and the vast majority distrusts government officials. Our humanitarian relief programs have provided a temporary safety net for internally displaced persons (IDPs) in the absence of a lasting solution to violent conflicts. Highlights of key achievements in each sector are discussed below.

Economic Growth: USAID's economic growth efforts achieved results in three main areas: 1) operational sustainability of USAID-supported microfinance and rural lending institutions with 26,000 active borrowers and $7.27 million in total loans outstanding, with 2.79 million in rural loans outstanding; 2) strengthening of banking supervision at the National Bank of Georgia and improving the legal and regulatory structure; and 3) land reform has resulted in the registration of more than 2.4 million land ownership certificates primarily in the farming regions, providing the basis for future expansion of rural credit programs and investment in rural areas. By improving the regulatory structure, increasing access to credit, strengthening confidence in the banking sector, and removing constraints to the development of market-oriented production, these programs accelerated the development and growth of private enterprises. By the end of FY 2004, USAID anticipates that Georgia will have over 80,000 operating private enterprises, up from 56,000 in 1999. USAID efforts will concentrate on interventions to address specific market needs based upon demand from industry and business associations. This includes both demand-driven policy reform and market-driven added value agribusiness development, which will begin its ramp-up phase in FY 2004. The Mission will continue activities in agricultural policy reform, land market development, and will consolidate its microfinance and rural credit activities in a single project, which will aim to improve the policy environment for non-bank financial institutions and provide technical assistance and grants to microfinance and rural credit institutions.

Energy Sector: USAID's strategy for the energy sector promoted its development towards economic sustainability. USAID's emphasis has been two-fold: (1) to create a business climate that will attract private sector participation and ownership, with consequent improvements in the management of resources and provision of services; and (2) to improve energy sector efficiency in economic terms, with

subsequent increases in capital and operating resources available to energy sector companies. However, the energy sector in Georgia continued to be plagued by extremely low collection of revenues, poor cash-flow management and consumer distrust. Efforts to address the poor financial discipline focused on start-up of the Georgia Energy Security Initiative (GESI) that includes a management contract for the United Distribution Company (UDC), which serves 70 percent of Georgia and most of the distribution companies outside Tbilisi, and close cooperation with the two management contracts for the Georgia Wholesale Electricity Market (GWEM) and the transmission and dispatch company (GSE). To further improve cash collection in the wholesale electricity market, USAID continued to condition part of its FY 2003 disbursements under the Georgia Winter Heat Assistance Program (GWHAP) that reimburses the power suppliers for electricity supplied to a target group of institutions and households supporting vulnerable groups. The overall prospects for progress appear good. The GESI and other new activities are or will be designed to overcome the factors impeding progress during the last few years of this strategic objective, including poor management and corruption at the United Distribution Company and lack of public understanding. The donor action plan has mobilized the GOG, with the support and assistance of the German government, to initiate a sector-debt restructuring agency. This agency will address the persistent problems arising from the trading and manipulation of legacy debt that destroys cash flow and liquidity of the sector entities. A recent positive change in the leadership of the Georgia Energy Regulatory Commission may lead to greater progress in energy sector. reforms.

Rule of Law: Through rule of law programs, USAID supported efforts to assist Georgia in establishing a sound legal foundation on which to build a stable market economy and democratic governance. This legal foundation was bolstered by greater public awareness of legal rights, improved public access to fair legal proceedings, and increased capacity of legal institutions to implement and enforce laws and regulations. The confluence of several years of targeted judicial reforms, such as training of judges and bar exams has resulted in a more cohesive and professional judicial system. Georgians are now more apt to utilize the courts for legal remedies, and view provincial judges as less biased and more likely to render decisions based on the law. Legislative achievements have included the introduction of Freedom of Information (FOI) legislation, licensing regimes that comply with the Administrative Code, and simplified procedures for the Constitutional Court. Journalists taking advantage of the FOI law have exposed corruption and embezzlement by officials both in Tbilisi and in the regions. Several top officials were removed from their posts as a result of these media stories, though none were arrested or sentenced. USAID will continue implementation of activities and programs designed for greater impact at the local level. Much of the rule of law related programming will take on an anticorruption focus.

Local Governance: USAID-supported activities have improved local governance and decision-making in the regions outside Tbilisi. By working both with elected officials and with citizens at the local level, USAID has changed the way local governments work in ten cities. City councils are now required by law to hold meetings which will be open to the public, including annual budget planning and approval meetings. These open meetings have helped identify community-specific concerns and have led to a process of cooperative interaction between local councils and local citizens in finding workable solutions to community problems. The program has been generally successful. USAID plans to expand it to other cities in Georgia.

A Civil Society and Media: Activities in this area have supported strengthening civil society institutions, a free and independent press, and continued assistance for political processes. Special funding enabled Georgian media to produce more than 300 newspaper articles and a plethora of television and radio shows covering the recent elections. Journalists were trained in fair reporting. Apart from the elections, USAID has funded lawyers to defend media outlets wrongfully accused of libel or against which excessive damages have been awarded in efforts to silence critics. USAID has engaged Georgian youth in three areas. First, it has shown political parties that youth are indeed interested in politics and serve as a dynamic resource whose voices must be heard. All major political parties have all organized youth auxiliary wings. Second, USAID has engaged youth in local government efforts. Youth in nine cities are actively participating in performance monitoring plans to monitor the effectiveness of local government services.

Political Processes: USAID's funding and support for electoral processes (observations, voter education,

monitoring and exit polling) enabled the Georgians to track and prove fraud in the November 2, 2003 Parliamentary elections. This led to large scale protests resulting in the resignation of the President, appointment of an interim President; and announcement of fresh Presidential elections on January 4, 2004 and Parliamentary elections in June/July 2004.

Depending on the new Government's priorities, USAID may also provide support to the GOG at the national and ministerial levels and not just through NGOs and local governments. For example, USAID is currently planning to launch a Parliamentary Strengthening Program under the Special Initiative for Elections Assistance. The Mission will continue to strengthen the judiciary, and support local governments in their efforts to lobby Parliament to enact legislation that would decentralize budgets and give more fiscal control to cities. These national-level measures are critical for the overall success of local government reform programs.

Humanitarian Assistance: The majority of resources for humanitarian assistance enabled communities to address local problems through prioritizing needs and mobilizing indigenous resources. In FY 2003, 475 community and local NGO-led projects were successfully completed. The projects were prioritized by the communities themselves to address needs in the areas of health, social infrastructure, and economic opportunities. The Georgia Winter Heating Assistance Program continued to provide critical support to vulnerable people throughout Georgia, while assisting in maintaining social stability, supporting energy sector reform, and privatization. Within the program, over 25,000 vulnerable households, more than 100 critical institutions, and almost 430 IDP centers received debt relief. At the same time, significant energy subsidies were granted to over 130,000 vulnerable households, more than 550 critical institutions, and to almost 450 IDP Centers.

Family Health and STI/HIV: USAID programs also improved access to family planning services and primary health care, and slowed the spread of STI/HIV infections in targeted populations of Georgia. With USAID support, maternal and child health services continue to improve in both quality and quantity. The key accomplishments of the program were: (1) 9,000 patients were treated at USAID-funded health facilities. The Georgia Primary Health Care (PHC) Center in Mtskheta, first of its kind serving rural Georgia, staffed with certified family medicine doctors and the Women's Wellness Center (WWC) in Kutaisi for preventive services, focusing on women's reproductive health needs; and (2) over 450 health care professionals were trained in health administration and infection prevention and control, contributing to better infection control and health care management services in the country. Adoption and implementation of a comprehensive training system to strengthen clinical and counseling skills of physicians and village midwives in one of the targeted sites resulted in the Infant Mortality Rate (IMR) being decreased from 25.2/1,000 live births to 11.9/1,000. As a result of Tuberculosis Control and Treatment Program in Georgia, ten physicians and sixty nurses from Tbilisi's dispensaries received a comprehensive, five-day training in the fundamentals of the Direct Observation Therapy (DOTS) strategy. Since 1995, USAID assistance has been provided to the United Nations Children's Fund (UNICEF) to strengthen Georgia's national immunization program, resulting in overall child immunization coverage of 85.7 percent in FY 2003, and declaring Georgia a polio-free zone in July 2002. Approximately 2,000 individuals belonging to high risk behavior groups have benefited from HIV testing, STI treatment, and testing. USAID funded STI/HIV project played a key role in enabling the GOG submit a successful proposal to the Global Fund (TB, Malaria and HIV/AIDS) and receiving a $12.0 million grant. This will give a major boost to the management and control of these diseases in Georgia

In the humanitarian programs the emphasis will continue to be placed on enabling communities to meet their basis needs. There also will be more cooperative work between Community Based Organizations (CBOs) and sectoral clusters in solving local problems. In the health programs USAID will continue to support the GOG's health reform efforts through institutional partnerships, strengthening national health information systems, and providing technical assistance in infectious disease prevention (vaccine preventable, STI/HIV/TB), and will launch a new women's health activity. Emphasis will be placed on upgrading the clinical and laboratory skills of health professionals to increase primary health care quality.

Gender Disparities: USAID has integrated gender issues into its programs, particularly in micro-credit, democracy and governance, and humanitarian relief and health programs to ensure that men and women

can participate in and benefit from programs equally.

**Country Close and Graduation:**

# Results Framework

**114-0130 Accelerated Development and Growth of Private Enterprises**
**SO Level Indicator(s):**
Increase in number of private enterprises registered
**114-0131** Improved policy and operating environment
**114-0132** Increased access to credit
**114-0133** Increased market-oriented production

**114-0131 Accelerated Development and Growth of Private Enterprises to Create Jobs**
**SO Level Indicator(s):**
Number of jobs created
**114-01311** Improved policy and operating environment
**114-01312** Increased access to financial services
**114-01313** Increased market-driven production and sales

**114-0150 A More Economically Efficient and Environmentally Sustainable Energy Sector**
**SO Level Indicator(s):**
Energy provided on an economic basis
**114-0151** Increased private sector participation in the energy sector
**114-0152** Legal and regulatory environment more conducive to private investment in the energy sector
**114-0153** Environmentally sound laws, regulations are adopted and implemented in the energy sector

**114-0151 A Foundation for a More Sustainable Energy System**
**114-01511** Improved commercial and financial performance of energy sector entities
**114-01512** A more diversified, renewable and cost effective energy supply
**114-01513** Increased environmentally-sustainable energy efficiency

**114-0220 Legal Systems That Better Support Implement. of Democratic Processes & Market Reforms**
**SO Level Indicator(s):**
Public perception of the Rule of Law
**114-0221** Access to legal remedies increased
**114-0222** More effective, transparent and fair legal sector institutions
**114-0223** Laws and regulations promoting democratic processes and market reforms enacted

**114-0230 More Efficient and Responsive Local Governance**
**SO Level Indicator(s):**
Index of public perception of local governance in targeted cities
**114-0231** Improved local government service delivery in key areas defined by constituent needs
**114-0232** NGO/CBOs and media actively promote citizens interests
**114-0233** Strengthened enabling environment and organizational frameworks for political participation (parties, elections)

**114-0231 More Effective, Responsive, and Accountable Local Governance**
**114-02311** Independent media highlights citizens' concerns and informs communities of key issues
**114-02312** Citizens' legal rights better protected
**114-02313** Improved capacity of local communities to engage local government

**114-0310 Reduced Human Suffering in Targeted Communities**
**114-0340 Catalyze Improvement of Social and Health Services in Targeted Areas**
**SO Level Indicator(s):**
% of people below poverty line
**114-0341** Communities meet basic needs

**114-0342** Prevention of disease and access to quality health care improved

**114-0410 Special Initiatives & Cross-Cutting Issues**
**114-0420 Program Support, Training, and Small Grants**