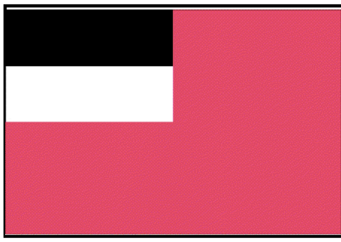

Georgia
Country Overview

BASIC FACTS:

Capital: Tbilisi
Area: 69,700 square kilometers
Population: 5.5 million (1999)
Currency: Lari
Exchange Rate: $1 = 2.09 Lari (May, 2001);
GNP: $3.4 billion (1999)
GDP Growth: 2.9% (1998); 3.3% (1999); 4.8% (1999-03)
GNP per capita: $620 (1999)
Inflation: 19.1% (1999)

EXECUTIVE SUMMARY

Georgia has an area of approximately 70,000 square kilometers, slightly larger than South Carolina, with a population of 5.11 million. The climate is subtropical, with warm summers and mild winters. The High Caucasus Mountain Range forms the northern border with Russia, while the southern boundaries with Turkey, Armenia and the eastern boundary with Azerbaijan are formed along the summit of the Lesser Caucasus Mountains. The western boundary is the Black Sea, with several ports - Batumi, Supsa, and Poti prominent among them. Melting snow in the spring and summer rainfall feed numerous rivers flowing into the valleys and provide abundant water for irrigation and hydroelectric power. The lowlands of the West are subtropical and are the centers of tea and citrus production, while grapes and deciduous fruits grow abundantly in the uplands.

Approximately 56 percent of Georgia's population reside in urban areas, of which about one-third live in Tbilisi, the capital. The ethnic composition is roughly 70 percent Georgian, 8 percent Armenian, 6 percent Russian, and 6 percent Azeri (1989 census). Seventy-five percent of the population is Orthodox (65 percent Georgian Orthodox, 10 percent Russian Orthodox), 11 percent Muslim, and 8 percent Armenian Apostolic. The nationwide literacy rate is 99 percent. The national language is Georgian although Russian can be used in almost all situations. English is now the favored language of study.

At the end of 1999 official unemployment was 5.6 percent, real unemployment is probably much higher. Unemployment and underemployment especially affect youth, women, and specialists with university or technical education who were working in state-supported sectors. Investors can benefit from the high level of education of the labor force, one of the highest in the former Soviet Union. During the Soviet period, a number of defense-related enterprises operated in Georgia and employed a skilled labor force of 90,000 people including 10,000 scientists.

Due to its strategic geographical position between Europe and Central Asia, Georgia remains the gateway for land transportation across the Caucasus, using its ports as bridges; its location on the Black Sea is one of the country's foremost natural assets. Some overland routes are problematic, but Georgia is publicly committed to building a functional trans-Georgia transportation infrastructure to its Caucasus and Central Asian neighbors.

The country's busiest seaport, Poti, has a shipping capacity of 5-6 million tons a year, and is used for most container traffic entering Georgia by sea. This port should develop quickly as more traffic comes through the city, and it is being modernized to handle heavier traffic. The southernmost port, Batumi, has a capacity of 4-5 million tons, and was designed for bulk traffic.

The repair and completion of the pipeline, and the building of the Supsa terminal cost $565 million. It is the second of two lines planned to carry more than five million tons of oil a year from Azerbaijan and its main foreign oil consortium in the next few years. The pipeline is 827 km long, 772 km of which are made from new steel pipes with a 530-mm diameter. The route has six pumping stations. It can carry up to 105,000 barrels of oil per day (b/d). It is hoped that by 2002 capacity will be raised to 300,000 b/d. At this time, 50,000 barrels of oil are passing through it.

On the same day, a new rail ferry was opened connecting Poti, Georgia to Odessa, Ukraine. The two events together mark the beginning of the revitalization of the silk route (the ancient spice trading route that caravans traveled through the Caspian and Caucasus regions to reach Europe) and highlight the viability of an east-west transit corridor from the Caspian.

The major airport in Georgia is in Tbilisi. Commercial flights connect daily between Tbilisi and other cities of the NIS. Several times a week, flights run between Tbilisi and Frankfurt, Istanbul, London, Vienna, and Zurich. Although the airport still experiences multiple problems with scheduling and organization, an EBRD air traffic control project was completed in 1996. In July 1997, Northrop Grumman announced a major sale of air traffic control equipment financed through a new Project Incentive Agreement with the Export Import Bank of the United States.

ECONOMIC OUTLOOK

In the mid-1990s Georgia began to experience modest but increasing levels of GDP growth and foreign investment. Until 1998 Georgia's economy grew on average 7% per year. This growth was attributable to the introduction of a new, stable currency, reduced rates of inflation, and the re-establishment of both economic and political stability. Economic growth and reform slowed in 1998, due to the Russian financial crisis, drought and political events, such as an outbreak of hostilities in Abkhazia and an assassination attempt against the President. Although growth through 2000 remains positive, Georgia's economic performance has slowed, with GDP growth of 3 percent in 1999 and 1.9 percent in 2000. While a severe drought in the summer of 2000 undermined Georgia's projections for economic growth that year, the decline is also due to fundamental economic problems that have eroded investor confidence in Georgia.

Foreign Direct Investment (FDI) has declined in recent years. According to the State Department of Statistics, FDI in 2000 was USD 60.14 million, compared to USD 83.65 million in 1999. FDI peaked in 1998 with USD 288 million, although a significant portion of this is attributable to one project: the Baku-Supsa early oil pipeline and Supsa terminal.

The key sectors of economic activity in Georgia have been energy, agriculture, trade, tourism, and transport, as well as significant projects in the food processing and telecommunications industries. The United States is the largest foreign investor in Georgia, having contributed USD 20.4 million in 1999 and USD 12.2 million in 2000, or 24 and 21 percent of overall FDI respectively.

Georgia is a leader in the former Soviet Union of developing the legal infrastructure for an attractive investment climate. Georgia maintains no currency controls, allows foreign investment in all but a few sectors deemed strategically important, and has implemented an impressive privatization program, including land privatization. Georgia is also the second country of the former Soviet Union to join the WTO, which will provide additional opportunities for investors to develop export markets. Despite these advances, economic activity in Georgia is below potential. The poor fiscal situation, pervasive corruption, and the arbitrary implementation of laws and regulations have inhibited foreign investment in Georgia. Problems with fiscal policy affected macroeconomic conditions in recent years. An IMF program initiated in 1996 was put on hold in 1999 due to Georgia's failure to meet certain budgetary targets. However, an improved macroeconomic picture and a more realistic budget in the second half of 2000 paved the way for IMF board approval of a new program for Georgia in January 2001.

Corruption is a major deterrent to potential investment. Many government officials have a reputation for dishonesty among the private sector and the general population. It is not unusual for government officials and departments to operate businesses, some in areas they are supposed to regulate. Western businesses report frequent attempts by Georgian officials, particularly tax and customs officials, to obtain extralegal payments.

In July 2000 the government of Georgia created an anti-corruption commission that made its report in the fall of 2000. Its recommendations include several measures that, if implemented, would improve the investment climate. It is too soon; however, to determine whether effective anti-corruption measures will be implemented.

Privatization is one of the main elements of Georgian macroeconomic reforms. Merrill Lynch International, together with Kantor Consulting and KPMG, were selected as financial advisors to the government in the privatization process. As of January 1, 1998, 10,515 small enterprises out of 10,656 originally targeted for privatization had been privatized, or eighty-nine percent. Among medium-sized and large enterprises, it is estimated that 1,292, or 80 percent, have been privatized. The state’s share in privatized enterprises varies considerably, but it is never more than 49 percent. TACIS (the European Union’s economic development organization) economic reports show that social services, trade and transport are the sectors where most of medium and large enterprises have been privatized.

Foreign investors wishing to participate in the privatization of enterprises find no legal restriction, and as a result, investors from the U.S., Netherlands, Germany, Italy, Iran, Turkey, Korea and other countries are active in Georgia.

The main privatization law in Georgia is the Law on the Privatization of State-owned Enterprises in the Republic of Georgia. It was adopted by the parliament on August 9, 1991. As this law is very general, a large number of subsequent laws exist regulating different aspects of privatization.

BUSINESS AND INVESTMENT CLIMATE

Although Georgia's policy of encouraging imports has meant few established barriers to U.S. products, it maintains import licenses on a number of goods of which unrestricted sale and use could be considered dangerous, including some medicines, medical equipment, chemicals, industrial vestiges, drugs, weapons, and ammunition. Obtaining the necessary licenses does not appear to pose substantial difficulties. The licenses may be obtained through the Ministry of Foreign Economic Relations. The effect of any Georgian barrier on US trade is minimal.

Import duties on most goods are set at 12 percent. Under the terms of the customs law that came into effect January 1, 1997, capital goods, spare parts, and goods intended for manufacturing are subject to a 5 percent tariff. Goods entering the country are also subject to a 20 percent VAT and a varying customs fee. Certain goods are also subject to an excise tax. In 1999, Georgia implemented a pre-shipment inspection program.

The import of wheat, baby food, diabetic food products and humanitarian assistance is exempt from the customs tariff. Selected medicines, items imported under intergovernmental agreements, goods in transit, and materials for local production are also tax-free. Property contributed by foreign investors in accordance with the firm's articles of incorporation, as well as foreign investors' personal use of property, are exempt from import duties and customs taxes. Additionally, equipment or materials imported for industrial maintenance are exempt from import duties and customs taxes.

Value added tax (VAT) is required for any (including foreign) company, branch, or representative located in Georgia (except foreign diplomatic organizations). The VAT applies to manufactured and purchased goods, (including imported), works and services. If bilateral agreements are in effect, a special reduced VAT payment or free VAT status can be established for the list of exported/imported goods, works and services.

Licensing applies to foreign as well as domestic investors in selected areas, the list of which is subject to change. Currently licenses are required for: gambling, lotteries, casinos, production or sale of medicines and substances subject to special control; production or sale of arms and explosives; forestry and natural resources; cellular communication service and establishment of television and radio channels; banking; insurance; and the issuance of securities, where issuance constitutes a public distribution. Sector-related ministries issue licenses in their spheres.

Although the business environment is improving, it remains burdened by government influence, corruption, and bureaucracy. Personal contacts play a significant role in the successful establishment of a business. Although the legal framework for private business is in place, the enforceability of contracts depends on the independence of courts. This is still not the case in Georgia.

Dilapidated infrastructure presents one of the most daunting constraints to potential foreign investors. Substantial progress must be made to provide the basic infrastructure on which business depends. Foreign investors have to supply back-up electricity generation capacity to ensure that their businesses can function without interruption. This adds large costs to doing business. Some small, private investments in domestic energy have shown encouraging results. Segmentation and privatization of the state electric monopoly, and keeping barriers low for new private investment in this sector are ways Georgia can bring an end to the persistent energy crisis and attract the investment needed for modernization.

POLITICAL CLIMATE

Georgia endured considerable instability in the immediate Post Soviet period. A civil war in the early 1990s resulted in the ouster of then President Gamsakhurdia in early 1992. Two assassination attempts against President Shevardnadze in 1995 and 1998 are believed to have been perpetrated by former supporters of Gamsakhurdia and paramilitary groups.

Beginning in 1989, separatist conflicts flared up in the areas of Abkhazia and south Ossetia. Although the situation in these regions has calmed considerably, there was renewed violence in Abkhazia in 1998 and partisan activity continues in these regions. Their status remains unresolved and the central government does not have effective control of these areas. The small and relatively prosperous Black Sea province of Ajara, while never the scene of political violence, has a constitutionally guaranteed degree of autonomy from the government in Tbilisi. Relations between the leadership of Ajara and Tbilisi are strained.

Although presidential and parliamentary elections in 1999 and 2000 were marred by irregularities, there were no reports of violence. There are periodic demonstrations by Internally Displaced Persons (IDP) and other groups complaining of non-payment of salaries and pensions, as well as demonstrations for lack of electricity, but none of these have been violent. Small opposition parties, including the Zviadists and communists, also demonstrate, but again these protests are non-violent. Violence has been directed towards small evangelical groups, but other religious groups, and not the government has perpetrated this.

Externally, Georgia maintains friendly relations with neighboring countries, including Turkey, Azerbaijan and Armenia. These relations serve as an additional incentive for foreign businesses intending to come to the region. Development of regional energy projects, including the Baku-Tbilisi-Ceyhan oil pipeline and Shah-Deniz gas pipelinewill strengthen Georgia's ties with its neighbors. It is also anticipated that these projects will generate greater investment in Georgia due to increased demand for goods and services associated with the development of the energy corridor. The economic boost from these projects will also result in greater levels of employment and revenue, thereby encouraging stability in the country.

SOURCES OF FINANCING

The banking system is in at an early stage of development. The recently adopted law on the Central Bank introduced a two-tier banking system. All commercial banks must become joint stock or limited liability companies.

The Commercial Banking Law allows the Georgian National Bank (GNB) to regulate against monopolistic practices and institute proceedings to liquidate banks that do not comply with prescribed prudential limits. As a result of the GNB role in bank oversight, the number of banks has steadily declined, from 247 in 1995 to 43 in early 2000.

Georgia has three large commercial banks with assets totaling US$133.7 million (54 percent of total commercial bank assets). All three banks are privatized, former state-owned commercial banks. In 1998, the Black Sea Bank (in which the EBRD and Bank of Greece both have stakes) and the Turkish bank Emlak Bankasi opened.

To improve the banking system, the GNB certifies commercial banks and issues licenses for the conduct of specific banking activities. Only those banks that have licenses are permitted to conduct hard currency transactions.

Georgian law does not limit the free flow of financial resources. In practice, however, the flow is restrained because of poor and unreliable inter-bank communication (regular banking transactions within Georgia can take several days). The average interest rates on credit are less than 30 days-43 percent, 30 to 90 days-39 percent, 90 to 180 days-32 percent, 180 days to 1 year-26 percent, and more than one year-22 percent.

TELECOMMUNICATIONS

During Soviet times, the telecommunications sector in Georgia was centrally managed and controlled from Moscow. This branch of the Soviet economy was under the control of the communist party and Soviet government. Telecommunications access in rural and mountainous areas in Georgia was lacking.

The collapse of the Soviet Union and the post economic crisis that ensued had a negative effect on all branches of the Georgian economy, including the telecommunications sector. During the long and difficult period of the economic crisis much of the infrastructure deteriorated even further. Economic stagnation and hyperinflation characterized this period. Transformation to a market economy was especially difficult for the Georgian telecommunications industry. It faced organizational and financial problems since it lost its main source of funding, and its Soviet-run management system.

The Ministry of Communications has granted over 500 telecommunication licenses since 1997. Most of the applicants requesting licenses have received one. The mechanism of licensing was not burdened by complicated procedures. It is important that licenses are not exclusive and do not confer privileged rents on their holders, nor do they cause future barriers for entrants.

The National Regulatory Commission was recently established and started functioning in 2000. The special regulatory body will be responsible for licensing, monitoring, setting tariffs and other technical aspects connected to the communication sector on behalf of the Law on Telecommunications, supported by the law on Privatization. The process of certification is conducted by independent certification agencies as well as by a special department of the Ministry of Post and Telecommunications on behalf of these agencies.

In accordance with the processes mentioned above, Georgia has attracted significant investment since 1997. US$170 million worth of telecommunication equipment has been installed in Georgia since 1997. This includes approximately 200,000 local and trunk-switching ports, two modern international gateways, four satellite ground stations, substantial microwave and fiber optic trunk transmission routes, infrastructure for 100,000 cellular subscribers, several international satellite earth stations and international gateways, two paging systems, and several trunk mobile devices. These assets were mainly purchased through foreign investment. As a result, telecommunications has become one of the most competitive and rapidly growing branches in the Georgian economy.

However, there is widespread concern that the way in which the telecommunication sector of Georgia is formed is not always transparent and competitive. Newly established companies could collude and form a cartel. Should this happen, there would be serious danger for the business environment and consumer rights protection, thus creating barriers for new entrants.

Despite the achievements, local networks that originally served the whole population and are still state owned, are in a state of collapse. This is mainly caused by a lack of funds and inefficient management. In order to prevent deterioration and secure the local telecommunications network, the Georgian government plans several progressive actions. The government plans to sell part of its assets in the telecommunication sector: the state still owns 51 percent of Telecom Georgia, 100 percent of Georgian Local Lines Company (GLLC) and a number of licenses still remain undistributed to mobile phone operators.

Shares of Telecom Georgia are considered the most attractive and significant. The Ministry of State Property Management intends to sell these shares through an open competitive tender. Priority will be granted to a strategic investor that is not connected to any of the existing players in the telecommunications market.

The Ministry of State Property Management together with the Ministry of Communications also intends to sell 100 percent of the shares of GLLC, which is the main local operator.

At present, the Georgian telecommunication sector is developed enough to provide advanced and high quality service to its customers. These services include international voice and data services, mobile GSM and AMPS systems, Internet, and paging.

There are four significant competitors operating in the Georgian international communications market. They are Georgian Telecom, Egrisi, Goodwillcom, and Saktelekom Plus. All of these companies operate through Intelsat and Eurosat as well as other international satellite link providers.

Three competitive players form the Georgian mobile phone market. Magticom and Geocel provide GSM system service, and Megacom is an AMPS operator. Magticom was formed in 1996 as a joint venture between Magti group (51%) and Telcel Wireless (49%). Telecom Georgia (2%), GLLC (12%), Turkcell (40%), and Celcom (46%) also formed Geocell in 1996 as a joint venture. The American Company – Schuman International Corporation, established Megacom in 1994. This particular sector seems to be very difficult for a newcomer to enter, unless a new system is introduced into the market.

Domestic long distance service is mainly provided by Telecom Georgia, however it has strong competitors presented by Fop Net, mobile phone companies, and GLLC.

There is moderate competition in the local call market. GLLC previously had over 500,000 lines in operation, but increased competition from new entrants such as New Net and its subsidiary, Akhteli, has resulted in a loss of 140,000 subscribers. New Net operates the most advanced exchanges in the country and is GLLC's main competitor with about 18% of the communications market.

Metromedia International Communications has established two paging companies – Paging 1 and Paging 2, which operate correspondingly on 1800Mhz and 1900Mhz frequencies. Paging service is available only in Tbilisi.

The best prospects for entry into the Georgian communication market seem to be providing Internet service and equipping the regions situated far from Tbilisi with modern communication systems and devices.

The two biggest Internet providers are SaNet (5,000 subscribers) and CaucasusNet (2,000 subscribers). Internet service has emerged as the most popular and progressive service. The development process for Internet service went in slightly the wrong direction (people mostly use IP service – Internet Phone Service, which is cheaper than international call service). The entry of a new company with better rates and faster service will inevitably create an increase in the number of potential subscribers. It is worth mentioning that most of foreign companies orient their business towards Tbilisi, for fast profit generation and to maximize services. Accordingly, the only company to recently install communication equipment outside Tbilisi is Iberia Tel, in cooperation with Ericsson.

INFORMATION TECHNOLOGY

Even though Georgia found itself in political and economic turmoil, followed by an information vacuum after the collapse of the Soviet Union and Communist regime, a progressive wave of information technology still managed to strike the country's borders. The first Internet provider in Georgia, Kheta, was established in 1991. During the same period it became apparent that Georgia had a surprisingly good supply of highly professional programmers who worked in various scientific institutes. Today, Georgia can easily be considered a moderately computerized country with a good supply of professional, cheap labor and a reasonable variety of companies involved in the information technology sphere.

The majority of the above companies are in retail trade - including the software producing companies. Computers of various modifications assembled in Georgia are the most popular products. The prices for these computers are far below the price of a computer with an internationally known brand name. Nevertheless, the quality of the locally assembled computers corresponds to the needs of the local consumer.

The distribution channels for the imported computers are not well developed in Georgia. This is due to higher custom's duties for trading companies than for end-users. Despite this situation, one still finds a reasonable number of companies which trade in imported UPS, monitors, computer cases, and other related accessories.

In Georgia, the largest computer purchasers are international donor organizations, such as U.S. Agency for International Development and the World Bank. In most cases, these organizations acquire large numbers of computers and related accessories for various governmental and non-governmental bodies. In accordance with the large number and variety of trading companies the purchaser must make a complex decision regarding the modification of computers, their delivery, installation, etc. The total sum generated by such projects constitutes a big share of the turnover capital generated by the information technology sector.

Regarding repair services, Georgian companies can be divided into two categories. The first category includes companies which specialize their business exclusively on the repair of computers and accessories. The second category includes companies that repair computers as only a part of their business.

The following authorized computer service centers conduct their activities in Georgia: Hewlett-Packard; Compaq; APC; DELL (provides service exclusively for its clients); and Canon (provides service exclusively for its clients and Xerox).

Various companies provide network installation. Most often when a client purchases a computer, the dealer provides its installation free of charge. However, there are several companies that only do installation work.