

EUROPEAN PARLIAMENT



Directorate-General External Policies

Policy Department

The Political and Economic Situation in Georgia and its relations with the European Union

NOTE

Abstract:

This note revises an earlier note of 2004 on the same subject and is intended to inform Members of the European Parliament who will be visiting Georgia of the situation in that country.

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EXECUTIVE SUMMARY

President Michael Saakashvili continues to dominate the political scene. Former Prime Minister Zhvania died unexpectedly in February 2005 and his supporters are increasingly marginalised. Zurab Nogaideli was appointed to replace him. Some mild economic reforms are being implemented but painful structural reforms remain to be undertaken.

There has been recent criticism of the delays in fulfilling pledges to improve the civil rights of prisoners and of the continued use of torture by security forces. Many corruption cases in the courts have been resolved by plea bargaining whereby the defendant pays large sums of money to the state which then drops the charges.

The Georgian Constitution of 1995 established a conventional parliamentary system under which ministers are appointed by the President and accountable to parliament, which is composed of a single chamber with 235 seats. Georgia is experiencing regional problems in Abkhazia, which has proclaimed itself an independent republic without Georgian consent, and in South Ossetia. The autonomous status of Ajara is recognised by the constitution and this region was recently incorporated once again into Georgia.

Since 1991, Georgia has endeavoured to pursue an autonomous foreign policy. Russia has been reluctant to accept this desire for independence and has signed cooperation and free trade agreements with Georgia. The status of Abkhazia and South Ossetia has constituted a major irritant in relations between the two countries.

In economic terms, Georgia is one of the poorest countries of the former Soviet Union. It has emerged from a worrying economic situation, thanks in particular to a debt relief agreement that enabled it to finance external trade. GDP has been increasing since 2000; growth of about 10% was achieved in 2004 and this rate is expected to be maintained in 2005 and 2006, with investment rising rapidly because of pipeline construction. Inflation is under control and the currency is stable.

Georgia has been admitted to the EU's European Neighbourhood Policy and an action plan is expected shortly which will replace provisions of the 1999 Partnership and Cooperation Agreement (PCA). The latter agreement with the European Union established a political dialogue, provided for trade in goods, with a human rights 'conditionality' clause, and the creation of an institutional cooperation structure. The Cooperation Council has looked into the efforts made to resolve the conflicts in the autonomous republics. Georgia has received about €420 million in grants via, *inter alia*, the Tacis Programme, the Food Security Programme, and aid from ECHO. The EU is Georgia's third leading trading partner after Turkey and the Russian Federation.

I. POLITICAL SITUATION

1. Introduction

Georgia, which has a population of some 5.5 million, is a country rich in natural resources. The country's surface area is 69 700 km² (twice the size of Belgium), and it is strategically situated between Asia and Europe. The country is divided into three main geographical regions: the Caucasus mountain range in the north, which stretches from the Black Sea to the Caspian Sea, forming a natural border with Russia; the plains of Southern Georgia, which also extend into Turkey and Armenia; and the Central Georgian basin area which borders on Azerbaijan to the east and the Black Sea to the west¹. The country's geographical diversity is complemented by its ethnic diversity: 70.1% Georgian, 8.1% Armenian, 6.3% Russian and 5.7% Azeri.

The unique qualities of its language (which is not Indo-European, Semitic, or Ural-Altaic, but Caucasian) and its culture (the Georgian alphabet and its literature date back almost two thousand years), as well as the wealth of resources located on such a small, yet strategically positioned territory, have made Georgia a constant target for its neighbours. The capital Tbilisi has been destroyed 26 times (with invasions by Romans, Byzantines, Russians, Persians, Arabs, Mongols and Turks).

In 1783, King Irakli II put Georgia, then under threat from both the Ottoman Turks and the Persians, under Russian protection. In 1801, Tsar Paul I annexed Georgia. The monarchy was abolished and the Orthodox and autocephalous Georgian church was placed under the authority of the Russian Synod. However, it took more than sixty years to conquer the Caucasus. At the end of the nineteenth century, the Tsarist regime intensified its policy of russification. Russian became the official language and Georgian a foreign language. This policy provoked a strong nationalist reaction from the people of Georgia.

With the fall of the Russian Empire, Georgia was able to proclaim its independence in 1918. However, under threat from the Turks, White Russian armies and the Bolsheviks, Georgia was not able to resist for long. The Red Army entered Tbilisi in early 1921. The (Menshevik) government went into exile and Georgia became a Soviet Socialist Republic.

In the Caucasus region, which is home to a mosaic of peoples, the Soviets created a whole series of autonomous entities based on ethnic origin between 1921 and 1924. But their demarcation and the way that they were interwoven was designed to avoid potentially dangerous groups of mountain peoples and to weaken unreliable subjects, such as the Azeris and the Georgians. In 1921/22 three autonomous republics on Georgian territory were created: Abkhazia, Ajaria and South Ossetia. This Soviet legacy has produced much conflict recently.

¹ See Annex I, p. 17.

In March 1990, as the Soviet Union was beginning to disintegrate, the Georgian Parliament declared the 1921 and 1922 treaties on which Georgia's annexation to the USSR was based, to be illegitimate. A referendum was held, by virtue of which Georgia proclaimed itself independent once again on 9 April 1991, after 70 years of enforced sovietisation. The date chosen for this declaration marked the anniversary of the brutal repression in 1989 by the Soviet Ministry of the Interior of a nationalist protest in Tbilisi, which irreversibly discredited the Communist party.

2. Domestic policy

2.1. Recent events and the constitutional system

In the first free parliamentary elections since 1919, held in October 1990, the nationalist coalition 'Free Georgia', headed by Zviad Gamsakhurdia, obtained 55% of the votes. Gamsakhurdia was then elected Head of State by an overwhelming majority. The Tbilisi government reacted to the declarations of sovereignty made by the Ossetians and Abkhazis, which were supported and exploited by certain Russian elements, by going on the offensive and exacerbating the situation, which rapidly degenerated into a bloody civil war.

In addition to ethnic tensions, Gamsakhurdia's position was also weakened by his economic policies. Perceiving hostile intent in the actions of all his neighbours, he sealed off his country in a form of autarchy, to disastrous effect. Georgia's leading industries, which had been established under the Soviets, collapsed. Finding himself isolated after losing his last remaining supporters to the opposition, the Georgian President fled the country in early 1992.

A Council of State turned to Eduard Shevardnadze, who was appointed Interim President and was subsequently elected and re-elected in 1995 and 2000. The then unanimous support for the former Soviet Minister of Foreign Affairs was a response to the tense situation in Georgia at that time, notably the conflict in Abkhazia and opposition from Gamsakhurdia supporters in Mengrelia. In order to break out of this impasse, the Georgian President had to call on the assistance of his Russian counterpart, Boris Yeltsin, and to agree to Georgia becoming a member of the CIS.

The Constitution adopted in 1995 grants the President extensive powers. He is the head of the executive and appoints the Council of Ministers, which is accountable to the parliament. The latter is made up of a single chamber (Sakartvelos Parlamenti) of 235 members elected for a term of four years. Following unsatisfactory elections to parliament Shevardnadze was forced to resign in November 2003 and replaced by President Mikhail Saakashvili (who is only 37 and was educated in the USA); the late prime minister, Zurab Zhvania; and the speaker of parliament, Ms Nino Burjanadze. Prime Minister Zhvania died in an accident in February 2005.

The new leaders received a massive public endorsement in the presidential elections of January 2004, followed by the victory of their National Movement-Democrats bloc in the March 2004 parliamentary election. This coalition won nearly two-thirds of the vote and has thus overturned the pre-existing structure of power in a convincing fashion, not yet repeated elsewhere in other CIS countries. Following the so-called 'Rose Revolution' 16 parties and coalitions contested the parliamentary elections but only two groups obtained the 7% of the vote needed for representation in parliament. Apart from the government bloc, the only other group represented is a coalition of 'Industry will save Georgia' and 'New Rights'.

The death in February 2005 of Mr Zhurab Zhvania, Prime Minister and ally of the President, but also head of an independent party, has deprived Georgia of an experienced political heavyweight who acted as a restraining influence on President Saakashvili and the only person able to provide an authoritative challenge to his judgements. Younger radical figures are moving to the forefront but they lack the former Prime Minister's breadth of political and administrative experience.

2.2. Human rights

Before the recent elections the Council of Europe stated that Georgia fell far short of commitments entered into upon its accession to the organisation in 1999. A report in September 2001 emphasised that little progress had been made as regards respect for human rights in Georgia and expressed concern at allegations of degrading treatment and torture of detainees and at acts of violence perpetrated by Orthodox extremists against members of minority religious groups. The current situation is improving but criticisms are being made in regard to the slow pace of reform and the continued use of torture by the security forces.

2.3. Regional problems

a) Abkhazia

This small autonomous republic on Georgia's Black Sea coast could have remained the renowned little paradise that it was during the Soviet era, when it was a favoured holiday spot for the Soviet elite. Although Abkhazia is inhabited by an ethnic group distinct from yet related to the Georgians, it has since ancient times shared a common history with Georgia. Islam came to Abkhazia in the 16th century and, with the exception of some tribes who were the forebears of the modern-day Abkhazs, a majority of Abkhazs emigrated to Turkey in 1864, when their region was annexed by Russia. The Abkhaz had

therefore become a minority in their own region (before 1990, 18% Abkhaz and 46% Georgian).

In August 1990, the Abkhaz government declared itself the sovereign authority. Tbilisi opposed this move and a civil war ensued. After several months of conflict the Georgian army was forced to abandon Abkhazia (which was being supported by the 'Confederation of the Peoples of the Caucasus' and some Russian forces), taking with it nearly the whole Georgian population (about 250 000 people). After a cease-fire was signed in December 1993, a CIS peacekeeping force took up position.

There is no doubt that Russian political calculations played a part in this crisis. However, the delays in negotiating a solution are also linked to hesitation on the part of the Georgian leaders, who were themselves tempted to regain control by force and were reluctant to accept a federal outcome.

Abkhazia remains outside Georgian control pending a political solution. It is isolated, its population has shrunk and its economy is in tatters. The elections of 2001 in Abkhazia were denounced by the international community, including the European Union. The conditions for fair and free elections were not fulfilled, owing primarily to the absence from Abkhazia of the 250 000 Georgians who had been driven from their homes. Abkhazia needs a compromise solution which satisfies international law and, in particular, the notion of Georgian territorial integrity.

The UN has sought to bring the Abkhaz and the Georgian factions to the negotiating table, but proposals which met with the approval of Georgia, the OSCE, the Council of Europe and other international organisations were rejected by the leaders of the Abkhaz secessionists Vladislav Ardzinba (President) and Raul Khadjimba (Prime Minister)², who - with the leader of south Ossetia - have appealed to Moscow for 'associate member' status within the Russian Federation. After a summit meeting between the Presidents of Russia and Georgia and the Prime Minister of Abkhazia in March 2003, agreements were signed which provided for:

- the return to Abkhazia of refugees who had fled the war in 1992-1993;
- the reopening of the railway line between Sochi and Tbilisi;
- the recommissioning of the Ingouri hydroelectric power station.

Following the election of the new President the situation is uncertain but his success in Ajara (see below) may provide a useful precedent for implementing a solution also for Abkhazia. This would require the support of Russia.

b) Ajara

Ajara is a region situated in the extreme south-west of Georgia, on the border with Turkey, facing the Black Sea. After three centuries of Ottoman domination, this region, inhabited by Islamic Georgians, was annexed by Russia in 1878. It remained under

² The revised UN proposal was also rejected by the Abkhaz authorities, in March 2003.

Soviet control after the USSR signed the Treaty of Kars with Turkey (October 1921), which conferred autonomous status on Ajara.

In May 2004 the entrenched leader of this autonomous region, Aslan Abashidze, lost power in a peaceful revolution after he had banned political parties other than the ruling 'Revival Union' and attempted to sever all links with Georgia. A young technocrat from the local capital, Batumi, has been put in charge and the region is being integrated with the rest of the country. The successful recovery of this region substantially strengthened the government of Mr Saakashvili in Tbilisi.

c) South Ossetia

The Ossetians are a people distinct from the Georgians. They do not speak a Caucasian language, but an Indo-European one related to Persian. It was this difference that enabled the Ossetians to maintain their autonomous status during the Soviet era.

The people of Ossetia feared that the upsurge in nationalist feeling in Georgia following independence would prejudice the rights acquired under their region's autonomous status. In September 1990, the Ossetians, who were keen to unite with their fellow countrymen in North Ossetia, proclaimed a federative republic within the USSR. The Georgian authorities responded firmly to this and a civil war ensued, triggering military intervention by Russia in mid-1992.

The OSCE was asked to find a solution to the conflict, and on 3 December 1992 a mission was set up in Georgia. The new government in Tbilisi is seeking demilitarisation and an expanded role for this OSCE mission, with a view to the control of smuggling and the entry of arms and pro-Ossetian volunteers from the northern slopes of the Caucasus. President Saakashvili has supported a negotiated solution under international auspices which would provide a high degree of autonomy to the region and even dual Russian-Georgian citizenship for its inhabitants.

Nevertheless, violence has been frequent and Russia is suspected of aiding those seeking independence through its local peace-keeping force. Since Russia has a veto in the OSCE Permanent Council and is opposed to a larger role for the OSCE mission, Georgia has sought to involve the EU. In 2004 Mr Saakashvili threatened to renounce a 12-year old cease-fire agreement concerning South Ossetia under which Russian forces maintain a peace-keeping mission there. He has subsequently presented proposals aimed at resolving the status of South Ossetia, including a high degree of autonomy, but these have been rejected by local leaders there. A solution is unlikely as long as Russia continues to support the leadership of South Ossetia.

3. Foreign policy

Since its independence, Georgia has tried to pursue an autonomous foreign policy but remains subject to pressure from Russia, its powerful neighbour to the north. Georgia is thus a member of the UN, the Black Sea Economic Cooperation Area (BSECA), the Commonwealth of Independent States, GUUAM (Georgia, Ukraine, Uzbekistan, Azerbaijan, Moldova) and the Council of Europe. It is also participating in NATO's Partnership for Peace Programme.

3.1. Relations with neighbouring countries

a) Russia

Negotiations between Georgia and Russia on a broad range of issues may soon result in a treaty. This would also provide for the withdrawal of Russian troops from their two remaining bases in Georgia (at Batumi in Ajara and Akhalkalaki, main town of an ethnic Armenian area).

Russia has not been happy with the independent foreign policy being developed by Georgia nor with its links to the USA, the EU and NATO. The support of Russia for the former autonomous republics, the ensuing war with Abkhazia and the struggle against Gamsakhurdia supporters in Mengrelia seriously weakened Georgia. It was then obliged to join the CIS (1993), to sign a Russia-Georgia Treaty of Friendship and Cooperation (1994), to continue to host Russian military bases and in February 2002, to ratify a Free Trade Treaty with Russia.

The conflict in Chechnya has put Russia in an uncomfortable dilemma in regard to its support for break-away republics in Georgia. It is clearly incompatible to resist autonomy for Chechnya but support it in Abkhazia and South Ossetia. Russia is also threatening attacks on groups of rebels from Chechnya said to be hiding in the Pankisi gorge inside Georgia and has refused to permit the OSCE to monitor this frontier region beyond May 2005.

In the recent past Russia has taken measures which have strained Georgia's independence. Georgia has regularly found itself deprived of Russian oil, gas and electricity supplies. A visa system was introduced for travel between Russia and Georgia from December 2000.

The visa restrictions imposed on Georgia were the subject of a debate in the European Parliament³ which, in its resolution on the subject, regarded plans to exempt residents of the secessionist Georgian regions of South Ossetia and Abkhazia from the visa system as

³ OJ C 262, 18.9.2001, p.259.

‘a challenge to the territorial integrity and sovereignty of Georgia’ and therefore called on the government of the Russian Federation to ‘reconsider these plans as they would amount to *de facto* annexation of these indisputably Georgian territories’ and to suspend the implementation of this visa system. The Russian authorities have granted Russian citizenship to inhabitants of the secessionist regions and issued them with Russian passports.

The attacks of 11 September 2001 on the USA had a surprising impact on relations between Russia and Georgia. Both countries swiftly declared their support for a Washington-led anti-terrorist coalition. As a reward for its cooperation, Russia received political support from the West for its war in Chechnya.

The increase in US military aid for Georgia, designated for the fight against al-Qaeda, precipitated a wave of discontent in the Duma, amongst some military officials and within Russian nationalist circles. Relations between Russia and Georgia deteriorated further in August 2002, when the Russian airforce bombed the Pankisi gorges (in Georgian territory bordering Chechnya). Moscow claimed that Chechen ‘terrorists’ were sheltering in the area. The Georgian Parliament condemned this act of Russian ‘aggression’ on 26 August 2002 and demanded the withdrawal of all Russian forces, including peacekeeping troops in the secessionist regions, and the closure of the Russian bases still operating on Georgian territory.

Despite the new Georgian President's closeness to the current Bush administration in the USA, Mr Saakashvili's visit to Moscow in February 2004, at which he offered enhanced border cooperation with Russia, did contribute to an improvement in relations. The President has stated that he will take Russia's interests into account provided that Russia respects the sovereignty and territorial integrity of Georgia.

b) Turkey

Relations between Turkey and Georgia are good. Turkey is developing a policy of good neighbourly relations, and has therefore greatly encouraged the establishment of the Black Sea Economic Cooperation Area (BSECA). On 16 March 2001 at Tbilisi, Turkish and Georgian representatives signed a Defence and Cooperation Agreement between the two countries. Military cooperation has developed considerably since then and Turkey has become Georgia's principal trading partner.

The Baku-Ceyhan oil pipeline now under construction should further cement relations between Turkey and Georgia, through whose territory it passes. (Current problems with the environmental impact of this pipeline may soon be resolved.)

c) Armenia

Armenia is pro-Russian by tradition and has not welcomed Tbilisi's strengthening of relations with Ankara and Washington. Moreover, Yerevan is still worried for the

Armenian minority in Georgia, which is concentrated in the Javakheti region, the poorest part of Georgia.

d) Azerbaijan

Relations between Azerbaijan and Georgia are good. However, the Azeri minority in Georgia (500 000 people) sometimes complain that they are the subject of discriminatory measures by the authorities in Tbilisi. Again, the Baku-Ceyhan pipeline is a major common interest.

3.2. Relations with the United States

President Bush visited Georgia on 10 May 2005. His speech in Freedom Square in Tbilisi attracted very large crowds; he praised Georgia for the example which it had set for others (he mentioned Iraq, Ukraine and the Lebanon) and said that

“The path of freedom you have chosen is not easy but you will not travel it alone. Americans respect your courageous choice for liberty. And as you build a free and democratic Georgia, the American people will stand with you.

The reported presence of Al-Qaeda operatives in the Pankisi gorges spurred the Bush administration to station several hundred US troops in Georgia who, since May 2002, have been providing training and assistance to the Georgian military to enable them to combat international terrorism. President Bush has assured Georgia of his support for the independence, sovereignty and territorial integrity of Georgia.

On 21 March 2003, the Georgian Parliament ratified a December 2002 military cooperation agreement with the United States. The current 'Train and Equip' programme will end in September 2004 and the USA is not seeking military bases in Georgia. The new President of Georgia was trained as a lawyer in New York and has close links with the US administration.

3.3. Relations with international organisations

a) CIS

Following the events in the Pankisi gorges, the Georgian Parliament showed its indignation at Russia's attitude by voting through a resolution calling for the country's withdrawal from the CIS. President Shevardnadze opposed this decision by pointing to its significant political and economic consequences.

b) NATO

Georgia is a participant in NATO's Partnership for Peace Programme, and it was against this backdrop that NATO military exercises were held in Georgia in June 2002. Russia did not send observers to these exercises and the Presidents of the secessionist Abkhazia and South Ossetia condemned them.

II. ECONOMIC SITUATION

1. Introduction

The rapid world economic growth of 2004 is likely to fall to 4% this year but in Georgia it is likely to rise from 8.4 to about 10% in both 2005 and 2006, largely because of pipeline construction and the impact of higher salaries on domestic demand. Georgia has no oil of its own and therefore suffers from the rise in oil prices and its impact on inflation, but recent falls in food prices and a strengthening of the local currency, the lari, should counteract this.

Georgia however is one of the smaller and poorer former Soviet Republics, with weak external financial and trade linkages outside the CIS. The growth collapse associated with the end of Soviet economic management in the early 1990s was reinforced in Georgia's case by a brief civil war on its borders. The economy began to recover strongly in the late 1990s (growth rate of around 75% from the period following the collapse of the Soviet Union) and was further supported by a revival of Russian growth after 1998.

Current GDP growth figures are high, especially because of investment in the Baku-Tbilisi-Ceyhan and South Caucasus Gas Pipeline projects, but expenditure has in the recent past exceeded revenue by a large margin. Unpaid salaries and pensions have been a major problem until recently. Many structural challenges lie ahead if Georgia is to attain autonomous, sustainable growth. Since the acute fiscal crisis in 1998, which led to a devaluation of the national currency (the lari), inflation has been brought under control and the exchange rate has stabilised.

Reform efforts are concentrating on privatisation and fiscal consolidation. This means essentially raising revenue by combatting smuggling and corruption, by collecting taxes due and by improving public expenditure policy. Enforcement of new legislation has been weak and frequent changes have not permitted all ministers to gain experience. Reform in the field of education is proving controversial. Currently there is rampant corruption in regard for example to admission to medical schools, but there are also problems of corruption elsewhere and issues such as deteriorating infrastructure, unqualified teachers and an unreformed school syllabus.

In the long term Georgia has good export prospects because of a competitive labour force, copious natural resources and a strategic location. The private sector is expanding because of a liberalisation programme, but poverty and unemployment remain high. Health and education standards appear to be in decline.

2. Specific economic analysis

a) Economic growth

Pipeline investment is leading to a resurgence in domestic consumption owing to higher levels of disposable income; it has important multiplier effects in linked sectors such as telecommunications. However, the growth is not broad-based. Manufacturing continues to be constrained by weak investment and agriculture is hampered by a lack of collateral for loans, and low-quality inputs and infrastructure¹.

b) Economic policy trends

The IMF approved a new poverty reduction and growth facility in June 2004 amounting to US\$144 million. The reform programme associated with this facility is intended to reduce corruption, increase tax collection, reform administration of customs and taxes and increase expenditure on social projects and infrastructure. This agreement may permit a further rescheduling of Georgia's foreign debt through the Paris Club of official creditors.

Inflation appears to be under control. The fiscal situation had deteriorated in 2003 with a serious government deficit leading to arrears in the payment of salaries and pensions. This situation is now much improved with rapid increases in tax revenue last year, to the extent that the government was able to double pensions as well as paying off arrears. The one half of the population living below subsistence standards is expected to be reduced to one third in 2008 and one fifth by 2015.

There has been a delay in construction of the BTC oil pipeline, which is currently being filled with oil. Exports from the terminal will not start until October/November this year and consequently Georgia cannot begin to collect transit fees until then.

c) Monetary policy

Monetary policy aims to be prudent, underpinned by fiscal consolidation and a managed exchange rate float which seeks to keep inflation low and safeguard competitiveness. The system for sale of government securities is being improved and the government intends to avoid contracting non-confessional external loans. But the existing high level of external debt and vulnerability to regional insecurity may have a negative impact on the exchange rate and therefore also on inflation and interest rates.

d) Industry, services and agriculture

¹ Agriculture constitutes over 20% of GDP.

⁵ See Minutes of the sitting of 28 February 28.02.2002.

Industry represented 13.3% of GDP in 2003, compared to 20.3% for agriculture and 13.6% for transport and communications. Output has been growing fast both for mining and manufacturing. Public sector enterprises still account for nearly 40% of industrial output but privatised and private companies are increasing their share. The main sectors targeted by privatisation are the transport, telecommunications and energy sectors. About 50 enterprises (out of 2800) produce over three-quarters of industrial output.

Georgia is open to foreign investment. Until 1994, civil conflict kept most investors out. Since then, much progress has been achieved in creating an environment favourable to business. Levels of foreign investment increased substantially in 2003, despite problems associated with the legal system, high taxes, corruption and criminality. But most of this investment was associated with pipeline construction.

The services sector has benefited from rapid growth in trade, telecommunications, hotels and catering. The number of mobile telephone subscribers increased by 35% in 2003 and a further 40% in 2004 to reach 800,000. Goods passing through the ports of Batumi and Poti increased by 13% by weight. The current account surplus from transfers and remittances has substantially decreased because of the visa regime which has resulted in a big decline of Georgians working in Russia.

Agriculture fared badly in 2004, contracting by 7% because of a poor harvest and shortage of credit. Land plots are small and most agriculture is based on subsistence farming with very low labour productivity. About 25% of arable land has been privatised and a further 30% leased out. Grape production more than doubled and exports of wine are likely to grow. Viticulture is an important sector but production of grapes has fluctuated strongly.

f) Foreign trade

Imports rose abruptly from 2003 especially because of pipeline construction with a consequent big rise in imports of steel pipes and capital goods. The trade deficit almost doubled in 2004 reaching US\$1.2billion. Rapidly rising real wages have also sucked in consumer goods. Export revenue has however also benefited from a rise in world prices for copper and steel, as well as from buoyant exports to the EU, Turkey and Russia. Customs data has been inadequate because of corruption and a failure to record goods but the situation is improving.

A surge in remittances from Georgians working abroad has contributed to relieving the deficit on current account and inflow of foreign investment exceed this deficit anyway.

III. RELATIONS BETWEEN THE EUROPEAN UNION AND GEORGIA

1. Background

Georgia and its neighbours in the South Caucasus, Armenia and Azerbaijan, have been included in the EU's Neighbourhood Policy (ENP). The European Commission is recommending a significant intensification of relations with Georgia, through the development of an Action Plan under the European Neighbourhood Policy (ENP). This recommendation is based on the Commission's Country Report (published in March 2005), which provides a comprehensive overview of the political and economic situation in Georgia and the state of its bilateral relations with the European Union. The ENP goes beyond the existing Partnership and Co operation Agreement to offer the prospect of an increasingly close relationship with the EU, involving a significant degree of economic integration and a deepening of political cooperation.

In March and April 2005 the Council discussed the reports from the Commission on the countries of the South Caucasus; it endorsed the main thrust of the Commission's proposals for further development of the ENP and accepted them as the basis for joint preparation of action plans. The country report for Georgia is available on the internet from http://europa.eu.int/comm/world/enp/pdf/country/georgia_cr_0503.pdf.

Action Plans will now be drawn up in collaboration with the governments concerned. The European Commission believes that key objectives for Georgia should be:

- * Strengthening respect for the rule of law (reform of judiciary, law enforcement agencies, penitentiary) and enhanced human rights protection
- * Strengthening of democratic structures and pluralism (reform of parliament, strengthening independence of media, reform of local self government, electoral reform)
- * Improvements in the business climate as well as public sector modernisation
- * Reform of tax and customs administrations and legislation and strengthening the fight against corruption and fraud
- * A transparent privatisation process
- * Progress in poverty reduction, sustainable development; environmental protection
- * Progress in the resolution of conflicts and enhanced regional cooperation.
- * Prudent macroeconomic policies need to be maintained to support effective implementation of an Action Plan.

2. Partnership and Cooperation Agreement (PCA)

This Agreement entered into force in 1999 and provides the current framework for relations with the EU, based on democratic values, including political dialogue and respect for the rule of law. From an economic perspective, the Agreement promotes a market economy. It has constituted the basis for a close partnership by establishing an institutional structure and by opening up possibilities for cooperation in a whole series of areas.

The Agreement comprises the following elements:

- a political dialogue;
- provisions relating to trade in goods, labour, the establishment and functioning of companies, crossborder supply of services, capital and payments, competitiveness, protection of intellectual, industrial and commercial property, economic and legislative cooperation, respect for democracy and human rights, cooperation for the prevention of illegal activities and the prevention and control of illegal immigrants, cultural cooperation and financial cooperation;
- a 'human rights' conditionality clause which allows for the suspension of the Agreement, even unilaterally, in the event of a breach of the essential elements of the Agreement, such as respect for principles of democracy and human rights and the principles of market economy;
- creation of an institutional structure comprising a Cooperation Council, a Cooperation Committee and a Parliamentary Cooperation Committee;
- a separate protocol relating to provisions for customs cooperation.

3. Political dialogue

The first meeting of the Cooperation Council between the European Union and Georgia took place in October 1999. The parties emphasised the importance they attach to democratic values, respect for human rights and the principles of market economy. They confirmed their firm intent to strengthen political, economic, financial and cultural relations, as well as to support Georgia's efforts to consolidate democratic reform and complete its transition into a market economy.

The Cooperation Council's role is to examine how to support efforts to resolve the conflict in South Ossetia, to identify the means by which to encourage regional cooperation in the Caucasus, to study the ways to implement the PCA in general, and to identify the necessary measures to facilitate trade and investment, in particular to reinforce the process of democratisation and respect for human rights, as well as to work in close cooperation to combat drug trafficking. It will now presumably constitute the main forum for elaboration of an ENP action plan.

On 6 April 2004, President Saakashvili met Javier Solana for a discussion about the situation in Georgia and EU-Georgia relations. They discussed in particular the role which the EU may play in the future.

For its part the EP adopted a resolution on Georgia on 18 December 2003 in which it

congratulated the people of Georgia on the political changes (the 'Rose Revolution') and the new authorities; on 26 February 2004 it also adopted a resolution on EU policy towards the South Caucasus calling in particular for the countries of the region to be included in the European Neighbourhood Policy. The European Parliament has emphasised the strategic importance to the European Union of the Transcaucasian region, not least as a result of its energy resources, and also the prospect of the region becoming one of the main transit routes between Europe and Asia.

In February 2002 in a resolution on a communication from the Commission concerning the European Union's Partnership and Cooperation Agreements⁵, Parliament called on the Council to work on a comprehensive and long-term Common Strategy for the prevention of violent conflicts and a framework for security and cooperation in the region, using the model of the Balkans Stability Pact. Furthermore, it proposed a Conference of the European Union and the three states in question (Georgia, Armenia and Azerbaijan) and an EU Special Envoy for South Caucasus.

At the sixth meeting of the EU-Georgia Parliamentary Cooperation Committee held in Tbilisi from 21 to 26 November 2004 the Committee welcomed the peaceful nature of the Rose Revolution, the inclusion of Georgia in the ENP, the appointment of an EU Special Representative to the South Caucasus Region, the process of economic and political reform, it recommended *inter alia* that the EU's Council of Ministers develop a stability pact for the South Caucasus and that Russia become involved more constructively in conflict settlement. It also regretted the outbreaks of violence in South Ossetia and rejected presidential elections held in Abkhazia.

4. Aid for Georgia

Since its independence, Georgia has received about €420 million in grants, as detailed in the table below:

Total EU grants 1992 to 2004	total in € million	% of total
ECHO Humanitarian Aid	98.25	23.4
FEOGA food aid	62.55	14.9
Exceptional Humanitarian Aid	6.0	1.4
Aid to mitigate effects of Russian crisis	4.0	1.0
Food security	71.25	16.9
Tacis National Allocations	111.0	26.4
Rehabilitation in conflict zones	19.5	4.6
Exceptional Financial Assistance	31.5	7.5
CFSP	1.6*	0.4
EIDHR	7.55**	1.6
RRM	6.65	1.5
Total	419.85	100

* CFSP budget used for assistance to border guards, activities of EU Special Representative for the South Caucasus and rule of law mission (EUJUST Themis).

** EIDHR=European Initiative for Democracy and Human Rights

Source: Commission Country Report for ENP
(http://europa.eu.int/comm/world/enp/pdf/country/georgia_cr_0503.pdf)

4.1 Tacis Programme

Georgia has received support in particular for institutional, legal and administrative reforms and the social consequences of transition to a market economy. It also participates in regional programmes such as Traceca, Inogate and the Regional Environment Centre for the Southern Caucasus.

4.2 Financial Assistance

An exceptional financial assistance loan of €110 million and a grant of €55 million has been provided to assist in Georgia's debt reduction strategy.

4.3 Humanitarian Aid (ECHO) and Food Aid

Humanitarian assistance from ECHO and EAGGF food aid accounted for €160 million and contributed to alleviating the serious humanitarian situation in the mid-1990s. Georgia was also granted over €70 million under the Programme for Food Security (PFS).

4.4 Rehabilitation of conflict zones and assistance with border checks

The EU has also provided aid for regions in conflict with Tbilisi (Abkhazia and South Ossetia). Under the CFSP, joint actions of the Council in 2001 and 2002 provided a Union contribution of €1.1 million to strengthen the capacity of the Georgian authorities to support and protect the OSCE team of observers on the border between Georgia and Chechnya.

5. Trade¹

Georgia joined the WTO in 2000. It benefits from the EU's General System of Preferences and its Most-Favoured Nation status laid down in the PCA. Trade has remained at low levels, although the EU provides 26% of Georgia's imports and takes 43% of its exports (2002). The EU is Georgia's third trading partner after Turkey and the Russian Federation.

The development of the Georgian economy, to which the EU has contributed, cannot but encourage greater trade between the two partners. The key to the success of the EU-Georgia partnership will be economic growth and political stability in the three Caucasian republics.

¹ See Annexes IV, V and VI, pp.20-22.



MAP OF GEORGIA



ANNEX II

GEORGIA - ECONOMIC STRUCTURE: Annual indicators

	2000	2001	2002	2003	2004
GDP at market prices (Lari m)	6,013	6,638	7,448	8,565	9,758
GDP US\$bn	3,0	3,2	3,4	4,0	4,5
Real GDP growth (%)	1,9	4,7	5,5	11,1	8,5 ^a
Consumer price inflation (av; %)	4,0	4,7	5,6	4,8	5,8 ^a
Population (m)	5,26	5,22	5,18	5,13	n.a.
Exports of goods fob (US\$ m)	459,0	496,1	601,7	830,6	n.a.
Imports of goods fob (US\$ m)	-970,5	-1,045,6	-1,084,7	-1,466,6	n.a.
Current-account balance (US \$ m)	-269,0	-211,7	-221,3	-378,7	n.a.
Foreign Direct Investment (US \$ m)	131,1	109,8	167,4	337,9	n.a.
Foreign-exchange reserves excl gold (US\$ m)	109,4	159,4	197,6	190,7	382,9
Exchange rate (av) Lari:US\$	19,76	20,73	21,96	21,46	19,17

Source: IMF, World Bank, UN

^a forecast/provisional

GDP by kind of Economic Activity 2003 (as %/total)		GDP by type of Expenditure 2003 (as %/total)	
Agriculture	20,0	Public consumption	9,0
Mining and manufacturing	18,0	Private consumption	74,0
Construction	5,0	Gross fixed investment	18,0
Transport, communication and trade	30,0	Net imports of goods & services	14,0
Total incl others	100,0	Total	100,0

Source: UN

Principal exports 2004 ^a	% of total	Principal imports 2004 ^a	% of total
Scrap metals		Fuels	
Machinery		Machinery	
Chemicals		Transport equipment	

Main destination of exports 2004 ^a	% of total	Main origin of imports 2004 ^a	% of total
Turkey	23,3	USA	11,0
Greece	11,0	Turkey	10,6
Russia	8,9	Russia	10,3
USA	6,5	Azerbaijan	8,2
Turkmenistan	5,8	Germany	6,5

Source: World Fact Book

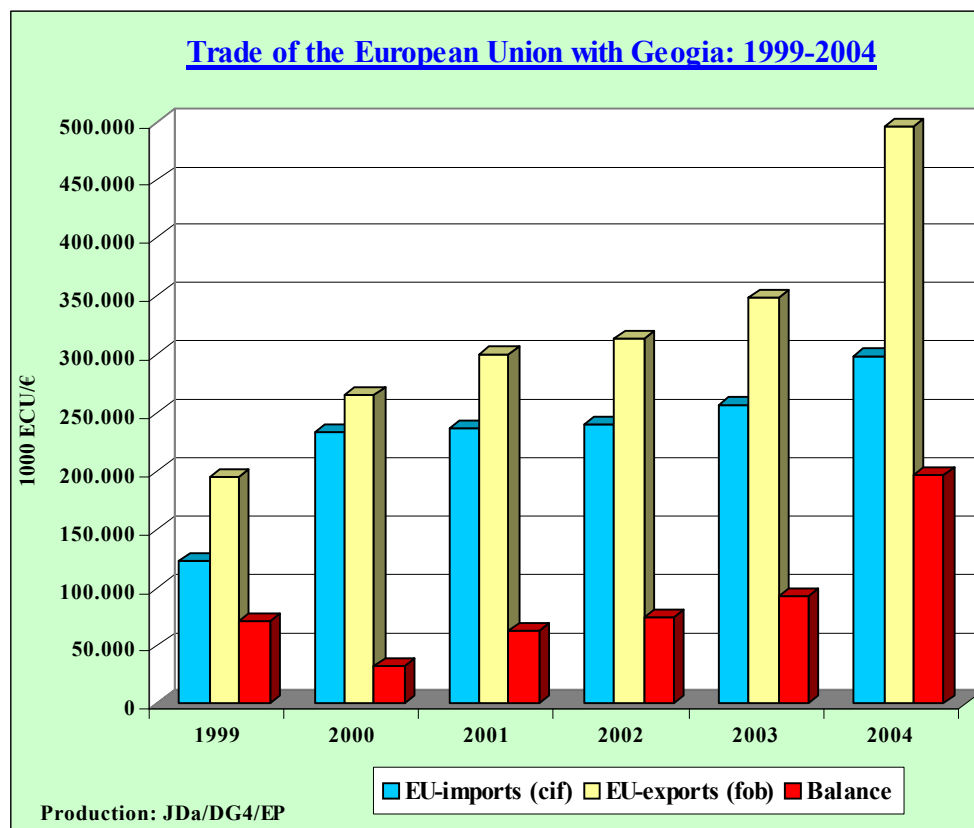
^a provisional

Trade relations EU-Georgia, 2004					
By products					1000 EUR
CN Chapters		Imports (cif)		Exports (fob)	
		1000 EUR	% of total	1000 EUR	% of total
01-99	Total	298.788	100,0	495.566	100,0
	of which:				
01-24	Agricultural prod. (incl. fish, prepared foodstuffs etc.)	33.248	11,1	49.573	10,0
	of which:				
01-05	Live animals; animal products	4	0,0	12.201	2,5
	of which:				
02	Meat and edible meat offal	0	0,0	9.818	2,0
06-14	Vegetable products	11.912	4,0	5.196	1,0
	of which:				
08	Edible fruit and nuts; peel of citrus fruits or melons	10.287	3,4	37	0,0
15	Animal or vegetable fats and oil and their cleavage products etc.	0	0,0	8.102	1,6
16-24	Prepared foodstuffs; beverages	21.332	7,1	24.074	4,9
	of which:				
22	Beverages, spirits and vinegar	19.626	6,6	4.402	0,9
25-27	Mineral products	172.908	57,9	3.467	0,7
	of which:				
26	Ores, slag and ash	31.258	10,5	104	0,0
27	Mineral fuels, mineral oils and products of their distillation etc.	140.960	47,2	2.716	0,5
			0,0		
28-38	Products of the chemical or allied industries	20.613	6,9	57.984	11,7
	of which:				
30	Pharmaceutical products	26	0,0	32.647	6,6
31	Fertilisers	18.156	6,1	0	0,0
33	Essential oils and resinoids; perfumery, cosmetic or toilet preparations	307	0,1	12.196	2,5
39-40	Plastics and rubber and articles thereof	177	0,1	11.556	2,3
41-43	Raw hides, and skins, leather, furskins etc.	351	0,1	500	0,1
44-49	Wood/art. of woods etc; pulp of wood or other fibrous cellulose	3.611	1,2	14.022	2,8
50-63	Textiles and textile articles	2.686	0,9	12.499	2,5
64-67	Footwear, headgear, umbrellas, walking-sticks etc.	16	0,0	2.493	0,5

68-70	Articles of stone, plaster, cement, asbestos etc.; ceramic products etc.	49	0,0	10.337	2,1
71	Natural or cultured pearls, precious or semi-precious stones etc.	11.742	3,9	2.040	0,4
72-83	Base metals/articles of thereof	42.013	14,1	21.303	4,3
	of which:				
72+73	Iron and steel and articles of iron or steel	28.267	9,5	12.718	2,6
76	Aluminium and articles thereof	12.737	4,3	2.647	0,5
84-85	Machinery and mechanical appliances; elec. eq., sound recorders etc.	6.811	2,3	135.261	27,3
	of which:				
84	Nuclear reactors, boilers, machinery and mechanical appliances	4.001	1,3	87.493	17,7
85	Electrical machinery/equip. and parts thereof; sound recorders etc.	2.809	0,9	47.768	9,6
86-89	Vehicles, aircraft, vessels and associated transport equipment	1.527	0,5	139.820	28,2
	of which:				
87	Vehicles other than railway/tramway rolling-stock etc.	379	0,1	40.605	8,2
88	Aircraft, spacecraft, and parts thereof	191	0,1	96.888	19,6
90-92	Optical, photographic, cinematographic etc. instruments	1.296	0,4	12.152	2,5
93	Arms and ammunitions; parts and accessories thereof	137	0,0	1.704	0,3
94-96	Miscellaneous manufactured articles	68	0,0	14.952	3,0
	of which:				
94	Furniture; bedding, mattresses etc.	41	0,0	12.788	2,6
Various ch	Other products	1.177	0,4	1.998	0,4
Source: COMEXT database, EUROSTAT					
Production: JDa/DG4/European Parliament					

Trade of the EU with Georgia by Member States					
EU-imports (cif)					
	2004		January-February:		
	1000 €	- % -	2004	2005*	% change
Total	298.788	100,0	52.886	56.602	7,0
<i>of which:</i>					
France	12.015	4,0	1.567	16.297	
Netherlands	21.071	7,1	2.235	1.507	
Germany	18.142	6,1	1.548	1.640	
Italy	27.883	9,3	11.945	5.776	
United Kingdom	24.995	8,4	1.654	2.861	
Ireland	42	0,0	0	0	
Denmark	325	0,1	250	591	
Greece	44.356	14,8	6.272	4.639	
Portugal	9.487	3,2	0	165	
Spain	102.075	34,2	25.638	18.721	
Belgium	6.208	2,1	729	907	
Luxembourg	21	0,0	0	0	
Sweden	106	0,0	30	92	
Finland	13	0,0	0	0	
Austria	603	0,2	131	93	
Malta	0	0,0	0	0	
Estonia	334	0,1	30	428	
Latvia	1.054	0,4	199	75	
Lithuania	1.257	0,4	29	284	
Poland	2.369	0,8	110	862	
Czech Republic	2.557	0,9	141	298	
Slovakia	3.193	1,1	367	699	
Hungary	33	0,0	0	0	
Slovenia	14.148	4,7	2	666	
Cyprus	6.499	2,2	8		
EU-exports (fob)					
Total	495.566	100,0	62.740	72.305	15,2
<i>of which:</i>					
France	39.864	8,0	6.854	4.716	
Netherlands	19.952	4,0	2.117	4.598	
Fr Germany	91.123	18,4	13.542	13.784	
Italy	49.848	10,1	6.460	9.735	
Utd. Kingdom	67.609	13,6	14.254	4.848	

Ireland	7.876	1,6	1.745	1.729	
Denmark	7.770	1,6	1.281	992	
Greece	13.532	2,7	715	4.351	
Portugal	5.961	1,2	1.639	1.354	
Spain	8.167	1,6	1.416	2.157	
Belgium	17.739	3,6	2.758	2.015	
Luxembourg	455	0,1	22	0	
Sweden	4.746	1,0	252	485	
Finland	6.655	1,3	410	5.359	
Austria	18.810	3,8	6.189	2.266	
Malta	316,28	0,1	0	0	
Estonia	85,83	0,0	2	99	
Latvia	3289,56	0,7	404	708	
Lithuania	4225,14	0,9	146	7.302	
Poland	8668,71	1,7	494	1.350	
Czech Republic	105079,28	21,2	1.121	1.188	
Slovakia	2089,06	0,4	48	489	
Hungary	8253,54	1,7	414	2.540	
Slovenia	3224,24	0,7	454	238	
Cyprus	227,52	0,0	0		
Source: COMEXT database, EUROSTAT					
Production: JDa/DG4/European Parliament					
*excluding Cyprus					



<u>Trade of the EU (25) with Georgia:</u>			
<u>1999-2004</u>			
			<i>1000 ECU/€</i>
	EU-imports (cif)	EU-exports (fob)	Balance
1999	123.375	194.210	70.835
2000	233.373	265.287	31.914
2001	237.167	299.763	62.596
2002	239.364	313.688	74.324
2003	256.200	349.468	93.268
2004	298.788	495.566	196.778
Source: COMEXT database, EUROSTAT			
Production: JDa/DG4/European Parliament			