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SECURITY PROBLEMS & Modern Challenges of the GEORGIAN NATIONAL CURRENCY

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EDITED AND FOREWORD BY

VLADIMER PAPAVA

თბილისის
უნივერსიტეტის
გამომცემლობა

Contents

FOREWORD

Recently, my foreign colleague told me that "economic trouble in any country, not to say anything about the economic crisis, is something good for economists overall because it is a time when the government and the population remember economists and the work they do." This deplorable truth refers not only to economists but also to doctors – usually people do not think about doctors until they have health problems. However, the healthcare system is always oriented towards preventive diagnostics. Unfortunately, if modern medicine promotes addressing a qualified doctor instead of a "Medicine Man," in countries with a relatively low political culture there is the practice of approaching not professional economists performing real economic diagnostics and economic processes, but an "Economics Medicine Man" or, in other words, an **"Econcine Man."**

In the second half of November 2014, the Georgian national currency, GEL, started to depreciate, which was caused, in the first instance, by an international factor, namely, the appreciation of the US dollar.[1] Due to the high level of the dollarization of the emerging markets, the appreciation of the US dollar was more sensitive for these markets.[2] Obviously, Georgia and its neighboring countries were no exception. At the same time, according to society's prevalent perception, which is not groundless, the situation in Georgia was worsened by the intentional or unintentional mistakes of the country's central bank; that is, the National Bank of Georgia (NBG) and the Government of Georgia.

Unfortunately, discussions in the media regarding this issue became a subject of cheap political speculations instead of making any objective analysis that

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1 See, for example, El-Erian, M.A., 2014. The Return of the Dollar. *Project Syndicate*, 11.10.2014, *https://www.project-syndicate.org/commentary/us-dollar-rally-global-rebalancing-by-mohamed-a--el-erian-2014-11* (download 03.05.2015); Feldstein, M., 2015. America's Risky Recovery. *Project Syndicate*, 04.28.2015, *https://www.project-syndicate.org/commentary/fed-low-interest-rates-by-martin-feldstein-2015-04* (download 03.05.2015).

2 See, for example, Roubini, N., 2015. The Dollar Joins the Currency Wars. *Project Syndicate*, 05.01.2015, *https://www.project-syndicate.org/commentary/dollar-joins-currency-wars-by-nouriel-roubini-2015-05* (download 03.05.2015).

could be transformed into recommendations and a roadmap of changes for the NBG and the Government of Georgia.[3]

It is normal that a political party on the side of the opposition tries to use any opportunity for criticizing the government, especially its economic team, for the depreciation of GEL. However, here the traditional "disease" of Georgian politics has emerged – almost total absence of a more or less distinguished professional economists within any of the political parties.[4]

Under such circumstances, it is almost impossible for a professional economist to communicate publicly – either with the opposition and its negative stance towards this issue or with the population finding itself in difficult social conditions and with the society needlessly worried owing to the disinformation. A clear example of this is the political attack on Georgia's Minister of Finance, which is being done mostly by using those so-called "black" PR methods instead of offering professional criticism.

Another topic is the political attack on the governor of the NBG. Political motives can also be seen in this case although the story itself is not new. Particularly, despite the clear and significant role of Nodar Javakhishvili, the Acting NBG President for that time, in successfully establishing the national currency in 1995, the Georgian Citizens' Union, a political party with the majority of seats in the Parliament, did not support Javakhishvili for the position of NBG president. This party also announced its fight against another NBG President, Irakli Managadze, who was ultimately dismissed from his position by the Georgian Citizens' Union which was transformed into an active part of the National Movement prior to the Rose Revolution. The National Movement, in its turn, allowed the new and unanimously supported NBG President, Roman Gotsiridze, to remain in office for only two years and then forced him to resign by using political manipulation. After this, the NBG was divided into two independent structures which has therefore contributed to the decaying of its

3 It should be mentioned that the artificial worsening of the situation in Georgia's economy was enabled not only by Georgian but also foreign "fake critics." For example, Shapiro, A., 2015. Georgia's Economic Crisis and Political Brinkmanship. *The Central Asia–Caucasus Analyst*, 04.15.2015, *http://www.cacianalyst.org/publications/analytical-articles/item/13176-georgia%E2%80%99s-economic-crisis-and-political-brinkmanship.html* (download 03.05.2015).

4 Georgia's disappointing experience shows that political parties remember the economy mostly during the pre-election period in order to draw upon the economic part of an election program. However, during the process of creating an economic program, non-professionals and, at best, specialists with low qualification are invited. As a result, the economic part of a party's program is written for paying a ritual tribute to local electors and foreign observers. Consequently, the activities of the government hardly match with the pre-election promises.

role.[5] The NBG can accomplish its function of macroeconomic stability only in the case of no political pressure and groundless blame placed upon it and its chief staff. It implies that the NBG must not be used as an instrument for political pressure, which did happen a couple of years ago. In other words, unlike the government, the NBG must be an apolitical organization (ensured by the constitution) and it must not obey the orders of various political parties.

In fact, we can say that mistakes were made by both – the NBG and the Government of Georgia. The mistakes of the government are mostly related to budget expenditures and are problematic not so much for the Ministry of Finance as for the other top-spending governmental agencies.

The situation is more complicated in the case of the NBG. In particular, discussions about its intervention into the process are limited with the issue of whether or not it should spend international reserves for maintaining the exchange rate of GEL or ensuring a more moderate (not jumping) depreciation. At the same time, there is a lack of critical analysis as a result of not using other effective instruments possessed by the NBG. As for the international reserves, their existence is of crucial importance, especially while the economy is facing a critical period, alongside those other instruments in the hands of the NBG. This is particularly the case when the reserves exceed the standard obligatory level for the central bank according to which the NBG is obliged to maintain its international reserves in an amount of foreign currency equivalent to at least three months of imports.

It should also be mentioned that spending international reserves for maintaining the national currency exchange rate, without the country's economic development and increasing its export potential and attractiveness for investments, is impossible. Otherwise, reserves will eventually be exhausted and GEL will not be saved.

Therefore, a short-run solution to the problem can be found in correcting the actions of the NBG and the government's spending policy, while the long-run solution requires from the government to adopt and implement an economic development plan.

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[5] For the sake of justice, it should be mentioned that the mistake of splitting the NBG was corrected by the United National Movement itself and in several months the NBG recovered as a single strong institution. It should also be noted that along with the splitting of the NBG, the role of its council weakened along with the inclusion of several non-economists. Unfortunately, this strategic mistake has hitherto not been corrected.

The prevalent opinion in the media, however, creates the illusions that Georgia's economic problems,[6] like the underdevelopment of its export potential, are the result of an incorrect economic policy of the Georgian Dream government. The issue with export, however, is more the result of Georgia's heritage of a Command Economy alongside the technological backwardness of the majority of its enterprises in the real sector of the economy as compared to what exists within advanced international standards. A solid ground for overcoming this technological backwardness was created after the Rose Revolution because the internationally recognized democratic and reformatory image of the post-revolution government increased Georgia's attractiveness for investments. Unfortunately, the incorrect economic policy of the government contributed to the concentration of the largest portion of these investments in real estate and not in the real sector of economy. This, in turn, increased financial resources in the country in light of the underdevelopment of the real sector of the economy. As a result, the model of the *Consumer Economy, Typical for Poor Countries,* was strengthened in Georgia.[7] This kind of an economy was mainly based on the currents of money inflow, but the country's economic conditions would inevitably become worsened once this trend started to decline. The biggest threat in this respect emerged during the period of global financial crisis although Georgia's economy was rescued by the large-scale international financial aid that the country received as a victim of Russia's military aggression in August 2008.[8] However, the country appeared unprotected against the appreciation of the US dollar which started in 2014 and for which we are now "paying the price" as well as for those mistakes emanating as a result of the economic policy of the National Movement government.

[6] When we talk about economic problems, we refer to the problems of economic origin, i.e. problems caused by the measures taken outside the area of economy are not implied here. One of these measures, for example, is a change in the visa regime, which complicated the entry of citizens of several foreign countries into Georgia.

[7] Papava, V., 2013. *The Main Challenges of 'Post-Rosy' Georgia's Economic Development*. Tbilisi, GFSIS, Expert Opinion, No. 4, pp. 4-7, *http://gfsis.org/media/download/library/articles/Expert_Opinion_ENG_4.pdf* (download 03.05.2015).

[8] For example, Papava, V., 2008. Post-War Georgia's Economic Challenges. *Central Asia-Caucasus Analyst*, Vol. 10, **No. 23, November 26,** *http://old.cacianalyst.org/?q=node/4991* (download 03.05.2015).

Despite the fact that the government was given not only explicit warnings as to the expected economic problems but also particular recommendations,[9] it is most unfortunate that it did not take effective preventive measures to this end.

The biggest made mistake in the recent decade is that despite the opposite political views, the country's political elite believes that good managers must be in the government. This is a principally false statement. In fact, managers should be in business while government needs governors.[10] In developed countries it has been accepted for a long time that a country is not a company[11] and that "the conduct of government affairs is different from industrial processes."[12] Unfortunately, in this regard nothing has changed in Georgia so far.

Another issue is the position of the International Monetary Fund (IMF) towards the economic processes taking place in Georgia. It is not enough to underline that the NBG and the government should act in a coordinated manner (which is obvious). For me, it is not a surprise that the IMF supports the position of the NBG with regard to the international reserves because even in a worse situation for Georgia, particularly in the autumn of 1998 when GEL depreciated as a result of Russia's default, the recommendation of the IMF was not to spend international reserves but put the exchange rate on free determination. As a result, the NBG would retain the reserves but the currency crisis would transform into a bank crisis (which actually happened in Russia in that period) and the country (Georgia) would end up with an economic crisis. The NBG and the government's economic team did not accept this incorrect recommendation and by reducing international reserves to an almost zero level, they saved Georgia's banking system and the whole economy from irreversible crisis.[13] Fortunately, today neither GEL nor the Georgian banking system faces a threat such as that of 1998, nor there is a need for the NBG to

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9 Kakulia, M., 2013. *On the Political Economy of Economic Slowdown in Georgia*. Tbilisi, GFSIS, Expert Opinion. No.4, *http://gfsis.org/media/download/library/articles/kakulia/On_The_Political_Economy_of_Economic_Slowdown_In_Georgia_ENG.pdf* (download 03.05.2015).

10 Business comprises professional employees qualified as "managers" according to their education while government institutions comprise professional employees whose education qualifies them as "governors."

11 Krugman P., 2009. *A Country is Not a Company*. Boston, Harvard Business Press.

12 Von Mises, L., 1944. *Bureaucracy*. New Haven, Yale University Press, p. 52, *https://mises.org/sites/default/files/Bureaucracy_3.pdf* (last seen at 03.05.2015).

13 Papava, V., 2003. On the Role of the International Monetary Fund in the Post-Communist Transformation of Georgia. *Emerging Markets Finance & Trade*, Vol. 39, No. 5.

spend international reserves fully; particularly, in the case when it has much richer instruments for maintaining macroeconomic stability than it did in 1998.

The paper is written by PhD students of Ivane Javakhishvili Tbilisi State University Faculty of Economics and Business, who established the TSU Center for Analysis and Forecast on February 18, 2015.

Of course, the results obtained by these young economists are not immune from mistakes, though I believe that they will be interesting for a wide range of readers whose professional remarks are welcome in order to contribute to the future improvement of the paper.

Vladimer Papava

May 3, 2015

INTRODUCTION

The exchange rate of the national currency has recently been the most topical economic issue not only for Georgia, but worldwide. Since the end of 2014 and the beginning of 2015, the devaluation of GEL (Georgian Lari) has become irreversible. According to the data from the NBG, on May 5, 2015 the official exchange rate of 1 USD reached 2,3303 which became a historical peak in the past 17 years (since 1998).

According to the NBG (NBG, 2008, p. 29), from the autumn of 1995 to 1998, there was a fixed exchange rate regime for the national currency (GEL) which later became an adjustable floating exchange rate regime*[14] when it was possible to establish the exchange rate of the national currency on the basis of market demand and supply. However, if necessary, the NBG had its regulatory mechanisms. The choice of an appropriate exchange rate regime for any country was, is and will be one of the most essential economic decisions that the country has to make (Akerlof, Blanchard, Romer, Stiglitz, 2014).

Until March 16, 2009, the abovementioned equilibrium was formed on the Tbilisi Interbank Currency Market, which was a joint stock company founded by seven commercial banks together with the NBG. Since September 17, 2009, however, currency auctions were launched in Georgia, while commercial bank trade switched to the Bloomberg system (NBG, Currency Policy and Reserves Management).

Today, the currency market in Georgia consists of commercial banks, investment funds and those legal entities and individuals that are interested in foreign currency trading. Despite the structure of the market, however, according to the Bloomberg Trading Platform the exchange rate is formed only on the basis of commercial interbank trading.

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* According to the NBG annual report for 2008 (pp. 25-26), there was the so-called “adjustable floating exchange rate regime” in 1995-1996. unfortunately NBG has stated different positions in two various thematic publications on the same issue.

Since its establishment, Georgia's national currency has passed through quite a few periods of depreciation and appreciation. GEL was first drastically devaluated in 1998 due to the problems caused by a default in the Russian economy. On the contrary, from 2003 to the summer of 2008, the national currency strengthened steadily, which was conditioned mainly by the significant growth of foreign investments, foreign debts, remittances and international grants. These abovementioned factors contributed to a foreign currency (especially USD) inflow to the country, the growth of its supply on the currency market and, as a result, an appreciation of GEL **(see Graph 1).**

GRAPH 1

Official GEL Exchange Rate against Foreign Currencies

Source: *https://www.nbg.gov.ge/index.php?m=582* (Last review on 02.05.2015)

Of note is that owing to the reasons mentioned above, the Georgian economy exhibited the symptoms of the so-called "Dutch Disease" in 2004-2008 (Aslamazashvili, 2006; Papava, 2007; Papava, 2005a) which was followed, on one hand, by exports decline due to the growth of prices of Georgian products denominated in foreign currency and, on the other hand, high inflation. According to the NBG, this was the moment when the NBG extracted net currency in the amount of USD 838 million and filled international reserves with this money (NBG, Department of Monetary and Financial Statistics).

PURPOSE OF THE RESEARCH

The purpose of this paper is to determine the reasons causing the change (devaluation, in the case of Georgia) of the national currency exchange rate.

Further, this paper will develop relevant recommendations for the stabilization of the currency and measures to avoid further threat.

RESEARCH TASKS

1. To study the local factors influencing devaluation
2. To study the international factors influencing devaluation
3. To study the subjective factors influencing devaluation

RESEARCH METHODOLOGY AND LIMITATIONS

The following research methods have been used: quantitative, qualitative, comparative, statistical analysis, grouping, induction, deduction, synthesis, case study and heuristic.

The study is based on the research of Georgian and foreign scientists, data from international organizations, materials from periodicals and both normative and statistical documentation of Georgian and foreign central banks. The research was conducted on the basis of the analysis of factual data obtained from the NBG, International Monetary Fund, National Statistics Office of Georgia and many other organizations.

Essence of the Problem

In the 4th quarter of 2014 significant strengthening of USD and a devaluation of currencies in Georgia's partner countries showed the importance of implementing a flexible and effective currency policy. Of note is that currency shocks in many developing and developed countries were simultaneously followed by an economic growth slowdown (IMF, 2015). For this reason, it is very important to share the international reality and this experience with Georgia, and pay due attention to this issue.

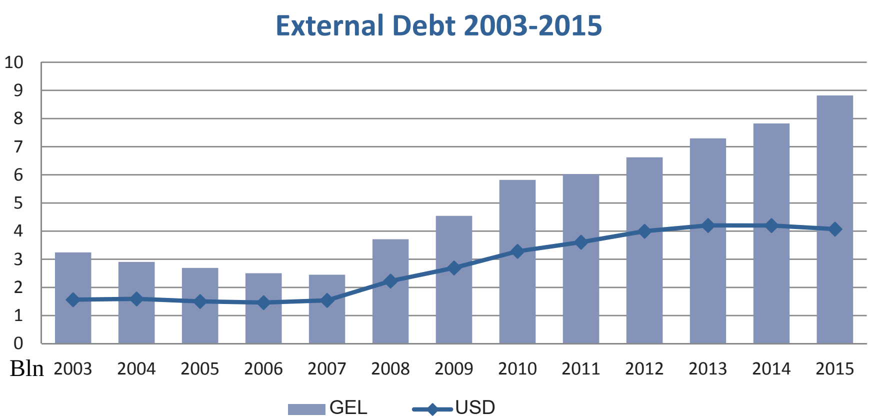
After the 2009 G-20 Pittsburgh Summit, it was clearly stated that the global vector of balanced and sustainable growth moved mainly to financial and fiscal stability. Therefore, there is a general consensus that financial and fiscal stability are core elements of a healthy and well-functioning economy. Considering the fact that a rapid and large-scale devaluation of a national currency affects the stability of the financial system which can lead a country to financial and economic crises, it is vital to solve this problem both timely and effectively.

It is important that the government and the legislative authority take the responsibility to develop a fiscal policy and an annual budget so that they encourage economic development and a sustainable growth of debt through which fiscal stability can be achieved.

Moreover, in Georgia, where most of the population have their loans denominated in foreign currency, USD (while having income mainly in GEL), the main problem is to return (taking into account the difficult social situation) this increased dollar, which is a problematic issue not only for borrowers and their families, but also for the banking system itself. Especially, in considering that more than 60% of Georgian bank loans are issued in USD, the problem becomes even more troublesome.

During the devaluation of a national currency, it is also important to underline the growth of foreign debt denominated in the national currency caused by its devaluation (despite the fact that the growth rate of the debt in foreign currency might not be as impressive) whose service is obligatory and necessary for stable development (at least for receiving new loans or their tranches). See Diagram 1.

DIAGRAM **1**



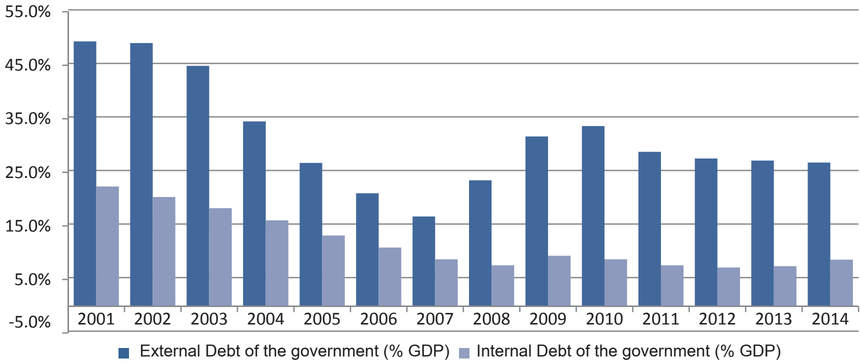
Source: *https://www.nbg.gov.ge/index.php?m=304#sagareoseqtori* (Last review on 02.05.2015)

An analysis of the government's foreign debt shows that it remained almost unchanged in 2003-2007 although the growth tendency changed and reached

USD 2,661,439 in 2008-2013, which was followed by a declining trend in 2013 (see Diagram 2) and which means that the government started to pay its foreign debts.

DIAGRAM 2

Changes in Governmental Debt in 2001-2014 in Regard to GDP



Source: *https://www.nbg.gov.ge/index.php?m=304#sagareoseqtori* (Last review on 02.05.2015)

There is a different situation concerning domestic debts. The government elected in the 2012 elections refused to increase the foreign debt and focused on the domestic debt (see Diagram 2) though, of course, any debt needs to be repaid.

The devaluation of GEL created a threat of certain risks to the Georgian economy. One of the country's leading television channels (with other channels following in suit) is trying to establish the opinion that there is a monetary crisis in the country (e.g., Samkurashvili 2015, Rustavi2, 2015), thus creating a negative background and allowing certain political parties to gain political points. At the same time, however, this has negatively affected both the local population and the expectations of foreign investors by managing to incite individuals to sell their national currency and investors to refrain from investing. In fact, monetary crises have never occurred in Georgia if we adhere to the classical explanation of a monetary crisis taking place when the devaluation of a currency reaches 25% or more during one quarter and is accompanied by a significant decrease in monetary reserves (e.g., Frankel and Rose, 1996;

Shmykova, 2004). Particularly, in the case of Georgia, the official exchange rate of GEL has changed in the following way:

- Since November 19, 2014, when GEL started to devaluate, the exchange rate was 1.7643 and reached 2.0839 on February 19 (a three-month period), a 17-18% devaluation of the national currency.
- Since December 19, 2014 to March 19, 2015, the exchange rate was 1.9166 and reached 2.2005 at the end of the period, which comprised a 15% devaluation of the national currency.
- Since January 19, 2015 to April 19, 2015, the exchange rate was 1.9434 and reached 2.2535 at the end of the period, which comprised a 16% devaluation of the national currency.
- Since February 19, 2015 to May 16, 2015 the exchange depreciated from 2.0839 to 2.3637, which is 17-18% devaluation.
- From the beginning of December to the end of February, the rate was 1.8421 and 2.1654, respectively, which is again a 17-18% devaluation.
- From the beginning of January to the end of March, it was 1.8821 and 2.2275, respectively, which is again an 18.4% devaluation.
- From the beginning of February to the end of April, it was 1.9970 and 2.3093, which means that the devaluation of GEL was less than 16%.

From the beginning of the devaluation until May 16, the exchange rate has changed from 1.7643 to 2.3637 which comprise a 33.9% devaluation. The period of time in this case is not three months but almost six months, which means that there was no monetary crisis in Georgia.

Of further note is that it is not only the part of the population with its bank loans in foreign currency that is experiencing hardship but Georgia's foreign debt denominated in the local currency (GEL) is growing as well. On the other hand, however, that part of the population which had deposits in foreign currency has benefited because their cash savings (denominated in the national currency) have significantly increased.*[15]

Various media resources are talking about financial and economic crises as a fact which has already taken place (e.g., Gotsiridze, 2015; Japharidze, 2015) although it should be noted that an economic crisis implies a significant large-

* According to the NBG data for 2014, the dollarization of deposits and loans is 60-61%. Altogether, the amount of loans issued by commercial banks is 13 billion and deposits comprise more than 11.6 billion (see General Macroeconomic Indicators and International Ratings, *NBG of Georgia*, https://www.nbg.gov.ge/index.php?m=494).

scale economic downturn and not a decline in economic growth which has not happened in Georgia.

When talking about the devaluation of GEL, it is important to pay attention to objective (having real influence) as well as subjective (speculations on the stock exchange, stock-jobbing, panic, etc.) reasons given that various segments of Georgian society often make political and otherwise biased statements which mislead the population into making wrong conclusions. Because of that the speculation on currency market appeared. For instance: on Friday (December 5, 2014) NBG announced official exchange rate at the level of $1=1,9527, however seling price for USD at local exchange offices and banks was much higher – 2,1; while buying price was as low as 1.85 GEL for each USD. Such a big spread clearly shows that speculation on the market existed.

The reasons for the devaluation of GEL can be analyzed from two directions; mainly, internal and external factors. Important external factors are the Russian-Ukrainian confrontation, the fall of oil prices, the decline in economic growth in all of Georgia's neighboring countries (IMF, 2015) and a revision/restriction of the customs policies in Armenia and Azerbaijan, among others.

Each of the abovementioned events, taken separately and together, has had an important effect on the Georgian economy. Mainly, the fall in oil prices has caused a decline in the economic growth in two of Georgia's largest partner countries, Azerbaijan and Russia (because of their high dependence on oil), which ultimately affected the Georgian economy by decreasing remittances and Georgian export. Further, the number of tourists and remittances from Ukraine to Georgia decreased owing to the Russian-Ukrainian confrontation. Also important, since January 2, 2015, when Armenia joined the Customs Union, the (re)export of cars from Georgia was interrupted just as in Azerbaijan, where the car re-export market was limited for Georgia in 2014 (Charaia, 2015). These problems altogether have significantly influenced the Georgian economy.

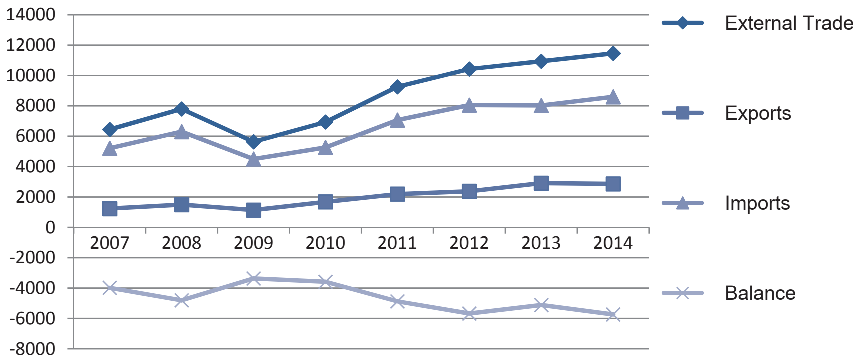
It is necessary to consider the influence of each of the aforementioned external factors (remittances, export, foreign direct investments and the tourism sector) on the Georgian economy and attempt to answer the following question: Could they affect the stability of GEL?

Foreign Trade

One of the most important factors contributing to a country's foreign currency inflow is foreign trade. Unfortunately, according to the National Statistics Office of Georgia, both the monthly and annual trade balances of the country have been negative since 1995 (earlier data is not available). The year 2014 was not an exception, either. The registered export index was three times less than the registered import index with the absolute indices at USD 2.861 billion and 8.596 billion. Compared to 2013, export decreased by 2% in 2014 (absolute index – USD 47 million) while import increased by 7% (USD 570 million). See Diagram 3.

DIAGRAM 3

Georgia's External Trade, 2007-2014 (USD million)

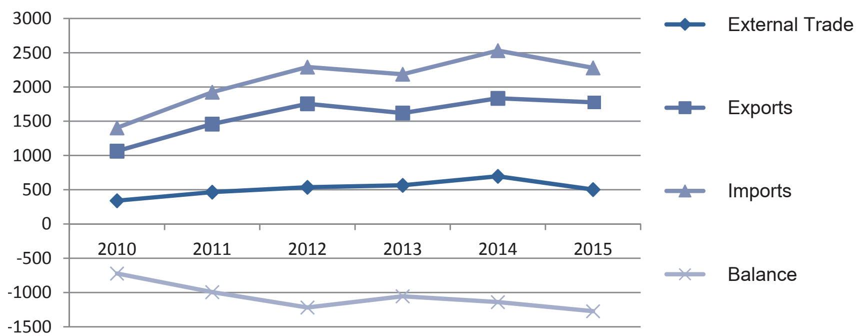


Source: *http://geostat.ge/?action=page&p_id=136&lang=geo* (Last review on 02.05.2015)

As for the 1st quarter of 2015, the situation, unfortunately, only got worse with the lag between export and import having grown even more. Mainly, in January-March 2015, the external merchandise trade turnover (without non-organized trade) comprised USD 2,279 billion (a decrease by 10% as compared to last year) of which export comprised USD 503 million (29% less) while import amounted to USD 1,776 million (3% less). Overall, the negative trade balance in January-March 2015 comprised USD 1,273 million (10% more as compared to the same period of last year), which is 56% of the external trade turnover (see Diagram 4).

DIAGRAM 4

Georgia's External Trade, 2010-2015 (USD million)



Source: *http://geostat.ge/?action=page&p_id=136&lang=geo* (Last review on 02.05.2015)

It is interesting to look at how the devaluation of GEL depends on the deterioration of Georgia's foreign trade indicators. Mainly, after comparing the data for January-October 2014 to the same indicators for 2013, it can be established that export has increased slightly by USD 13 million (from USD 230 million to USD 243 million). As for import, it has also increased (although this is to be considered in a negative light) quite significantly, by USD 593 million (from USD 6,416 billion to USD 7,008 billion). As a result, the negative factor of the trade balance for the first ten months of 2014 has also increased as compared to the first ten months of 2013, from USD 2,784 billion to USD 2,890 billion (although this growth is not important). Overall, the correlation of the export and import factors made 3,0, which deteriorated in the 1st quarter of 2015 and made 3,5.

After analyzing the abovementioned trends, it can be concluded that the export decline and the import growth have made their impact on the devaluation of GEL which, as a result, caused an increased trade deficit and a deterioration of the export-import correlation indicator.

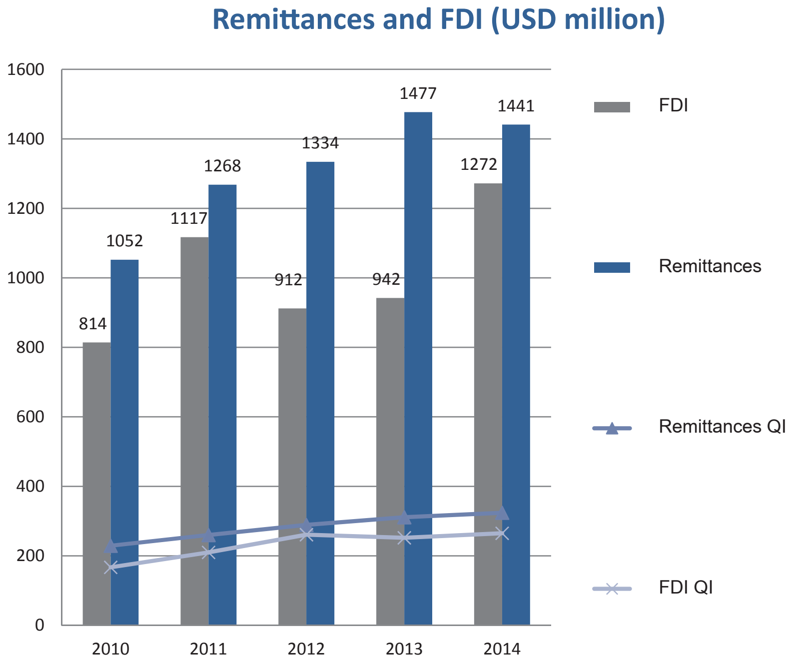
Unfortunately, under the conditions of the devaluation of GEL, when the local production is getting an additional price advantage, local companies have not been able to substitute foreign imports which once again shows the low competitiveness of local manufacturers. With the devaluation of GEL, export has decreased, which in other equal conditions is also caused by the existence of necro enterprises in the Georgian economy (e.g., Papava, 2002, 2005b).

For the sake of objectivity, it should be noted that Georgian export has decreased because of serious problems in the region (mainly the Russian-Ukrainian confrontation) and the weakening of the economies of other countries (mainly, Russia) and not only owing to limits on local Georgian production (e.g., due to economic, political, taxation problems) and the decline in competitiveness. It is also important to note the objective reasons such as Armenia's connection to the Customs Union and, as a result, the interruption and almost suspension of car (re)export from Georgia (mainly), Azerbaijan's limitation on the import of used cars and the decline in the demand from Russia on imported products, including those from Georgia, as a result of the devaluation of RUB (mainly, wine and mineral waters).

Remittances

Remittances play an important role in the Georgian economy. According to the statistics of recent years, remittances in absolute numbers exceed those of foreign direct investments, both quarterly and annually (see Diagram 5).

DIAGRAM 5



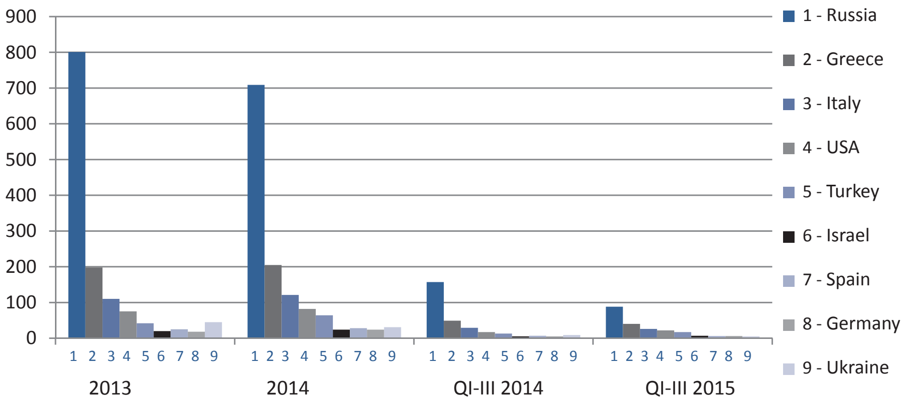
Source: **Created by the authors based on NBG Balance of Payments, Remittances by country** https://www.nbg.gov.ge/index.php?m=304 (Last review on 02.05.2015) and GEOSTAT, FDI Pillar, http://geostat.ge/?action=page&p_id=139&lang=geo (Last review on 02.05.2015)

Taking into account that remittances are "gratuitous," unlike investments, and their accrued profit is not taken abroad but is intended for buying (mainly) staple goods by local families, we will see that it plays an important role in forming the Georgian economy. It is a pity, however, that this money is spent on foreign and not local goods (Gharibashvili, 2014) which means that money earned abroad and sent to Georgia is again transmitted abroad and does not serve the long-term development of the Georgian economy.

In recent years, at least half of the incoming remittances were regularly made from one country – Russia. The year 2014 was no exception with approximately half (USD 709 million) of the USD 1,442 million in remittances to Georgia coming from Russia. This amount, however, has decreased in absolute indices from USD 801 million to USD 709 million as compared to the previous year (see Diagram 6).

DIAGRAM 6

Remittances by Country (USD million)

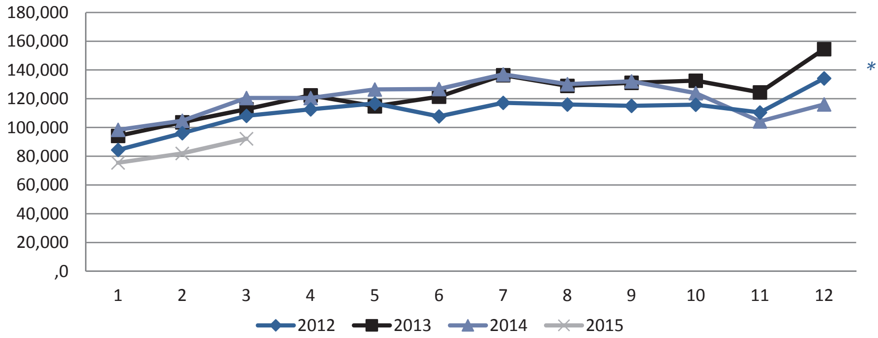


Source: **Created by the authors based on NBG Balance of Payments, Remittances by country,** *https://www.nbg.gov.ge/index.php?m=304* (Last review on 02.05.2015)

The same trend is observed according to the data for the 1st quarter of 2015: the decreased total amount of remittances can be explained by decreased transfers from Russia; specifically, the amount of transfers decreased from USD 157 million to USD 88 million. Remittances from Greece have also decreased from USD 49 million to USD 40 million while transfers from the USA and Turkey have increased (by USD 5 million and USD 4 million, respectively).

Noteworthy is that there was quite a big inflow of remittances to Georgia in the first half of 2014, which exceeded the index of all previous years. The fall in the second half of the year, which was mainly conditioned by the Russian factor, caused the total index to decrease as compared to the previous year (see Diagram 5).

Remittances in 2010-2015 (USD million)*



Numbers from 1 to 12 mean the order of the months according to the calendar

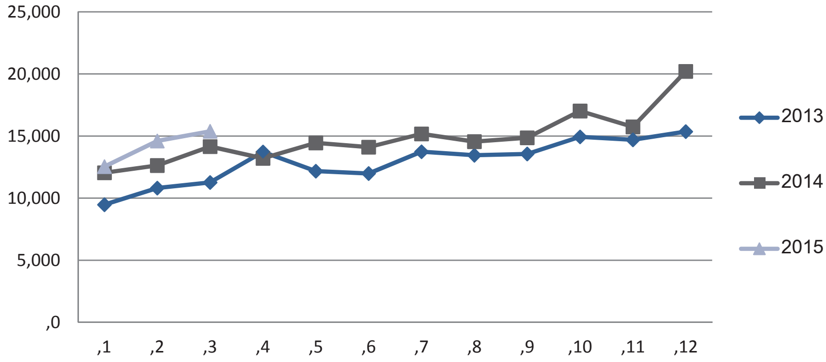
Source: **Created by the authors, based on NBG Balance of Payments, Remittances by country,** *https://www.nbg.gov.ge/index.php?m=304* (Last review on 02.05.2015)

As Diagram 5 shows, remittances have been increasing since January 2015. This should not be disregarded because it indicates that Georgian labor emigrants (and not only them) have overcome the crisis stage and continue to transfer more and more money to Georgia. Of course, this may also be related to other objective reasons as the amount of remittances usually increases in the month of December in advance of the New Year (the dynamics of the previous years prove the same) while January begins with a less inflow although increasing later again.

In 2014, as compared to the previous year, the decreasing incoming remittances to Georgia were accompanied by an increasing amount of outgoing remittances from Georgia; particularly, from USD 155 million to USD 178 million (see Diagram 8). Moreover, in the 1st quarter of 2015, outgoing remittances reached their historical peak with USD 43 million having already been sent from Georgia abroad (1st quarter of 2014 – USD 39 million and 1st quarter of 2013 – USD 32 million).

DIAGRAM 8

Remittances in 2013-2015 (USD million)*



** Numbers from 1 to 12 mean the order of the months according to the calendar*

Source: **Created by the authors, based on NBG Balance of Payments, Remittances by country** (*https://www.nbg.gov.ge/index.php?m=304* (Last review on 02.05.2015)

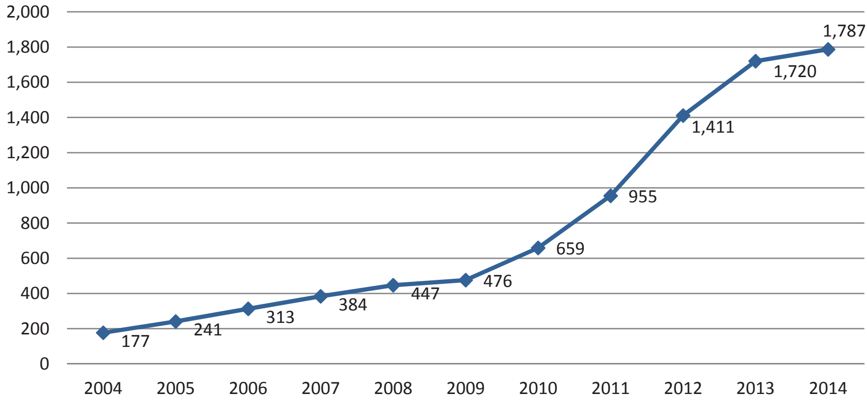
In total, the decrease in remittances to Georgia and the growth of transfers from Georgia in 2014 made USD 59 million (USD 36 million incoming and USD 23 million outgoing transfers) while in the 1st quarter of 2015, as compared to the 1st quarter of 2014, both indicators reached even more – USD 78 million (USD 74 million incoming and USD 4 million outgoing remittances). In 2014 and in the 1st quarter 2015, remittances showed a significant decrease which was at the same time accompanied by the growth in remittances from Georgia abroad which could, therefore, have also played its role in the devaluation of GEL.

Tourism

Despite the political speculations, the tourism sector is one of the most important sectors of the Georgian economy and had a 5-7% share in the GDP in the last years. Noteworthy is that tourists are spending more money on holidays in Georgia (see Diagram 9). This index has exceeded USD 4.9 billion in the last three years alone (2012-2014) which, in fact, is more than it has been since 1991 when Georgia declared independence until and including the year 2011 while the income from tourism in 2014 grew by 4%, from USD 1,720 billion to USD 1,787 billion.

DIAGRAM 9

Income from Tourism (USD million)



Source: **Created by the authors, based on NBG Balance of Payments, Current Accounts,** *https://www.nbg.gov.ge/index.php?m=304* (Last review on 02.05.2015)

Unfortunately, the data for 2015 would make the situation clearer although they are not yet available. In any case, it can be surmised that the number of tourists visiting Georgia, owing to different international events and alongside the recent visa facilitation, will not lead to a decrease in the number of tourists but, on the contrary, the amount of visitors should increase.

Considering the growing incomes from tourism, it would be absurd to say that this field has caused the devaluation of the national currency. Quite the opposite, it could only have had a positive effect on the exchange rate of GEL which would have led to its strengthening and not devaluation.

Foreign Direct Investments

According to statistics, from 1996 to 2014, foreign direct investments (FDI) to Georgia grew by USD 13,7 billion of which more than 40% comes from EU countries. Accordingly, after the EU Association Agreement came into force, new investment flows are expected from the EU. On the one hand, this is indeed a positive trend; however, on the other, it increases the country's dependence on a particular region; namely, the European Union. In the case of any economic difficulties in the EU, this will also be reflected in the amount of FDI transferred to Georgia.

It should be noted that FDI has the largest impact on the Georgian economy. In particular, according to the data of 2013, the share of organizations with a Georgian-foreign equity participation in total exports exceeds 50% and shows that Georgian export is mostly dependent on these types of enterprises. In particular, if we exclude the share of re-export (which, according to expert estimates, accounts for 30-35% in recent years) from total Georgian exports, it turns out that the share of these types of enterprises in real exports accounts for over two-thirds (see Table 1). However, this index is basically being carried out with a default of low technology industries which will not be a positive factor for the long-term economic and social development of the country.

TABLE 1

Share of Organizations Created by Georgian-foreign Equity Participation in the Georgian Economy

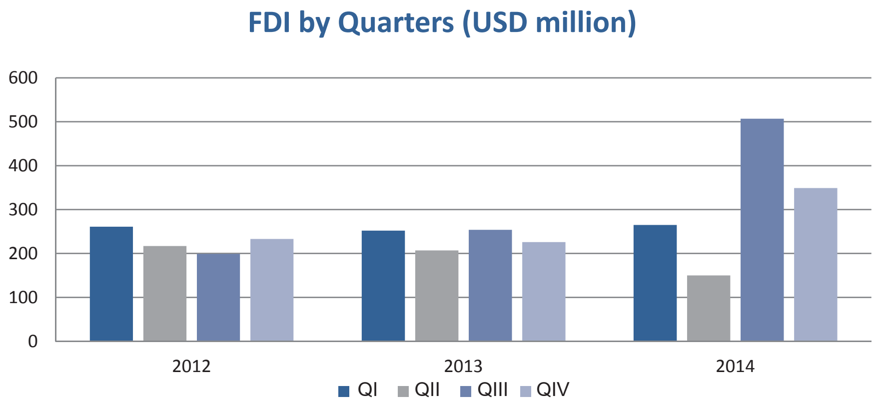
Region / Economy	Value Added	Employment	Exports	Tax Incomes	Salary	Capital Formation
Developed Countries	12,7	7,5	19,3	13,9	14,6	10,5
Developing Countries	12,2	7,9	17,3	14,6	15,4	11,6
Transitional Economies	21,7	3,0	...	...	11,2	25,7
Georgia	33	18	52	46,5	15	40

Source: V. Charaia, "OLI Paradigm and Investment Development Path for Georgia," Political-economic Talks with Vladimer Papava, seminar, 18.12.2014, *https://www.youtube.com/watch?v=KIrMmMiNvzE* (Last review on 02.05.2015)

It is also interesting to note that organizations created with Georgian-foreign equity participation generate one-third of the value added tax (VAT) while employing one-fifth of the country's total employees alongside contributing greatly in other important directions. In comparison, this data is higher than the average data in developed as well as developing and transition countries.

In November 2014, before the official publication of FDI dynamics, the majority of experts said that the main reason for the depreciation of GEL was a decrease in FDI. However, as a result of a detailed examination, it is clear that this index did not decrease but was at its historical maximum for the last six years (since 2008). In the year 2014 alone it increased by 35% (Khaduri, N., 2015). This means, therefore, that it could not have had any negative role in the devaluation of the national currency (see Diagram 10). Moreover, FDI has reached its historical maximum in terms of the quarters (Q3) when the depreciation of GEL had not yet started. Accordingly, it could only act in the direction of strengthening GEL and not vice versa.

DIAGRAM 10



Source: http://geostat.ge/?action=page&p_id=139&lang=geo (Last review on 02.05.2015))

There is an opinion that the increase in FDI in 2014 was not a positive event as such in that a large part of it was the reinvestment which did not come from abroad but was circulating inside the country (Kakulia, 2015). However, if we take into account that reinvestment was going in parallel with FDI in previous years as well (according to GEOSTAT: 2010 – 28% or USD 229 million; 2011 – 30% or USD 336 million; 2012 – 13% or USD 120 million; 2013 – 28% or USD 268 million; 2014 – 21% or USD 266 million), we can see that the indicator of FDI without taking the amount of reinvestment into consideration has increased by 50% in comparison to the last year (according to GEOSTAT: 2010 – USD 585 million; 2011 – USD 781 million; 2012 – USD 792 million; 2013 – USD 674 million; 2014 – USD 1006 million). Therefore, we can say that taking FDI into account from any point of view could affect the strengthening of GEL only from a positive side.

NBG and its Policies

It is noteworthy that the criticism of the National Bank of Georgia (NBG) in parallel with the depreciation and instability of GEL has increased while the NBG itself has been giving explanations concerning its mandate and obligations. To make the issue clear, it is necessary to distinguish Articles 95 and 96 of the Organic Law on the National Bank of Georgia as well as the main directions of the monetary and exchange rate policy under which the principal functions of the NBG are defined with only two directions: 1. Ensuring price stability and 2. Stable functioning of the financial sector.

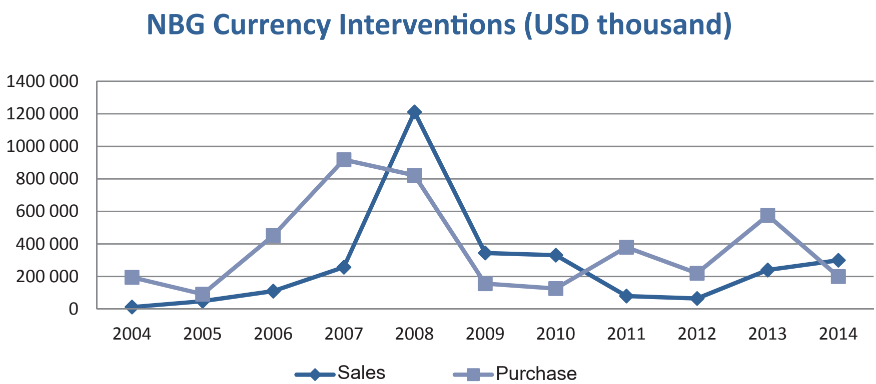
If we take into consideration the fact that the sharp depreciation of GEL can significantly harm individuals with obligations in foreign currency, as well as their solvency, alongside the growing inflation risk the entire stable functioning of the financial sector is also in danger. Therefore, it is both unreasonable and illogical to state that the stability of the exchange rate is not a commitment of the NBG.

Let us analyze the influence and the role of the NBG's monetary policy during the given period of the currency devaluation.

Currency Interventions

One of the main accusations against the NBG was the foreign exchange interventions carried out in recent years. In particular, net purchases carried out by the NBG since 2011 (procurement minus sales) were positive. Overall, in 2011, 2012 and 2013, USD 790 million were withdrawn from the market (see Graph 2).

GRAPH 2

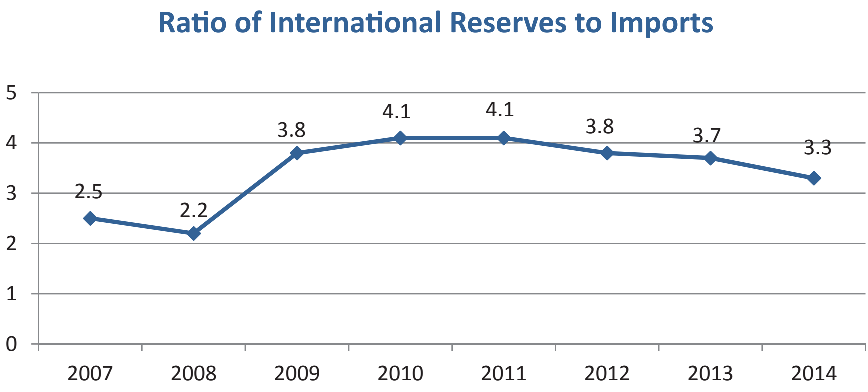


Source: https://www.nbg.gov.ge/index.php?m=304 (Last review on 02.05.2015)

However, it is interesting that demand growth on USD did not push the NBG (especially in November-December 2014) to return the already withdrawn currency to the market. This decision was officially based on mandatory norms, which means keeping the official reserves equal to three times the amount of import (recommendation of the IMF).

Graph 3 shows that the ratio of international reserves to imports declined sharply in late 2014 and dropped to the 3.3 level (which was mainly caused by a rise in the volume of imports) but it was still higher than the statutory norm. Moreover, if the economy demands such an action (spending reserves), then it is normal to make such a sacrifice. This practice already existed in Georgia at the end of the 1990s as well as in 2008.

GRAPH 3



Source: *https://www.nbg.gov.ge/index.php?m=304* (Last review on 02.05.2015)

In that case, the implementation of interventions by the NBG with the purpose of selling USD would, of course, slow down the depreciation of GEL. At the same time, it is necessary to note that reserves by their nature exist exactly for such a problematic and severe economic situation. Therefore, it is not understandable why the NBG puts more attention on the reserves instead of on the financial stability of the country.

According to the NBG president: "Spending reserves to cover up the fundamental shortages will not help at all – this would only postpone the problem" (*BNE IntelliNews Daily*, 2015). However, his words are essentially wrong. There is no question that it is not correct to fight against long-term problems with short-term instruments but to avoid those short-term difficulties which are under the NBG's responsibility; i.e., the stability of the national currency in the light of financial stability in order to avoid panic and an exacerbation of the issue (Eliava, L., 2015). This is possible not only via spending international reserves (as the NBG president tries to show) but also with the help of other monetary instruments such as a minimal obligatory reserves percentage, a monetary policy rate and others.

The positions of the NBG are to support from the IMF side. According to Mr. Azim Sadikov (IMF Resident representative), the NBG should maintain adequate reserves (Sadikov, A., 2015). However, we should not forget the main goal of the IMF – not only in Georgia but worldwide – which is not economic growth but the maintenance of specific principles such as keeping international reserves. With this principle, economic deterioration, in the case of the maintenance of international reserves, is the successful result.

Moreover, we can say that the NBG was implementing an inconsistent policy and wasting its international reserves which it had collected for many years. To prove this claim, we can look at the following facts:

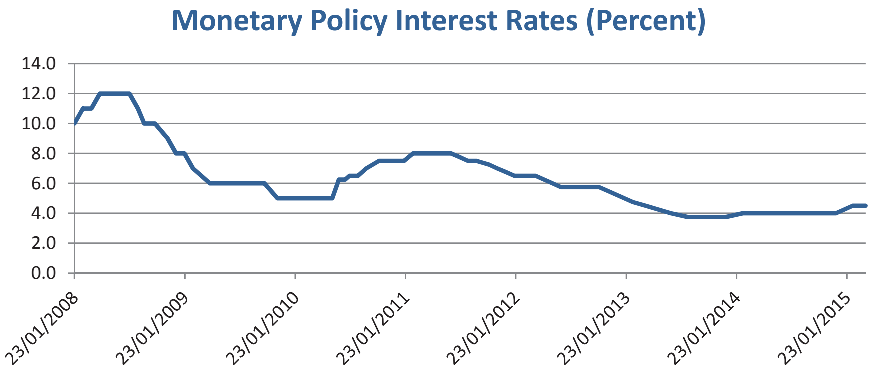
1. Since November 2014 (since the GEL devaluation started) to May 11, the NBG has sold USD 280 million (November 2014 – USD 40 million; December 2014 – USD 40 million; February 2015 – USD 120 million; March 2015 – USD 40 million and April 2015 – USD 40 million).
2. At the same time, the NBG has used another of its important tools – Refinancing Rate. With the help of that, the NBG (from November 20, 2014 to May 8, 2015) has increased the remains of the GEL amount from GEL 330 million to GEL 930 million; i.e., by GEL 600 million.

As a conclusion, we can say that the NBG was supplying the economy with USD (to maintain the stability of GEL), on one hand, and increasing the amount of GEL in the economy by the same amount or even more (taking into account the exchange rate). As a result, the NBG was not taking out the “extra” GEL amount from the economy but annulling its previous (supply of USD to the market) “kind” action. Consequently, the NBG’s claims that it did everything to maintain the stability of GEL has nothing to do with the reality.

Accommodative Monetary Policy

In addition to foreign exchange interventions, it is important to look at the soft monetary policy of the NBG in recent years. Monetary Policy Loans (with a period of seven days, issued through an auction) were launched in 2008 (see Graph 4). Later, Permanent Refinancing Loans entered into force in 2010 which are 1% more expensive than a standard Monetary Policy Loan. Therefore, through the refinancing loans the NBG has its impact not only on short-term interest rates but on long-term interest rates and aggregate demand (Bluashvili, 2013). Of important note is that the NBG was using an interest rate of short-term deposit certificates (less than seven days) as a monetary policy rate until 2008.

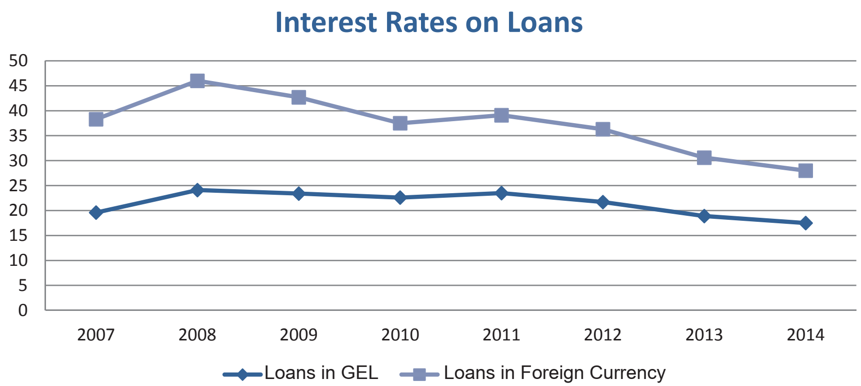
GRAPH 4



Source: *https://www.nbg.gov.ge/index.php?m=304* (Last review on 02.05.2015)

The monetary policy rate has been decreasing since 2011 and fell from 8% to 3.75% – the lowest level (see Graph 4). Such an easing of the monetary policy by the NBG reduced interest rates (see Graph 5) and increased the supply of GEL in the economy through credit channels which changed the balance on the currency market and thus negatively affected the exchange rate.

GRAPH 5



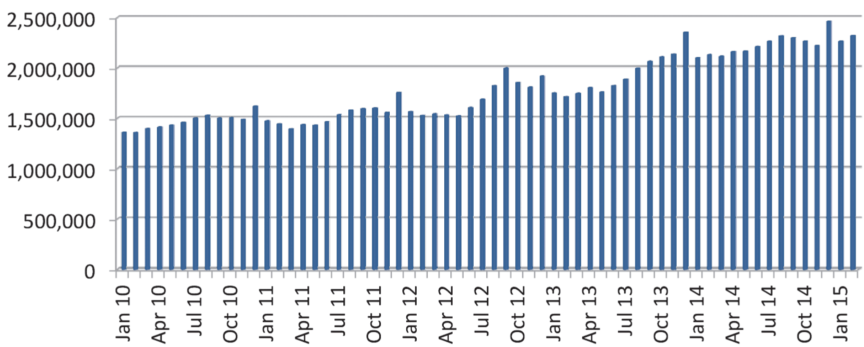
Source: *https://www.nbg.gov.ge/index.php?m=304* (Last review on 02.05.2015)

If the abovementioned accommodative monetary policy carried out by the NBG was done with the purpose of economic growth maintenance (Farmer, 2012), it is interesting why the NBG was "taking care" of economic growth when by legislation this was not its "responsibility" (as claimed by the NBG concerning the stability of the exchange rate).

As we mentioned above, there was an oversupply of GEL in the economy, which negatively affected the exchange rate. If we consider the dynamics of the reserve money supply, we will see that in December of 2013 and 2014, the volume of reserve money increased sharply. In December 2014 alone this figure increased by about GEL 500 million (see Diagram 11).

DIAGRAM 11

Dynamics of Reserve Money 2010-2014 (GEL thousand)



Source: *https://www.nbg.gov.ge/index.php?m=304* (Last review on 02.05.2015)

We would also like to highlight that according to current legislation, the functions of the NBG board have been diminished. In fact, we can say that the board has become symbolic while its actual functions have been distributed among various agencies and committees. In particular, the NBG has created a Monetary Policy Committee whose members are heads of NBG departments. This Committee determines the monetary policy rate as well as other key issues. Questions arise, then, as to the degree to which the department heads depend upon the NBG president, if they can become independent and if they are able to make any objective decisions. We are of the opinion that the functions of the board should be restored and it should be staffed by independent, impartial and, most importantly, highly qualified economists. This should be written into the Organic Law of the National Bank of Georgia.

Minimum Reserve Requirements

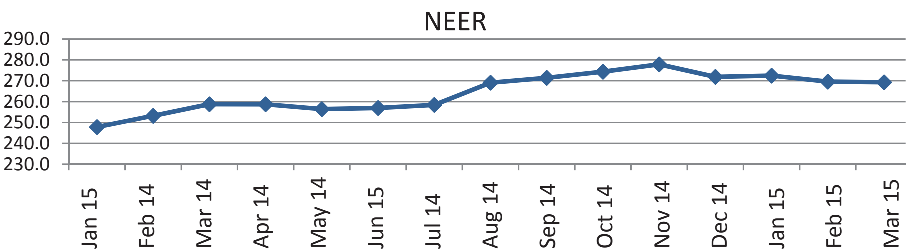
In addition to the abovementioned facts, it is important to underline the issue of the minimum reserve requirements. As we know, the statutory reserve requirement is set by the NBG for commercial banks borrowing in both local and foreign currencies. In other words, banks retain lesser amounts of money to grant to the economy (through the channel of credit).

According to the decision of the NBG, the reserve requirements have dramatically increased since 2011 (only in foreign currency while it has remained unchanged for GEL) from 5% to the current 15%, which has a negative impact upon (and has already influenced) the exchange rate of the national currency. By our assessment, it is necessary to decrease the stated reserve requirement (on borrowing funds in foreign currency) and return the norm of 5%, which was in place until 2011 (GEL should remain unchanged).

It is also important to note that as a result of the depreciation of GEL, inflationary expectations have risen sharply. It is well known that a significant portion of the Consumer Basket in Georgia consists of imported products (Mdivnishvili, 2014), which naturally increases the exchange rate effect on price levels. If, however, we take into consideration the fact that USD has strengthened against the currencies of almost all of our trading partner countries, we will see that no important threats are expected in the near future.

GRAPH 6

Nominal Effective Exchange Rate Index



Source: *https://www.nbg.gov.ge/index.php?m=304* (Last review on 02.05.2015)

Additionally, it is important to consider the so-called effective exchange rate (nominal) which shows the weighted exchange rate (according to trade turnover) against the currencies of the major trade partner countries, which is worse in comparison to early 2014, but has improved from November 2014 and, therefore, is not an adequate reason for the depreciation of GEL (see Graph 6).

Fiscal Policy

Fiscal policy can make a big impact on the reduction and growth of the economy. Stable economic growth requires fiscal stability and a stable long-term fiscal consolidation which, in its turn, requires strong and sustainable development. The management of government expenditures and a country's revenues affects the aggregate demand and, resultingly, the entire economy.

Financial stability (i.e., preventing financial crisis) is a guarantee for the normal functioning of the international financial architecture. At the same time, fiscal stability and fiscal development play an important role in a country's economic development.

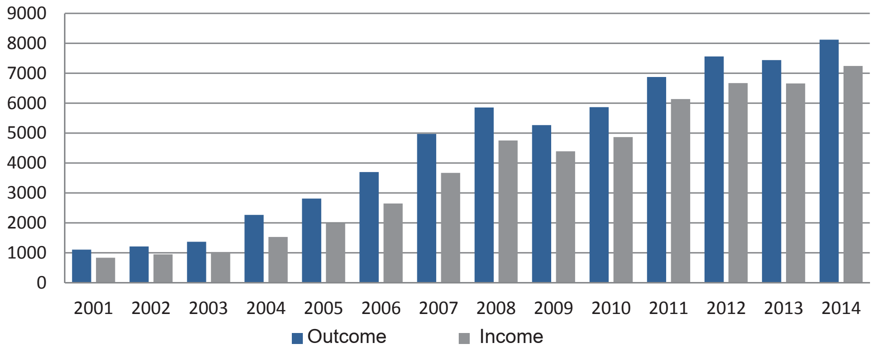
In many developed or developing countries, a great deal of attention is paid to fiscal responsibility, which often has a legal status with authorities having a legal duty to implement fiscal policy. Fiscal policy and stability represent a major issue to which legislators and government officials must direct due attention.

Fiscal policy can make a huge influence on the exchange rate of GEL. A clear example of this is the active expenditure policy implemented by the Ministry of Finance at the end of 2013 which, in its turn, did have an impact (created depreciation) on the exchange rate of the national currency. This is a clear example of how budget policy is capable of making rapid fluctuations on the currency market. It should also be noted that the situation of 2014 is significantly different. In this case, if we want to know how fiscal policy impacted the exchange rate of GEL, an analysis of only one or two months will not be enough. It is necessary to review the dynamics of the budget revenues and expenditures for a whole year. In this case, we will see that the Ministry of Finance did not implement sharp spending policies but, on the contrary, every month is characterized with stability.

By the adjusted numbers of 2014, the incomes of the state budget amounted to GEL 9,157,085,122 whereas payables were equal to GEL 9,009,812,202. The total planned budget income was GEL 9,105,000,000 while total payments were GEL 9,080,000,000. Budget revenues exceeded budget payments by GEL 147,272,920 according to the actual situation in 2014 (see Diagram 12).

DIAGRAM 12

Income and Outcome of the Georgian State Budget (GEL thousand)

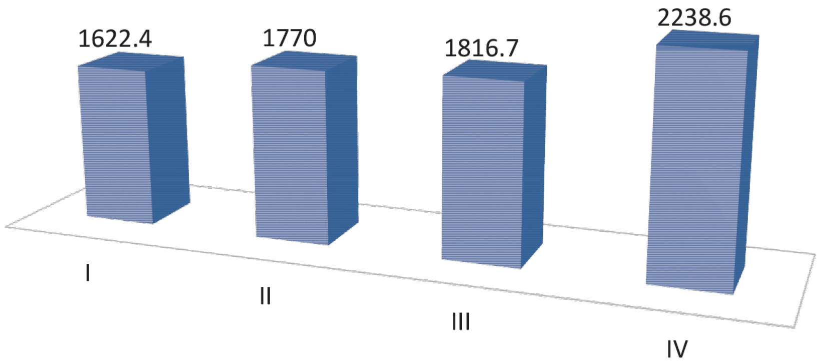


Source: *http://mof.ge/images/File/biuj2014_12tve/TAVI_I.pdf* (Last review on 02.05.2015)

Of further note is that the depreciation of the exchange rate started in the 2014 fiscal year at the end of the 11th month. The total revenues for this period amounted to GEL 7,808,313,573 while the total expenditures amounted to GEL 7,724,760,495 and tax revenues were exceeded by GEL 83,553,078. If we analyze the budgetary expenditures, we will see that the first three quarters were characterized by almost equal rates although the fourth quarter showed a sharp increase in GEL 421.9 million. Expenditures alone in December were GEL 373.9 million more than those of November (see Diagram 13), which enables us to conclude that budgetary costs did not play a part at the initial stage of the depreciation of GEL. However, the revenues of the month of December exceeded expenses providing an additional GEL 373.9 million for the economy. This would make for an additional depreciation of the exchange rate afterward, even though a large amount of money was spent on the purchase of fixed assets (vehicles, office equipment, real estate, etc.).

DIAGRAM 13

Georgian State Budget Expenditures in 2014 by Quarters (GEL million)

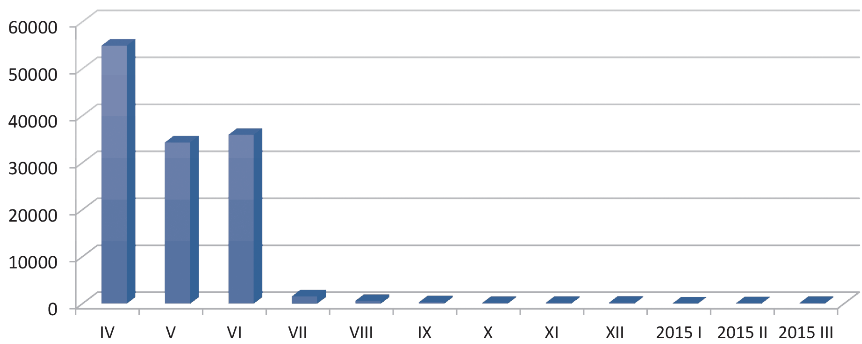


Source: http://mof.ge/4568 (Last review on 02.05.2015)

The return policy of the untaxed minimum from the side of the state can be considered as a factor stimulating the growth of GEL. In the year 2014 alone, GEL 128,354,3 from the budget was returned to the population. This policy still continues in 2015 which does, of course, contain another risk of GEL depreciation if other factors remain unchanged (see Diagram 14).

DIAGRAM 14

Returns of Untaxed Minimums in 2014-2015 (GEL thousand)



Source: http://mof.ge/images/File/biuj2014_12tve/TAVI_I.pdf (Last review on 02.05.2015)

According to the fiscal policy analysis of 2014, we can conclude that at the initial stage of the depreciation of the exchange rate of GEL, the Ministry of Finance was not implementing a sharp spending policy, which could be reflected in a mass increase of GEL. The commitment of the government about returning the untaxed minimum (GEL 128 million in 2014), which the Ministry of Finance is carrying out within its competence, made for an indirect increase in the money supply. Also, we should remember that the Ministry of Finance boosted its spending policy in December 2014 which meant an increase of GEL 374 million as compared to November 2014. Despite the fact that revenues exceeded expenditures in December, it can be said that this supported the devaluation of GEL for the following month and not in December itself.

It should be noted that the Ministry of Finance has halted activities of new foreign debt since 2012 (loans denominated in foreign currency) although it started to increase the internal debt (in national currency). We are of the opinion that the debt policy should be revised by the Ministry because the high demand on the national currency encourages the NBG to supply commercial banks with an additional amount of GEL, which then contributes to the devaluation of the national currency.

- We may consider the following factors as objective reasons for the devaluation of the national currency: the deterioration of the trade balance (including a decrease in exports and import growth), the decrease in money transfers, the crises in neighboring countries (mainly in Russia and Ukraine) and the change in the customs policies in Armenia and Azerbaijan.
- Factors which have been actively discussed in some expert circles but would not affect the devaluation of the national currency are: FDI inflows and revenues from tourism.
- It is important to pay more attention to promoting local production and activating the real sector of the economy, which will lead to an increased demand for local currency and reduce its sensitivity to external shocks.
- Close cooperation between the NBG and the government is obligatory for the sustainable macroeconomic stability of the country.
- There is a general public perception that interventions by the NBG are only those with foreign currency (USD). However, intervention is, in fact, any move which the NBG undertakes while participating in the foreign exchange market. Present work shows that the NBG was systematically increasing the amount of GEL and decreasing the amount of USD in the last years.
- It is important to make amendments to the Organic Law on the National Bank of Georgia. In particular, this concerns Article 3 where the functions and responsibilities of the NBG are defined. According to this Article, the main objective of the NBG is price stability. In Paragraph 2 of the same Article 3 we read that the “NBG should ensure the stability and transparency of the financial system and promote sustainable economic growth in the country, if it is possible, in a way which does not endanger the fulfilling of its primary objective.” In this case, it turns out that the NBG should reject all other objectives in order to maintain price stability which is necessary for ensuring financial stability.
- The NBG has other mechanisms for intervention in the case of the stability of the exchange rate of GEL in addition to international currency reserves. In particular, the NBG has the power to regulate the amount of GEL in the economy by means of the refinancing rate. However, the NBG has improperly used this ability in recent months. On one hand, it was supplying

the economy with USD (reducing international foreign currency reserves) while, on the other hand, it was increasing the amount of GEL (with the help of the refinancing rate mechanism). In the end, the first intervention was being neutralized by the second and its positive effect was lost.

- Another tool of the NBG for strengthening the exchange rate of GEL is the management of minimum reserve requirements. In particular, commercial banks have an obligation to deposit compulsory reserves at NBG accounts equal to 15% (and 10% for local currency) which, in our opinion, is quite a high rate and if necessary (as in 2008), could be decreased to 5%. However, this possibility of the NBG is unfortunately being neglected.

- According to the law in force, the functions of the NBG's board have declined and have more a symbolic than a real power. The actual functions of the board are distributed among various agencies and committees. In particular, the Monetary Policy Committee was established whose members are heads of NBG departments. The Committee determines the monetary policy rate and other key issues. Questions arise, then, as to the degree to which the department heads depend upon the NBG president, if they can become independent and if they are able to make any objective decisions. We are of the opinion that the function of the board should be restored with the board then staffed by independent, impartial and, most importantly, highly qualified economists. This should be written into the Organic Law of the National Bank of Georgia.

- It is necessary to define the responsibilities of the government's economic team and the NBG for each specific economic issue.

- Based on the 2014 fiscal policy analysis, we can conclude that the depreciation of GEL at the initial stage was not caused by the sharp spending policy of the Ministry of Finance.

- The commitment given by the government about returning the untaxed minimum was directly reflected in an increase in the amount of GEL in the Georgian economy.

- In December 2014, as compared to November 2014, the Ministry of Finance carried out sharp spending policies for the purpose of achieving a high level of budget fulfillment, which increased the amount of GEL in the economy. On the other hand, however, a non-fulfillment of the budget funds would result in other negative consequences.

- It is necessary that the Ministry of Economy and Sustainable Development of Georgia take charge of the long-term economic development plan of the country and its implementation. Within the Socio-economic Development Strategy – Georgia 2020, every ministry must develop a common individual work plan framework. Georgia 2020 should be reviewed because it envisages a 7% growth rate while Georgia's economic growth varies between 2-5% until 2020 according to the International Monetary Fund. Only 2% growth is expected in 2015, for example.

- The Ministry of Finance has halted activities of a new foreign debt since 2012 (loans denominated in foreign currency) but started to increase the internal debt (in national currency). We are of the opinion that the debt policy needs overview by the Ministry because of the high demand on the national currency encourages the NBG to supply commercial banks with an additional amount of GEL, which contributes to the devaluation of the national currency.

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