



July 2007

Country Classification of Georgia

CURRENCY EQUIVALENTS

(as of 12 July 2007)

Currency Unit	–	Georgian lari (GEL)
GEL1.00	=	\$1.6663
\$1.00	=	GEL0.600132

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
DMC	–	developing member country
GDP	–	gross domestic product
GNI	–	gross national income
GNP	–	gross national product
HIPC	–	heavily indebted poor country
IBRD	–	International Bank for Reconstruction and Development
IDA	–	International Development Association
IMF	–	International Monetary Fund
LDC	–	least-developed country
OCR	–	ordinary capital resources
TA	–	technical assistance
UN	–	United Nations

NOTE

In this report, "\$" refers to US dollars.

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I. INTRODUCTION

1. Georgia became a member of the Asian Development Bank (ADB) in February 2007. In accordance with ADB policy,¹ new member countries should normally be classified to determine their eligibility for the Asian Development Fund (ADF) and ordinary capital resources (OCR).² This paper discusses the economic and social conditions in Georgia and recommends that Georgia be classified as a Group B1 country in ADB.

II. CLASSIFICATION POLICY

2. According to ADB's 1998 graduation policy (footnote 1), the eligibility of developing member countries (DMCs) to borrow from the ADF is based on two criteria: per capita gross national product (GNP), and debt repayment capacity. Regarding per capita GNP, the 1998 graduation policy adopted the World Bank's per capita GNP estimates based on the Atlas method and the International Development Association (IDA) operational cutoff for eligibility. In particular, the 1998 graduation policy applied the IDA eligibility per capita operational cutoff of \$925 in 1997 US dollars.³ A multidimensional evaluation procedure, combining quantitative and qualitative assessments, was used to assess the debt repayment capacity of DMCs.

3. Application of the two criteria is captured in a decision matrix in Table 1 below that yields the following system of four groups on DMCs' eligibility for borrowing from the ADF and OCR:⁴ (i) ADF only (Group A), (ii) ADF with limited amounts of OCR (Group B1), (iii) OCR with limited amounts of ADF (Group B2), and (iv) OCR only (Group C).

4. Under the graduation policy framework, cost-sharing limits for project financing by ADB change for the borrowing DMCs as follows: 80% for Group A, 75% for Group B1, 70% for Group B2, and 65% for Group C.⁵ The government contribution to technical assistance (TA) should be at least 15% of the total TA costs for Group A, 20% for Groups B1 and B2, and 30% for Group C. Such contribution will be subject to the limit of total TA costs minus foreign exchange costs and costs of domestic consultants. The new policy on cost-sharing as set out in the paper *Cost Sharing and Eligibility of Expenditures for ADB Financing: A New Approach* (footnote 2) became effective in March 2006. While such policy, which supersedes the cost-sharing limits under the graduation policy framework, has become effective, certain financial parameters still need to be established in order to determine the new country cost-sharing ceiling applicable to Georgia. Until a decision on such a new ceiling has been taken in accordance with the new policy framework, the cost-sharing ceiling applicable to Georgia under the graduation policy framework will constitute the country cost sharing ceiling under the new policy framework.

¹ ADB. 1998. *A Graduation Policy for the Bank's DMCs*. Manila.

² On 25 August 2005, the Board approved the paper *Cost Sharing and Eligibility of Expenditures for ADB financing: A New Approach* (R129-05). Cost-sharing under this new policy framework supersedes the existing policy on cost-sharing limits. On 6 February 2006, the Board approved the paper *Revising the Procurement Guidelines* (R11-06). The existing policy on domestic preference is superseded by the revisions to domestic preference scheme under the new policy framework that becomes effective on 1 April 2006.

³ Per capita income by the World Bank Atlas methodology is IDA's basic indicator or proxy for poverty. The operational cutoff stood at per capita gross national income (GNI, formerly GNP) of \$1,065 in 2006 US dollars.

⁴ This excludes DMCs that have graduated from regular ADB assistance.

⁵ ADB. 2002. *Review of Cost-Sharing Limits for Project Financing as an Element of ADB's 1998 Graduation Policy*. Manila.

Table 1: Decision Matrix of Classification

Debt Repayment Capacity	Per Capita GNP Cutoff			
	Below Per Capita GNP Cutoff		Above Per Capita GNP Cutoff	
	LDC ^a	Other	LDC ^a	Other
Weak	ADF only (Group A)	ADF only (Group A)	ADF only (Group A)	ADF with limited OCR (Group B1)
Limited	ADF with limited OCR (Group B1)	ADF with limited OCR (Group B1)	ADF with limited OCR (Group B1)	OCR with limited ADF (Group B2)
Adequate	OCR with limited ADF (Group B2)	OCR with limited ADF (Group B2)	OCR with limited ADF (Group B2)	OCR only (Group C)

ADF = Asian Development Fund, GNP = gross national product, LDC = least-developed country, OCR = ordinary capital resources.

^a The following bank DMCs are classified as LDCs: Afghanistan, Bangladesh, Bhutan, Cambodia, Kiribati, Lao People's Democratic Republic, Maldives, Myanmar, Nepal, Samoa, Solomon Islands, Timor-Leste, Tuvalu, and Vanuatu, (United Nations. June 2007. *List of Least Developed Countries*. Available: www.un.org).

Source: Asian Development Bank.

III. ECONOMIC CONSIDERATIONS

5. Georgia is a small country located south of the Caucasus Mountains and east of the Black Sea. It borders Armenia, Azerbaijan, the Russian Federation, and Turkey. It has a land area of 69,700 square kilometers. The population was estimated to be about 4.5 million in 2005. Georgia is rich in natural resources such as forests, water resources, and mineral deposits including manganese, iron, coal, copper, and gold. Georgia's geographical location gives it strategic importance in serving as the gateway from the Black Sea to the Caucasus, and as a key link between Europe and Asia, particularly as a vital link in the oil and gas transit system from the Caspian Sea to international markets.

6. Georgia has a relatively small economy. The GNP in 2005 was about \$5.9 billion based on the World Bank's estimates using the Atlas method. The incidence of poverty in 2005 was about 39.4% and poverty is relatively higher in rural areas. Unemployment is on the rise and is an important contributory factor to the persistence of urban poverty. The unemployment rate in 2006 was 13.6%. Peaceful settlements of the conflicts in the regions of South Ossetia and Abkhazia continue to be elusive. Further, the Pankisi Valley has seen an influx of Chechen refugees. According to the United Nations High Commission for Refugees, as a consequence of conflicts, Georgia's internally displaced persons number 214,018.⁶ The conflicts in Abkhazia and South Ossetia within Georgia took a toll on the economy.⁷

⁶ ADB. 2007. *Georgia: Country Economic Report*. Manila.

⁷ World Bank. 2007. *Georgia—Country Brief 2006*. Available: web.worldbank.org

7. The Georgian economy's performance has improved in the last 3 years: (i) gross domestic product (GDP) growth averaged 8.4% annually from 2004 to 2006; (ii) the fiscal accounts exhibited a sharp acceleration in revenue collections and provided the necessary fiscal space for growth-supporting public expenditures; (iii) the current account deficit although widening, has been largely financed by a surge in foreign direct investment inflows accompanied by rising foreign exchange reserves; and (iv) external debt sustainability has strengthened, with improvements in key indicators (footnote 6).

8. In the World Bank, Georgia is classified as an "IDA only" country. Eligibility for IDA assistance is primarily based on relative poverty, defined as gross national income (GNI) per person below an established threshold, and lack of creditworthiness to borrow on market terms.

9. The 1998 graduation policy reviewed country classifications based on 1997 per capita GNP and assessment of debt repayment capacity based generally on a specific set of data sources covering 1989–1996. For consistency, this section examines Georgia's status in terms of 2005 per capita GNP, and debt repayment capacity up to 2005,⁸ using generally the same data sources and same methodology as for the 1998 graduation policy paper. The most recent available data from other specific sources have also been used.

A. Per Capita Gross National Product

10. By United Nations (UN) standards, Georgia does not belong to the group of least-developed countries (LDC).

11. According to *World Economic Outlook*, the real GDP of Georgia grew at 9.0% in 2006, compared with 9.6% in 2005 and 5.9% in 2004. Real GDP growth is projected to be 7.5% for 2007 and 6.5% for 2008. Annual inflation (based on the consumer price index) was 8.3% in 2005 and 9.2% in 2006. It is projected to be 6.3% in 2007 and 5.5% in 2008.⁹ The average annual population growth rate for 2002–2005 was almost nil (footnote 6).

12. Georgia's per capita GNP was estimated at \$1,560 in 2006 US dollars, which was higher than the IDA operational cutoff of \$1,065 in 2006 US dollars.¹⁰ Per capita GNP in dollar terms (nominal prices) using the Atlas method has steadily increased from 2002 to 2006 (Table 2). It is expected that Georgia's per capita GNP will most likely stay above the IDA's operational cutoff in the medium term, in view of projections for real GDP growth and inflation in 2007-2008.

Table 2: Economic Indicators

Item	2001	2002	2003	2004	2005	2006
GDP Growth (% , in constant prices)	4.7	5.5	11.1	5.9	9.6	9.0
Consumer Price Index (annual percentage change, average of period)	4.7	5.6	4.8	5.7	8.2	9.2
GNP (\$ billion, nominal prices) ^a	3.1	3.4	3.9	4.8	5.9	
Per capita GNP (Atlas method, current \$) ^a	570	720	830	1,030	1,310	1,560

GDP = gross domestic product, GNP = gross national product.

^a World Bank estimates, using the Atlas method.

Sources: IMF. 2007. *World Economic Outlook*. Available: www.imf.org.

World Bank. June 2007. *World Development Indicators Online*. Available: devdata.worldbank.org

World Bank. 2003–2007. *Operational Policies, OP3.10, Annex D*. Available: www1.worldbank.org

⁸ Currently, a complete set of data is available from the same data sources only up to 2005.

⁹ IMF. 2007. *World Economic Outlook*. Available: www.imf.org

¹⁰ World Bank. July 2006. *Operational Policies, OP3.10, Annex D*. Available: www1.worldbank.org

B. Debt Repayment Capacity

1. Quantitative Variables

13. **Debt Sustainability Ratio.**¹¹ The 3-year moving averages of debt sustainability ratios from 1997 to 2005 were all negative, ranging from (3.9%) to (14.8%).

14. **Gross Domestic Savings Rate.** The gross domestic savings rate was 14.0% in 2005. The average of gross domestic savings rates for 1997–2005 was 6.3%.

15. **Private Capital Inflows.** The share of private capital inflows in total capital inflows, as an indicator of debt repayment capacity, increased to 61.4% in 2005 from 31.9% in 2001. The average value of the share of private inflows in total capital inflows for 1997–2005 was 48.2%. Foreign direct investment increased significantly in 2004 and 2005.¹²

16. **Size of the Economy.** The size of Georgia's economy as measured by GNP, Atlas method, increased from \$3.1 billion in 2001 U.S. dollars to \$5.9 billion in 2005 U.S. dollars (Table 2). In terms of 2005 GNP (footnote 12), Georgia's economy is smaller than those of Kazakhstan (\$44.6 billion), Uzbekistan (\$13.6 billion), and Azerbaijan (\$10.4 billion), but larger than the economies of Armenia (\$4.4 billion), the Kyrgyz Republic (\$2.3 billion) and Tajikistan (\$2.2 billion).

2. Qualitative Variables

17. **Classification as Heavily Indebted Poor Country.** Georgia is not classified as a heavily indebted poor country (HIPC). In the context of IDA grant eligibility consideration, the Debt Sustainability Assessment-based risk rating of Georgia for fiscal year (FY) 2007, undertaken jointly by the IMF and the World Bank, was "Green Traffic Light", indicating that Georgia was considered to be at a low risk of debt distress.¹³

18. **Vulnerability to Fluctuation in Export Growth.** Georgia's exports of goods and services increased steadily from 2000 to 2005, with an average growth rate of about 25.9% (footnote 12). Base metals and mineral products accounted for 36.3% of total exports of merchandise goods in 2006. Although there has been some diversification, Georgia's export structure remains quite concentrated, with the top five export categories accounting for three fourths of export revenues of merchandise goods (footnote 6). Georgia is considered to be "highly vulnerable" to fluctuation in export growth of goods and services.

19. **Main External Financing Source.** Private financing, including foreign direct investment and portfolio investment, accounted for about 62.7% of Georgia's total external financing in 2004, and 61.4% in 2005 (footnote 12). Georgia's main external source of financing is considered to be "diversified financing", as neither private nor official financing accounted for more than two-thirds of the country's external financing in 2004–2005.

¹¹ The debt sustainability ratio as defined in the graduation policy paper links the key elements bearing on a country's external debt sustainability: non-interest current account balance, the inflow of foreign direct investment, the stock of external debt, and the differential between the growth rate and the real interest rate.

¹² World Bank. 2007. *World Development Indicators Online*. Available: devdata.worldbank.org

¹³ World Bank. June 2006. *Assessing Implementation of the IDA14 Grants Framework*. Available: www.worldbank.org

20. **Rating for Sovereign Borrowing.** Georgia is classified as “rated”. In December 2005, Georgia was assigned an initial long-term foreign currency sovereign credit rating of B+ by Standard and Poor’s (S&P’s). S&P’s noted major rating factors with respect to strengths: the government’s strong political commitment to prudent financial policies and market-oriented structural reforms; moderate and decreasing levels of government debt; and good economic prospects underpinned by strong market-oriented policies. It also noted major rating factors with respect to weaknesses: a narrow economic base; weak, albeit improving, external indicators; high inflation and inadequacy of monetary policy instruments; and political uncertainty arising from regional conflicts.¹⁴ In November 2006, S&P’s reaffirmed the B+ long-term foreign currency sovereign credit rating, however, revised the rating outlook from positive to stable due to increased geopolitical risk (footnote 6).

21. **Degree of IDA Access.** The World Bank classifies Georgia as an IDA only borrower. Georgia is currently eligible to borrow IDA concessional resources. The World Bank’s country partnership strategy (CPS) for Georgia for FY2006-09 noted that, while Georgia’s debt situation is improving, it still faces a moderate risk of worsening that will likely preclude normal IBRD lending during this CPS period. Georgia’s debt burden is still vulnerable to adverse external and domestic developments that can be mitigated by continued implementation of measures to increase foreign direct investment and enhance export performance.¹⁵

22. Taking into account the preceding considerations, including the quantitative and qualitative variables (paras. 13–21), Georgia’s debt repayment capacity is considered to be “weak”.

C. Joint Application of the Two Criteria

23. The 1998 graduation policy paper stated that the decision matrix (Table 1) provides the foundation for classifying and graduating DMCs. Thus, Georgia is classified as a Group B1 (ADF with limited amounts of OCR) country.

IV. RECOMMENDATION

24. It is recommended that the Board of Directors approve the classification of Georgia as a Group B1 country for the purpose of access to ordinary capital resources and eligibility for resources from the Asian Development Fund.

¹⁴ Standard & Poor’s. January 2006. *Georgia (Government of)*. Available: www.ratingsdirect.com.

¹⁵ World Bank. October 2005. *Country Partnership Strategy for Georgia*. Available: web.worldbank.org.