



FREE Network project
May 2020

COVID-19 in the Region of FREE Network

The Case of Georgia



COVID-19
PAPER SERIES

Introduction

The Covid-19 pandemic is affecting all the inhabited continents of this planet and leaves none of us untouched. It has already killed thousands of people across the globe, closed down cities, borders and businesses and most countries are still just in the initial phase of this crisis. Although there is 24/7 reporting on the pandemic, much of the focus in international media has been on the most affected countries and richer countries in Eastern Asia, the EU and the US. Much less attention has been given to countries around the Baltics, in Eastern Europe and the Caucasus. However, these countries are home to more than 200 million people and to the institutes that form the Forum for Research on Eastern Europe and Emerging Economies, i.e. the FREE network. We have therefore started to collect data on this region from official sources with the ambition to offer a regularly updated, comprehensive and easily comparable overview of the health impact of the Covid-19 pandemics, as well as the policies and practices countries in the region adopt to deal with it. The countries in the network and the region we include are Belarus, Georgia, Latvia, Poland, Russia, Sweden, and Ukraine. For comparison we also include Italy as a point of comparison since it is a country that has been particularly badly affected and we have several people in our faculties that know Italian and follow these developments closely.

The quality of the health data will by necessity vary between countries and this also affects the comparability of numbers. For example, the ability and willingness to test the population for the virus differs significantly between countries and will obviously affect the number of infections that is reported to the European Centre for Disease Prevention and Control (ECDC), the main source of data on health outcomes in our tables and graphs. Other data that we report, such as border or school closures, are easier to compare, but there may still be differences in how these policies are implemented on the national level. However, we still believe that it is useful to compile this data for our region in one place as a starting point for discussions on how the virus is spreading and governments respond to the crisis.

Since the FREE network focuses on economic issues, we put particular emphasis on high-frequency indicators in this area and on measures governments have taken to deal with the economic consequences of the pandemic. In the initial phase of this collaborative project, the focus will be on providing a descriptive picture of the state of the situation using the best data we can find, but over time, this will be complemented by more in-depth policy analysis of the measures and implications for the economies in the region.

The main data is presented in a summary page that facilitates comparisons between countries, and this is complemented with more detailed country pages.

Introduction

Georgia has close to 4 million inhabitants. It borders Russia, Azerbaijan, Armenia and Turkey, which are also its main trading partners. The capital and largest city is Tbilisi with about 1,5 million inhabitants. Agriculture and the tourism sector dominate the local economy.

Georgia reported its first case of Covid-19 on February 27, 2020 and its first deaths on April 6, 2020. The government reacted quickly, banning direct flights from China in late January 2020 and imposing severe travel restrictions even within the country in March 2020. Schools and universities were closed on March 11, 2020. The government banned all larger public gatherings on March 21, 2020, the same day when the country declared the state of emergency. The four major cities of Georgia - Tbilisi, Batumi, Kutaisi and Rustavi - were put under lockdown on April 15, 2020.

As of May 8, 2020, Georgia reported a total of 9 fatalities, suggesting that the virus has quite successfully been contained so far. A breakdown of the healthcare system seems unlikely at the moment. Economically, the situation is more heterogenous. Georgia's public finances are in a tolerable enough shape to handle a crisis. The **public debt to GDP ratio** is not very high (44.9% in 2018), and the government budget deficit is also below 3% of GDP. Georgia's **financial system** has been praised as one of the strongest among in the ECA region. However, annual inflation in January-February was 6.4%, which is significantly higher than the target level of 3%. Georgia is facing uncertainties in terms of inflationary expectations, and this limits the National Bank of Georgia's (NBG) ability to stimulate the economy under the current circumstances. Most probably, NBG will not cut the policy rate to avoid provoking further currency depreciation and stoking inflationary

expectation even further. Moreover, a major weakness in the Georgian economic system lies in its lack of a broad social safety net infrastructure, which could help support afflicted groups during downturns. Finally, another risk is the substantial informal sector: workers in these sectors are hard to reach via conventional policy measures.

Below, we outline how the Georgian economy has been affected by Covid-19 and what the policy responses have been so far. We will also discuss several economic scenarios and explain which further policy options are thinkable.

How Does the Covid-19 Crisis Affect the Georgian Economy? Demand Side Effects

1. **A decline in domestic consumption** resulting from behavioural and policy changes is to be expected on the demand side - i.e. people staying home as a precaution or because they are required to. In addition, currency depreciation and possible price spikes (due to herding behaviours and potential disruptions in supply chains) are also expected to have a negative effect on consumption and investment.

Household consumption accounts for 66.7% of the Georgian GDP (Geostat, 2018). A significant reduction in household consumption (e.g. spending on transportation, clothing, electronics, and domestic services) would therefore result in an overall slowdown of GDP growth. A slowing of internal demand would hit people working in the informal sector particularly hard; namely, those without a regular salary (e.g. temporary workers, taxi drivers, and other self-employed service sector workers) and small and micro business-owners. Their situation is worsened still because the government's fiscal stimulus and assistance is unlikely to reach them directly. They



are also not expected to benefit from the extra liquidity injected into the financial system, as they will not qualify for bank loans to cover temporary income losses. Another vulnerable group are the formal sector workers employed in companies that face a dramatic decline in their usual economic activities (restaurants, hotels, the entertainment industry, transport, etc.). These companies are likely to put their workers on unpaid leave or simply fire them. Moreover, the slump in household demand will also be made worse by the fact that most families are likely to have limited savings and, therefore, their capacity to smooth consumption is limited. Hence, the crisis may cause a significant drop in well-being and, possibly, further deterioration in individuals' physical and mental health, alongside the direct impacts of Covid-19

2. A decline in domestic investment because uncertainty and deteriorating business sentiments will stall business investment decisions. Expectations of a global recession could become

self-fulfilling if 'business-as-usual' does not resume in the next few months. If companies expect a slowdown in demand, they will also delay investment, and GDP will decline further. Investment (gross fixed capital formation) accounts for approximately 28% of Georgia's GDP. Thus, the Georgian government has announced capital spending to combat the expected drop in private investment.

3. A decline in tourism and related business seems inevitable as tourism arrivals and receipts are expected to decrease sharply as a result of the numerous travel bans, and due to precautionary behavior. According to our preliminary calculations, the Georgian economy lost between 3-9% of potential tourism revenue in February. Since the tourism sector accounts for 6% of Georgia's GDP (GNTA 2018), a direct hit to the industry will substantially impact GDP. In table 1, we work out GDP losses associated with the following scenarios:

Table 1: Net effect of the coronavirus crisis on tourism in Georgia

	Table 1. Net effect of the coronavirus crisis				
	Effect on GDP (percentage points)				Tourism revenues (Mln. USD)
	Transport	Accom. and food services	Travel companies	Total change in GDP	
Scenario 1: no international, outbound or domestic tourism in March-May 2020	-0.18	-0.36	-0.28	-0.82	-514
Scenario 2: no international, outbound or domestic tourism in March-July 2020	-0.41	-0.82	-0.64	-1.87	-989
Scenario 3: no international, outbound or domestic tourism in March-December 2020	-1.19	-2.34	-1.84	-5.37	-2,010

Note: after each period indicated in the scenarios, tourism is assumed to immediately recover to 2019 levels.

Source: Geostat, NBG, authors' calculations.



4. **The spillover effect on other sectors:** a drop in demand for goods and services in the region, in China, the EU, and the US - will affect the overall economy via trade and production linkages.

While it is difficult to predict how Georgia's economy will react to a global shock of such magnitude, some preliminary estimations may

Table 2: Correlations of growth rates

Table 2	Georgia	Russia	Armenia	Turkey	China	Kazakhstan	Italy	Germany	France	US	Israel	Ukraine
Georgia	1.00	0.87	0.88	0.66	0.58	0.81	0.67	0.74	0.85	0.69	0.77	0.73
Russia		1.00	0.90	0.60	0.73	0.83	0.64	0.67	0.82	0.63	0.79	0.91

Source: World Bank, authors' calculations.

In order to explore how a slowdown across major world economies will affect Georgia, we have followed three economic scenarios relating to

Table 3: Coronavirus effect on growth rates.

Table 3. Coronavirus effect on growth rates	Real GDP annual growth change in 2020 compared to the baseline scenario, pp				Real GDP growth, % in 2020, assuming a 5% baseline
	Russia	Germany	US	Georgia	Georgia
Scenario A: Outbreak causes localized disruption	-0.9	-1.2	-0.2	-1.09	3.91
Scenario B: Widespread contagion	-3	-2.8	-1.3	-3.09	1.91
Scenario C: Global pandemic	-4.8	-3.6	-2.4	-4.55	0.45

Source: Orlik et al. (2020); authors' calculations.

5. **A decline in trade** is likely and it is possible to find certain similarities between the current situation and the economic slowdown in the Eastern Europe and Central (EECA) region in 2014-2017, caused by a drop in oil prices and global appreciation of the US dollar. The latter resulted in a sharp decline of external demand, falling commodity prices and regional currency crises, which equally affected the Georgian economy. The country's goods exports fell by 23%, while imports contracted by 15% in 2015. Trade was only restored to the 2014 level by 2018. While, the forthcoming crisis is expected to not only have

already be made. Georgia's growth rate over the last 20 years correlates notably to several neighboring economies. One of the greatest correlations is, unsurprisingly, with Russian economic growth. Russia's growth is also highly correlated with other countries, reflecting global economic linkages. These correlations are reported in table 2 below:

major world economies, as reported by Orlik et al. (2020). The numbers reflect growth rate changes relative to the baseline (no virus outbreak).

stronger negative impacts on external demand, but also disruptions in the production value chains, affecting Georgia's trade in more severe ways. Trade of all commodities, except food and medicine, is projected to decline, depending on the duration of the shock.

6. **A decline in Foreign Direct Investment (FDI)** is to be expected since foreign investors prefer to invest in safe assets. Additionally, currency depreciation expectations will negatively affect FDI. The FDI in Georgia amounted to 1,267.7 mln. USD in 2019 (7.1% of GDP).



7. **A decline in remittance inflows** seems likely: since all countries will suffer economically in the aftermath of the health and oil price crises, we expect significant slowdown in remittance inflows from the rest of the world. The remittances decline will hit Georgia particularly hard as it is

among the **top receiver countries** of foreign transfers. For instance, in 2019, money transfer inflows accounted for 9.8% of GDP. Various scenarios for just how much Georgia is set to lose in monetary inflows is presented in table 4 below:

Table 4: Net change in money transfers.

Table 4. Net change in money transfers inflow in 2020 due to coronavirus (Mln. USD)		
Scenario 1: 10% decrease of net money transfers in the remaining months of the year (March-December)	Scenario 2: 30% decrease of net money transfers in the remaining months of the year (March-December)	Scenario 3: 50% decrease of net money transfers in the remaining months of the year (March-December)
-114	-372	-629
Net change in consumption spending due to money transfers decline*		
-570	-1,857	- 3,146
Net change as a share of household total real consumption spending**		
+0.3%	-2.6%	-5.5%

* \$1 of transfers is assumed to become \$0.8 equivalent of consumption spending.

** USD/GEL exchange rate is assumed to equal to the official exchange rate as for March 20th (3.1818) in the remaining months of the year (March-December). Inflation is assumed to be 6% in 2020.

Source: Geostat, NBS, authors' calculations.

Supply Side Effects

1. **Production disruptions** may occur on the supply side. Domestic production suffers as a result of forced business closures and the inability of workers to get to work, as well as disruptions to trade and business as a result of border closures, travel bans, and other restrictions on the movement of goods, people, and capital (in the PRC as a whole fell to 50%–60% of normal levels but is now normalizing, after the introduction of extremely restrictive measures that – so far – no country in the West has been able/willing to mimic. However, in the absence of such restrictions, the crisis may be prolonged, and production might be hard to restart quickly). The overall impact on production may be mitigated by

the fact that in some sectors (particularly in manufacturing) production can be ramped up in later periods to compensate for lower production (providing closures do not last too long).

2. **Long-term economic effects** need to be taken into account. Covid-19 will impact health via mortality and morbidity, and through changes in (and the diversion of) healthcare expenditure.

Currency Depreciation

The expected decline of tourist inflows, remittances, and exports as a result of reduced foreign demand from Georgia's trading partners and low world oil prices have already affected the lari exchange rate (mostly through expectation channels). On the other hand, due to restrictions on air travel, the outflow of currency from Georgia



to foreign countries will be reduced (the import of tourism services will be lower), which will have a positive effect on the exchange rate. Another positive factor may be that Georgia's reliance on remittances from oil-exporting countries (like the Russian Federation) has been significantly reduced in recent years.

What Has Been Done to Address the Covid-19 Crisis?

The Government of Georgia timely started applying measures to address dramatic impacts on various market participants:

Businesses

1. Restructuring loans for businesses affected by the crisis;
2. Companies that operate in the tourism industry: hotels and restaurants, travel agencies, passenger transportation companies, site-seeing companies, arts and sports event organizers, etc., will have their property and personal income taxes deferred by the Georgian government for four months;
3. Doubling the volume of VAT refunds to companies, with the aim of supplying them with working capital;
4. Designing a state program to co-finance interest payments on bank loans by hotels with 4-50 rooms, throughout the country, for the next six months.

Workers

1. Loan payment deferrals for three months;
2. Personal income taxes deferred for employees in the tourism industry.

The Health Care System

1. No new measures are planned at this point.

The Financial System

1. Easing lending restrictions for commercial banks;
2. NBG has not cut policy rates and is unlikely to do so given the risks of inflation.

Other Measures

1. Boosting capital expenditure (CapEx) projects with the aim of providing additional economic incentives;
2. Governmental price fixing for specific products (rice, pasta, sunflower oil, flour, sugar, wheat, buckwheat, beans, milk powder and its products) by subsidizing corresponding businesses.

Will the Current Measures Be Sufficient?

Given the rapidly changing scope of the crisis, the short answer is simple – probably not. As the forecast seems pessimistic, it is the role of the fiscal stimulus and, where possible, the monetary policy to help soften the economic shock.

It is evident that the measures adopted by the government as well as private commercial banks in Georgia will not be able to directly reach a sizeable group of the population affected by the shock – i.e. those unemployed due to Covid-19; those working in the informal sector; people with low income; or households that are very reliant on remittances transfers. It is important for the government to connect with these groups quickly, not only for humanitarian reasons, but also in the



interest of a broader development agenda. In case of relatively prolonged quarantine sizable part of the population will no longer be able to support themselves and their families in coming months.

What More Can Be Done?

We broadly outline the additional monetary and fiscal policy measures that may be considered:

More Forceful Fiscal Intervention:

As previously mentioned, Georgia's systemic weakness lies in its lack of a broad social safety net infrastructure, which could help target and support afflicted groups during downturns. An unemployment benefits system, which in other countries acts as an "automatic stabilizer" and reduces and mitigates the effect of economic downturns, simply does not exist in Georgia. Yet even with an unemployment benefits system in place, the sizeable informal economy would prevent such a system from effectively easing labor market tensions. In the current situation, the government should attempt to provide cash relief for workers in the informal sector, for the low-income self-employed, and for independent contractors. These groups of workers are the most vulnerable to income flow reduction during the crisis, furthermore, they are unlikely to have access to sick leave benefits or to take advantage from cheaper bank credit.

Based on the experience of other countries, the government perhaps should consider the following measures in addition to current measures:

- Providing **low interest emergency loan/cash advances to affected adults, or direct cash payments to affected households, in particular households with the elderly and children.** These

measures are valuable as they can quickly reach afflicted groups. Unfortunately, this solution is not well-targeted and risks wasting government funds on those who are not disadvantaged.

- Simply providing "**helicopter money**", or cash transfers to households below a certain income threshold (**similar measures are being considered in the US**) may be an option, but this measure is subject to the same concerns as above. However, the advantage is that cash transfers allow households to optimize their expenditure and do not distort consumption choices.
- Another form of wide-reaching support could be state **subsidies to help support utility payments** for a limited time. These measures, equally, are not well-targeted, nevertheless there may be methods to direct them towards the households which need them the most.
- **Measures to encourage companies to not cut employment in the months following the crisis:** following the example of other countries, Georgia may support salary payments for companies, on the condition that they do not reduce employment or force workers to take unpaid leave.

Naturally, none of the proposed measures are perfect as they cannot specifically target those most affected by the crisis, yet they may act as a short-term second-best solution. As these examples show, Georgia should consider to develop a targeted social safety net system in the future. Such a system can make the country more resilient in the face of future crises and unexpected emergencies.



Monetary Policy

While other countries push for fiscal stimulus and monetary expansion, Georgia is facing uncertainties in terms of inflationary expectations. As discussed, this limits NBG's ability to stimulate the economy under the current circumstances. Annual inflation in January-February was at 6.4%, significantly higher than the 3% target. Going forward, a sharp decline in aggregate demand would reduce the pressure on inflation, while a depreciating nominal effective exchange rate will exert upward pressure. Therefore, the possibility to reduce the monetary policy rate depends on which effect will dominate in the future. In the meantime, NBG has approached the IMF to increase access to funding under its Extended Fund Facility program (NBF). Alongside the additional funds from other international donors, this will positively affect the economy, strengthen

the nominal effective exchange rate and, consequently, curb inflation.

In addition to the measures already announced, **NBG has the option of decreasing the minimum reserve requirements for deposits attracted in a foreign currency. This will stimulate FX lending and economic activity, without creating depreciation or inflationary expectations.**

Overall, the Georgian government responded very timely and efficiently to contain the virus outbreak, earning well-deserved **plaudits from the international community** and approval from the general public. However, as the scope of the crisis continues to change rapidly, additional measures might soon be needed. As the economic landscape becomes more uncertain, the government needs to ensure that emergency economic stimulus measures directly reach the people most affected by the crisis.



Disclaimer

This policy brief was first published as an ISET policy note on March 25, 2020 under the title "[The Economic Response to COVID-19: How is Georgia Handling the Challenge?](#)". This brief is an adaption of the original note and is published with the consent of the authors.

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