Research

Fiscal Effects of COVID-19 in Georgia

Economic Outlook and Indicators

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The Covid-19 pandemic is having a severe impact on economic activity worldwide. What was already a global health crisis is now evolving into a global economic crisis with dire and sweeping consequences. The nature of this particular shock is markedly different from past downturns, affecting supply, demand, and consumer confidence. The well-worn mantra 'extraordinary times require extraordinary action'[1] is pertinent today - the pandemic has heightened the need for swift and targeted government responses, and in this regard fiscal policy plays a key role. Support for those affected by the pandemic is being provided on an extraordinary scale around the globe - revenue and spending measures is estimated to amount to US$3.3 trillion globally so far[2]. Governments are deploying a wide range of 'timely, temporary, and targeted' measures including paid sick and family leave, transfers, unemployment benefits, wage subsidies, tax deferrals, and liquidity support for firms. Given their relatively strong tax-benefit systems, advanced economies are able to rely on a wide range of fiscal instruments. However, developing economies have less room in their budgets to respond to the pandemic. Indeed, the additional spending and tax cuts and deferrals necessitated by the pandemic result immediately in sizeable budget deficits and worsened public debt dynamics.

The pandemic has sharply weakened Georgia's economic growth prospects for 2020. Severe containment measures are already significantly lowering tax revenues while state expenditures increase. Extreme uncertainty is also hampering capital inflows and delaying investments, as well as weakening domestic demand. According to estimates in PMC Research Center's recent assessment in which three scenarios (optimistic, less pessimistic, and very pessimistic) were considered, Georgia's real economy is expected to shrink by **4.3%** in the optimistic scenario, and by **8%** and **12.9%** in the less pessimistic and very pessimistic scenarios, respectively.

Impact on tax revenues and expenditures

Due to the stagnation in economic activity, the budget revenues from taxes will inevitably fall. Based on the three scenarios for economic growth in 2020, PMC Research Center has estimated the magnitude of the decline by analyzing the impact on each type of tax separately[3]. As a result, PMC RC estimates a **1756 million GEL** decrease in tax revenues in optimistic scenario, a **2208 million GEL** decrease for the less pessimistic scenario and a **2843 million GEL** drop in the very pessimistic scenario.

	Optimistic	Less Pessimistic	Very Pessimistic
Expected decrease in tax revenues in 2020	**1 756 mln GEL**	**2 208 mln GEL**	**2 843 mln GEL**

In order to mitigate the health and socio-economic impacts of the shock, the Government of Georgia (GoG) has announced the Anti-Crisis Economic Plan worth 3.5 billion GEL on 24th April[4]. The fiscal relief package includes subsidies, transfers, tax deferrals, and liquidity support for firms. Our scenarios for expenditure were designed based on the aforementioned economic growth scenarios forecasted by PMC Research Center. The stimulus package proposed by the GoG, to supplement the three-month containment period, corresponds to the optimistic scenario in PMC RC's previous research[5], while the other two scenarios (less pessimistic and more pessimistic) come into play if the situations worsens and some of the package items are extended[6]. A detailed list of the items in the package that directly affect the budget, based on different scenarios, can be seen in table 1:

Table 1: Anti-Crisis Plan	Optimistic	Less Pessimistic	Very Pessimistic
Spending Measures		Million GEL	
200 GEL per month for six months for people left unemployed by COVID-19	460	460	690
One-time assistance of 300 GEL for the self-employed	75	75	75
600 GEL in assistance for socially vulnarable families	83	83	125
Subsidies for utility bills for 3 months	150	175	200
Exchange rate subsidy to maintain prices of 8 primary food products	15	20	25
Subsidy for travel agencies and guides	5	5	5
Revenue Measures			
VAT refund	350	350	350
Salary of 750 GEL will be fully exempt from income tax for six month for emploeeys with salary up to 1500	250	250	250
Liquidity Support			
Subsidising 80% of the bank loan interest expenses for six months for small hotels	60	60	60
Price insurance of construction materials	200	200	200
Credit guarantee scheme for businesses	280	280	280
Grants supporting micro and small enterprises increased from 20k to 30k GEL	30	30	30
Agrocredit for financing annual crops: full financing of loan interest	30	30	30
Healthcare investment	350	400	500
Total package	**2 338**	**2 418**	**2 820**

Based on PMC Research Center's calculations, additional expenditures arising from the anti-crisis package amount to **1738 million GEL**, while the less pessimistic scenario this figure rises to **1818 million GEL**, and in the event of the very pessimistic scenario proving true it reaches **2220 million GEL**. Revenue measures, such as income tax exemption and VAT refund were subtracted from the income tax revenue and VAT revenue of the planned budget for 2020, and neither were included in this calculation. Additionally, we expect the GoG to partially offset this temporary spending by reprioritizing current expenses (300 mln GEL). On the basis of all of these anticipated developments, which are summarized in table 2, we estimate a new budget deficit[7].

Table 2: Effects on 2020 Budget	Optimistic	Less Pessimistic	Very Pessimistic
Real GDP Growth	**-4.3%**	**-8%**	**-12.9%**
Expected decrease in tax revenues (-) in mln GEL	1 756	2 208	2 843
Expected additional expenditures (-) in mln GEL	1 738	1 818	2 220
Expected reduction of expenditures (+) in mln GEL	300	300	300
Expected Budget Deficit in mln GEL	-4 905	-5 437	-6 474
Expected Budget Deficit as a % of nominal GDP	**-9.8%**	**-11.2%**	**-14.1%**
Expected Government Debt as a % of nominal GDP	**53%**	**56.1%**	**61.4%**

If the optimistic scenario unfolds, the budget deficit is expected to be **4905 million GEL**, while in the event of the less pessimistic scenario it is expected to be **5437 million GEL**, while under the very pessimistic scenario the budget deficit is forecasted to be **6474 million GEL.** To put these numbers into perspective, the budget deficit as a % of GDP will increase from **3.1% to 9.8%** in the optimistic scenario, while in the less pessimistic and very pessimistic scenarios it will amount to **11.2%** and **14.1%**, respectively. The increased budget deficit will increase government debt as a % of GDP to **53%** in the optimistic scenario, which is a 10 percentage points increase from the initially planned **42.7%**. If the less pessimistic or very pessimistic scenarios play out, the government debt to GDP ratio will go up to **56.1%** or **61.4%**, respectively. Increased debt translates to higher taxes in the future, putting the burden of the COVID-19 crisis on future generations.

Donor assistance to budget

In order to balance the budget, the Government has to turn to donor lending. On April 14, the Prime Minister of Georgia, Giorgi Gakharia, announced the receipt of donor financing of US$1.5 billion, which is planned to be disbursed in the course of 2020. Approved and announced lending by donors so far are listed in Table 3. Out of this US$1.5 billion, it is also known that 250 million will be disbursed by the IMF to the National Bank of Georgia[14], thus not contributing to the state budget. Meanwhile, assistance to the private sector of US$1.5 billion has also been announced, of which a total of US$200 million has thus far been confirmed by various donor organizations. Despite this announcement of donor financing being made approximately a month ago, the full breakdown of the sources of this funding is not yet known. As of writing, approved budget support amounts 481 mln USD, while announced budget is 470 mln USD, totaling 951.5 mln USD.

Table 3	Support to 2020 Budget	Status
International Monetary Fund	$200 mln to be allocated to budget support[8]	Approved
European Commission	Over €183 million to support immediate and short-term needs[9]	Approved
European Commission	€150 mln macro-financial assistance[10]	Announced
World Bank	$80 mln to mitigate health and social impacts of the pandemic[11]	Approved
The US Government	$3.7 mln support to the healthcare system[12]	Approved
European Investment Bank	€200 mln contribution to healthcare infrastructure and fiscal needs[13]	Announced
Agence Française de Développement (AFD)	€70 mln support to energy sector; €50 mln for social reforms	Announced
Asian Development Bank	Details not yet disclosed	Announced

Recommendations

1. Planned budget spending should be reprioritized to provide space for COVID-19-related expenditure. The financing of emergency health and social needs is becoming more challenging, particularly considering the already high level of Georgia' debt and the inevitable increase to its budget deficit due to the pandemic. The Government should assess the resource requirements for health responses and support packages, and should identify and cut low-priority spending (current and capital) to create space and keep balance for emergency spending measures and post-crisis response. Meanwhile, the generation of additional revenue from privatization should also be considered.

2. Fiscal measures should be targeted to assist the hardest-hit households and firms. The government should ignore lobbying pressure from different sectors and businesses seeking benefit from fiscal policy package. While advanced economies can afford a broad-based stimulus, developing countries have less room in their budgets to follow suit. Accordingly, financial constraints should be taken into account when determining the extent and scope of the support instruments, while clear criteria should be designed for sectoral support. Priority should be given to sectors/sub-sectors that have been almost completely shut down during the pandemic, and will potentially suffer a steep decline in demand for some time (e.g. tourism and its sub-sectors).

3. Effective public financial management is key to safeguarding against fiscal risks and enhancing the Government's capacity to respond to the crisis. The Government should intensify the monitoring of revenues and expenditures as well as the national debt and liquidity position. Moreover, fiscal policy responses need to be adequately costed and monitored.

[1]https://www.ecb.europa.eu/home/search/coronavirus/html/index.en.html
[2]IMF Fiscal Monitor, April 2020
[3]The analysis is based on IMF paper „Challenges in Forecasting Tax Revenue", as well as taking into consideration special characteristics of Georgian tax structure
[4]http://georgiatoday.ge/news/20805/PM%3A-GEL-3.5-billion-will-be-Spent-on-Crisis-Management
[5]as a scenario with -4% growth rate is a working scenario for Georgian government, as of writing
[6]More specifically, some components of supportive measure will be sustained proportionally to the period of containment. These components include: subsidy for electricity, natural gas, and utility , subsidy on basic food products, healthcare costs and credit guarantee scheme for businesses.
[7]The budget deficit was calculated from the state budget, using the assumption that change in non-financial assets will be the same figure as initially planned
[8]https://www.imf.org/en/News/Articles/2020/05/01/pr20202-georgia-imf-execbrd-complete-6threv-eff-approves-request-support-address-covid19
[9]https://eeas.europa.eu/delegations/georgia/77393/eu-announces-%E2%82%AC183-million-support-georgia-covid-19_en
[10]https://eeas.europa.eu/delegations/georgia/78001/letter-eu-ambassador-carl-hartzell-prime-minister-giorgi-gakharia_en
[11]https://agenda.ge/en/news/2020/1336
[12]https://ge.usembassy.gov/message-from-ambassador-kelly-degnan-new-u-s-support-for-georgias-response-to-covid-19-may-8/
[13]https://agenda.ge/en/news/2020/1174
[14]https://www.imf.org/en/News/Articles/2020/05/01/pr20202-georgia-imf-execbrd-complete-6threv-eff-approves-request-support-address-covid19?cid=em-COM-123-41535

Basic Economic Indicators	2015	2016	2017	2018	2019
Nominal GDP (mln USD)	14 948.2	15 141.7	16 248.5	17 596.6	17 736.6*
GDP per Capita (USD)	4 012.6	4 062.1	4 358.5	4 722.0	4 763.5*
GDP Real Growth (%)	3%	2.9%	4.8%	4.8%	5.1%*
Inflation	4.0%	2.1%	6.0%	2.6%	4.9%
FDI (mln USD)	1 729.1	1 650.3	1 962.6	1 265.2	1 267.7*
Unemployment Rate (%)	14.1%	14.0%	13.9%	12.7%	11.6%
External Debt (mln USD)	4 314.9	4 515.7	5 177.4	5 434	5 741
Poverty Rate (relative)	20.2%	21.0%	22.3%	20.5%	-

*preliminary data