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The World Bank

# Trade and Transport Facilitation in the South Caucasus

## Georgia Policy Note

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## **Currency**

(exchange rate effective October 1, 2003)

Currency Unit = Georgian Lari

1 .0 GEL = 0.47 US\$

US\$1.0 = 2.11 GEL

## **Weights and Measures**

Metric System

## **Abbreviations and Acronyms**

AMCHAM	-	American Chamber of Commerce
ARMPRO	-	Armenian Public Private Facilitation for Trade and Transport
ASYCUDA	-	Automated System of Customs Data and Management
AZERPRO	-	Azerbaijan Public Private Committee for Trade and Transport
CCI	-	Commission for Collaboration with Investors
COWI	-	Consultancy within Engineering, Environment and Socio-economics
EBRD	-	European Bank for Reconstruction and Development
ECMT	-	European Council of Ministers of Transport
FDI	-	Foreign Direct Investment
FIAC	-	Foreign Investment Advisory Council
FIAS	-	Foreign Investment Advisory Service
FIATA	-	Federation Internationale des Associations de Transitaires et Assimiles
FSU	-	Former Soviet Union
GDP	-	Gross Domestic Product
GEOPRO	-	Georgian PRO-Committee for Trade and Transport Facilitation
GSM	-	Global System for Mobile Communication
HIPC	-	Heavily Indebted Poor Countries
IFIS	-	International Financial Institutions
MoTrade	-	Ministry of Economy, Trade and Industry
MoTC	-	Ministry of Transport and Communications
NGOs	-	Non-Government Organizations
PREGP	-	Poverty Reduction and Economic Growth Programme
PRO	-	Public Private Committee for Trade and Transport Facilitation
PSI	-	Public Services International
SDRG	-	State Department of Bridges and Roads (Georgia)
SGMS	-	Agreement on International Railway Freight Communications
SME	-	Small and Medium Enterprises
TEU	-	Twenty-Foot Equivalent Unit
TIR	-	Transport International Routier
TLA	-	Transit Leading Agency
TRACECA	-	Transport Corridor Europe, Caucasus, Central Asia
TTFSE	-	Trade and Transport Facilitation in Southeast Europe
TTFSC	-	Trade and Transport Facilitation in the South Caucasus
USAID	-	United States Agency for International Development
VAT	-	Value Added Tax
WCO	-	World Customs Organization
WTO	-	World Trade Organization

**TRADE AND TRANSPORT FACILITATION IN THE SOUTH CAUCASUS  
GEORGIA POLICY NOTE**

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## **ACKNOWLEDGMENTS**

This Policy Note explores impediments to international trade and transport in the South Caucasus, with a particular focus on Georgia. It builds on the sector analysis undertaken in the Spring of 2002 and defines a strategy and action plan, following the policy dialogue that has taken place over the past two years. Some of the activities identified at that time are now underway.

The Team included Gérald Ollivier (Team Leader), Michel Zarnowiecki (Senior Customs Specialist), Martin Humphreys (Halcrow Consultant), Gevorg Sargsyan (Operations Officer), Sergo Vashakmadze (Economist) and Judith Deane (Country Officer). We would like to thank the State Chancellery, the Ministry of Finance, the Ministry of Transport and Communications, the Customs Department, the Ministry of Economy, Trade and Industry, GEOPRO, the Georgian Business Confederation and all other Government bodies and private sector representatives for their valuable inputs. We would also like to thank the TRACECA Team for their active contributions and for the systematic sharing of their reports, on which this Policy Note builds.

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## **TRADE AND TRANSPORT FACILITATION IN THE SOUTH CAUCASUS GEORGIA – POLICY NOTE**

### **Executive Summary**

The regional framework of the CIS-7 Initiative, the Georgia Poverty Reduction and Economic Growth Program, the FIAS Study of Administrative Barriers, together with the recent World Bank Trade and Transport Facilitation sector work in the South Caucasus (TTFSC) and the Integrated Trade Diagnostic Study all emphasized the significance of transit and trade as engines of economic growth for Georgia. Trade and regional cooperation are also included in the Millennium Development Goals.

Border agencies, particularly the Georgian Customs, have made some progress in improving the milieu for traders over the past two years. A number of action plans were developed in recent years and are under implementation. Those include, without being limited to, the “Action Plan to eliminate administrative barriers to improve the business environment” (Presidential Decree N729, June 8, 2002), the Georgian Customs Development plan (2003), and the draft “State Program for Systemic Development of Transit Potential of Georgia”, referred to as “Transit Strategy” in the document.

This note, as part of the TTFSC sector work, reviews the situation in 2002, with particular respect to trade, transport and potential transit flows. It quantifies the impact of existing impediments on the total cost of available logistic services in Georgia and for other Caucasian countries, at consignment level. It reviews the legal, institutional, procedural, infrastructure and industry impediments and makes recommendations to alleviate those.

The economy of Georgia is dominated by services (56 percent) and agriculture and related business (22 percent). Within services, the transport and communications sector represents 14 percent of GDP, and is one of the rare sector to have grown 13 percent annually, on average, since 1997. Two factors contribute to explain this high figure: (i) large transport assets were developed during the Soviet times and remain in place, although with substantial maintenance needs; and (ii) traffic flows from the Caspian Sea, primarily in the form of crude oil, are rapidly expanding.

Transit generates significant budgetary resources for the Georgian government and an **estimated minimum of US\$200 million in direct economic activity for the country**, even though its impact is only moderate in terms of employment. Each ton of general cargo transit by rail generates between US\$20 and US\$55 of income to the various transport intermediaries in Georgia. Since the transport intermediaries are currently profitable, this economic activity generates employment opportunities in logistics and potentially in small processing, and cash flow to upgrade infrastructure and invest in new areas.

Among potential transit cargoes for the TRACECA Corridor, six types stand out: (i) equipment for the oil industry active in the Caspian area; (ii) humanitarian support and reconstruction material to Afghanistan; (iii) containerized consumer goods to oil exporting countries; (iv) containerized equipment required to sustain SME-led growth in the Caucasus and Central Asia; (v) cotton exports from Uzbekistan and Turkmenistan; and (vi) more oil and gas from the Caspian Sea. All six types offer significant opportunities, but also face competition from alternative corridors.

Transport costs in the Caucasus are relatively competitive when one considers only official monetary tariffs, but relatively high when taking the standpoint of a shipper and integrating all unofficial monetary expenditures and the time required. Based on interviews with transport operators in the region in 2002<sup>1</sup>, the transport of a container (TEU) by road from Baku to Bandar Abbas (2,800km/US\$1,500) was estimated to cost only slightly more than the same transport from Baku to Poti (950 km/US\$1,300), despite a distance three times higher. Transport of a container (TEU) by road from Tbilisi to Moscow was estimated to cost US\$3,500 for only 2,500 km compared to US\$1,500 for 2,800 km from Baku to Bandar Abbas. There are considerable differences in the physical and institutional contexts of these estimates which qualifies their direct comparability, but they do offer an indication of considerable variation in unit costs by corridor.

The multiple borders transporters have to cross to reach Central Asia through the Caucasus and the number of times cargoes need to be handled, with the associated legal and illegal payments and delays, explain to some extent the low volume of non-oil transit to date. The impacts of impediments to trade and transport are both direct and indirect. They increase the costs of inputs for domestic production. They limit the ability of Georgia to use its strategic location fully for shipments to the Caucasus and Central Asia and to compete with alternative corridors. The unofficial payments along the corridor also encourage smuggling and mis-declaration based on personal arrangements, creating unfair competition for firms operating within the legal framework.

The Government made progress in improving the legal framework and defining the required reforms, but operators are still faced with a wide array of impediments. The frequent rotation of Customs Directors, the disputes over the territory managed by the State, and strong interest groups have limited the effective implementation of new laws. Many established procedures, particularly as they relate to transit activities, need overhauling. The high level of smuggling calls for the implementation of integrated multi-agency solutions to ensure that regular State revenues are captured. Altogether, capturing additional transit traffic will require the implementation of the reforms and recommendations defined to date, with close monitoring by the private sector, followed by active promotion of the results achieved, as experienced by users.

The priority recommendations identified in 2002/2003 were the following: (i) strengthened dialogue and partnership with the private sector on trade and transport facilitation, using particularly GEOPRO (estimated cost US\$50k per year) and liaising with the Commission for the Collaboration with Investors (CCI) set up in December 2000 ([www.fiac.ge](http://www.fiac.ge)); (ii) definition of a priority list of investment across transport

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<sup>1</sup> Halcrow (2002), *Trade and Transport Facilitation in the South Caucasus Review of the Current Situation, Analysis of impediments, Recommended Mechanisms*.

modes to facilitate access to markets, locally and internationally (US\$150 k/TRACECA) with support from the private sector; (iii) introduction of systematic targeting, selectivity and advance processing of information supported by the computerization of border agencies, starting with the Georgian Customs, expanding the currently used software package, ASYCUDA (estimated cost : US\$0.2 million for technical assistance plus US\$2 million for hardware in the first phase); (iv) immediate measures to reduce personal interactions between Customs and users during clearance and to fight requests for unjustified additional fees (estimated cost: US\$150 k); (v) improved transit procedures and management (US\$700 k); (vi) improved transparency regarding procedures and rules for import, export and transit cargo (US\$50 k); and (vii) the harmonization of taxes and tariffs related to trade and transport with neighboring countries, after conducting a study (US\$50k). The Government of Georgia, supported by various donors, has started the implementation of these recommendations.

These priority recommendations and other recommendations listed at the end of the document (Table 5) aim at the following goals for Georgia:

- 1. Attract additional transit traffic and maximize the economic impact of transit activities, in partnership with Armenia, Azerbaijan and Central Asian countries.** To accomplish that goal: (i) develop a no-hassle, price competitive, high-quality integrated transit system through Georgia to Azerbaijan and Armenia, coordinated by one of the existing border agencies, with independent monitoring, in cooperation with the State Customs Committees in Azerbaijan and Armenia; and (ii) upgrade transport infrastructure for both local and international traffic, based on economic selection of projects, in support of the Poverty Reduction and Economic Growth Strategy. The approach should build on the draft Transit Strategy designed by the Ministry of Transport and Communications.
- 2. Reduce logistical costs to contribute to increasing competitiveness of Small and Medium Enterprises (SMEs).** To accomplish that goal: (i) emphasize facilitation of legitimate trade in the mission of border agencies by eliminating any unnecessary or duplicative requirement, completing the border agency computerization throughout the territory, and measuring performance from a user perspective, with special attention to the needs of SMEs in terms of small loads; and (ii) continue the strengthening of the transport policy formulation capacity encompassing all modes, and aiming particularly at facilitating the development of multi-modal logistic services. These activities should take place in close consultation with the private sector. The reduced logistical cost will lower the cost of intermediary inputs for SMEs, increasing their competitiveness first on the local market and progressively enabling them to export.
- 3. Fight excessive fees and eventual cases of requests for unofficial payments and smuggling to create a level-playing field for all companies in Georgia and increase revenue collection.** To accomplish that goal, define and implement a series of organizational measures, in addition to the ones directly targeted at trade facilitation and long-term development of border agencies, to directly combat unofficial payments and smuggling, as described in section C. This would include inter-alia improved transparency of requirements for all agencies, the progressive harmonization of trade and transport practices and charges with neighboring countries, reduced personal interactions between users and border officials during transactions, and the strengthening of post release checks and of existing mobile preventive and enforcement units.



## Introduction

The promotion of trade has taken an increasingly significant role within poverty alleviation strategies. Trade unleashes the value of local products by broadening market access and releasing latent demand. The first wave of trade reforms focused, primarily, on trade liberalization by reducing high tariffs and the long list of trade restriction and licensing requirements. It also facilitated access to the World Trade Organization for many transition and developing countries, including Georgia.

Trade liberalization revealed the need for second-generation reform addressing the wide variety of non-tariff trade barriers, such as improper procedures or high levels of administrative corruption and state capture, and shifted the attention to the facilitation of trade in itself. The relevance of trade aspects in the development agenda led the World Bank to launch a new Trade Department to focus on impediments limiting trade.

The overall approach of the World Bank on trade matters in Georgia includes some regional and country specific sector work, in partnership with other donors. The broad regional framework is provided under the CIS-7 Initiative<sup>2</sup>. This initiative gathers seven CIS countries<sup>3</sup>, the World Bank, the Asian Development Bank, the European Bank of Reconstruction and Development, the International Monetary Fund and bilateral donors in a collaborative international effort to enhance the economic growth and poverty reduction prospects of these CIS-7 countries. The initiative emphasizes the need for improvement in the business environment of these countries, particularly aspects affecting their trade. A first phase of the initiative includes the launch of a comprehensive Trade Diagnostic in each CIS-7 country, as recently completed in Georgia. These will be used as input into Poverty Reduction Strategies under preparation and further growth studies or economic memoranda. Additional CIS cross-country studies are planned. At a national level, CCI and the Foreign Investment Advisory Service also completed in 2002 a Study of Administrative Barriers to Investments, which led to the preparation of an action plan created by Presidential Decree on June 8, 2002. Trade and regional cooperation are also included in the Millennium Development Goals.

This policy note is part of the trade and transport facilitation in the South Caucasus (TTFSC) efforts launched by the World Bank (ECSIE Transport) in 2000, and includes two reports, the first one, in 2000, providing an audit review of the trade facilitation environment<sup>4</sup> and the second one, in 2002, providing a review of the current situation, an analysis of impediments and a number of recommended mechanisms<sup>5</sup>. A regional workshop in June 2001 in Tbilisi offered a venue to discuss the first report with a broad number of stakeholders. Close relationships have been maintained with the TRACECA<sup>6</sup> program representatives, a regional program gathering countries in Central Asia, the Caucasus, and around the Black Sea, with support from the European Union. The TRACECA program plays a significant role in removing non-tariff trade

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<sup>2</sup> <http://Inweb18.worldbank.org/eca/cis7.nsf>

<sup>3</sup> Armenia, Georgia, Azerbaijan, the Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan.

<sup>4</sup> World Bank (2000), *Trade Facilitation in the Caucasus*.

<sup>5</sup> Halcrow (2002).

<sup>6</sup> [www.traceca.org](http://www.traceca.org)

barriers in the region, based on a corridor approach, in accordance with the Baku Multilateral Agreement on International Transport signed by 12 countries in 1998.

The purpose of this note is to summarize, for stakeholders in the Government, the business community, and donors, the key findings of recent studies on transport, transit and trade facilitation and to formulate a set of short-term (less than a year) and mid-term (less than three years) recommendations to improve the trade and international transport environment in Georgia and the South Caucasus, for which Georgia is such an essential access route. It estimates the impact of existing impediments that directly affect international transport and movement of consignments in or through the country by reviewing the total cost of available logistical services in Georgia and for other Caucasian countries. It reviews the legal, institutional, procedural, infrastructure and industry impediments. It does not however cover internal transport, telecommunications or air transport, and further work will be required in these areas.

## A. Current Situation

### A-1. Overview

The physical location of Georgia on the most direct route between the Black Sea and the Caspian Sea, and Central Asian countries makes the country a key transport link and corridor for the movement of goods in the region, particularly for Azerbaijan and Armenia. This location on the “Silk Road” historically brought considerable benefits to Georgia. Georgia, in close cooperation with other countries on the Silk Road, has sought to recreate this corridor since 1993, under the umbrella of the TRACECA initiative (transport corridor Europe Caucasus, Central Asia). Georgia and its ports offer a significant access point for trade to and from the landlocked countries to the South and East. This role is strengthened, currently, by the unresolved conflict between Armenia and Azerbaijan, over the Nagorno-Karabakh region, and the resulting border closures between the two countries, and between Armenia and Turkey.

According to Schneider and Ernste<sup>7</sup>, among the states of the former Soviet Union in 1998-99, Georgia’s shadow economy was the largest at 64 percent of GDP. The estimated GDP in 2001 was US\$3.2 billion for a population of 5.4 million. From 1991 to 2001, the share of services in the economy has grown from an estimated 34 to 56 percent, while industry fell from 37 to 22 percent and agriculture from 29 to 22 percent. Private consumption share of GDP increased from 67 percent to 88 percent over the period. Georgia can be classified as a heavily indebted poor country (HIPC).

**Agribusiness.** Georgia’s agricultural sector traditionally accounts for almost half of employment. Agricultural production in Georgia has recovered significantly from its decline following independence when there was a move away from traditional to cereal crops. Several multilateral and bilateral agencies are involved in projects to assist agricultural development in Georgia. For example, the World Bank is providing credits for up to US\$30 million for new technology, training and irrigation. Within the food and agricultural products category, wine, hazelnuts, mineral water and tea are among major exports of Georgia. Wine exports have had a nine-fold increase from US\$4 million in 1995 to US\$36 million in 2002. About

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<sup>7</sup> International Monetary Fund (2002), *The Growth of the Underground Economy*.

three quarters of Georgia's wine exports are to Russia, although Georgia has begun to export small volumes to a number of other countries as well.<sup>8</sup> Hazelnuts are also being established as a new export product, primarily to Turkey, with exports reaching US\$22 million in 2000.<sup>9</sup> Exports of mineral water had the highest share of total exports in 1997 (US\$17.6 million) but lost more than \$10 million by the end of 1998 due to the crisis in Russia. Since 2000, the value of exports of mineral water has been rising and by 2002 had increased to above US\$17 million, or about 5 percent of total exports. Investment is needed to help develop cultivation of pre-independence volumes for export especially to the newly independent state countries.

**Transit Services.** Transit generates significant budgetary resources for the Georgian government and an **estimated minimum of US\$200 million<sup>10</sup> in direct economic activity for the country**, even though its impact is only moderate in terms of employment. Each ton of general cargo transit by rail generates between US\$20 and US\$55 of income to the various transport intermediaries in Georgia. Since the transport intermediaries are currently profitable, this economic activity generates employment opportunities in logistics and potentially in small processing, and cash flow to upgrade infrastructure and invest in new areas.

The present corridor includes roads, railways, pipeline infrastructure, ports and shipping routes, but further investment in physical infrastructure and, more importantly, in institutional capacity is needed to ensure that the potential of the location is realized. At the moment, the main flow on the corridor is unidirectional, consisting primarily of oil and gas products, moving west to the Ports of Poti, Batumi and Supsa from Azerbaijan and Kazakhstan (see A-3 Transport).

**Conflicts.** The various conflicts that have affected Georgia since independence have also weakened the control of its borders, particularly in those areas close to the autonomous region of Adjara in western Georgia, to the breakaway territories of Abkhazia and South Ossetia, and the Pankisi Gorge. This contributes to a significant smuggling problem and tax evasion, particularly with respect to oil products and excise goods.

**Poverty Alleviation.** The issue of poverty reduction and economic development is one of the most important objectives of the Government of Georgia. With active participation of and support from the civil society, non-governmental organizations and the international community, the Government of Georgia elaborated the long-term Economic Development and Poverty Reduction Program of Georgia (EDPRP). The Program was discussed and approved at the Governmental meeting in June 2003. In November and December 2003 the EDPRP was respectively discussed and supported by the IMF and World Bank Boards of Directors.

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<sup>8</sup> Ukraine is the second largest market for Georgian wine (10 percent) followed by the US (3 percent).

<sup>9</sup> A special government commission has been established by presidential decree to support and coordinate hazelnut production in Georgia.

<sup>10</sup> Bank's conservative estimate of the minimum direct economic activity generated by transit, considering all transport intermediaries and border agencies involved in transit. The estimate is based on the logistical costs of transport through the Georgian segment multiplied by the volume of cargo transiting through the country.

The main goal of the Program is to foster economic development of the country, to ensure that all layers of the society benefit from the results of the economic growth, and to take care of the socially vulnerable population.

The nature of poverty in Georgia<sup>11</sup> suggests that economic growth based on agriculture, industry, trade and transport, will be central to poverty alleviation. SMEs are expected to be a primary driver of this growth, as they are in many other successful transition economies<sup>12</sup>, but will only be able to do so if equal conditions and opportunities for all companies are in place. This type of environment calls for a concerted program to address smuggling and corruption in particular, via the strengthening of public governance. The Program also underlines the need to accompany growth by improved revenue mobilization and redistribution by the Government. This would reduce the impact of frequent external shocks reflecting present exposure to volatile export markets (Turkey and Russia) and to an economy overly reliant on the agricultural sector, which is subject to the vicissitudes of the weather<sup>13</sup>.

## A-2. Trade Situation

All three South Caucasus countries are highly dependent on trade with total trade value representing the equivalent of about 55 percent of GDP for Georgia in 2000, 56 percent for Armenia and 64 percent for Azerbaijan. These figures should be considered with caution, however, since there is considerable uncertainty over official statistics<sup>14</sup> due to serious under-reporting of imports, high levels of smuggling and the large unofficial economy. It is likely, for example, that restricted exports of some goods such as wood have not led to a disappearance of this trade, but rather to a transfer of some of it to unofficial trade. In 2000, Georgia imported US\$1 billion and exported US\$0.6 billion, based on IMF figures. Together activities in trade, transport and communications generated 27 percent of the Georgian GDP in 2000.

In 2001, the dominant exports were scrap metals (10 percent), wine (10 percent), aluminum waste and scrap (6 percent), ferro-alloy (6 percent) and mineral waters (5 percent). The bulk of these products are low value-added and have high freight cost ratios as shown in the Table 1 below. As such their competitiveness and access to foreign markets are seriously impacted by high logistic costs. Export of scrap metals to Turkey and Russia, a major part of exports since 1999, is subject to restrictions. It provides limited long-term opportunities, but offers a temporary way to survive by selling existing assets. Georgia's main export partners include Russia (23 percent), Turkey (22 percent) and Azerbaijan (3 percent). About 87 percent of wine exports were destined to Russia, Ukraine and Kazakhstan. CIS countries and Turkey combined absorbed 68 percent of Georgian exports, while exports to EU countries represented only 18 percent of the total. Exports to Germany dropped sharply in 2001 compared to 2000, from 10 percent of exports to 2 percent following the global economic downturn, showing that the high level of competition faced by Georgian product.

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<sup>11</sup> See “Poverty Reduction and Economic Growth Program of Georgia”.

<sup>12</sup> World Bank (2001) “Transition: the First Ten Years- Analysis and Lessons for Eastern Europe and the former Soviet Union”.

<sup>13</sup> Droughts in 1998 and 2000 had a significant impact on increasing poverty.

<sup>14</sup> Trade volume estimate varies between US\$1.0 billion (official statistics) and US\$1.6 billion (IMF) for Georgia in 2000.

In 2001, the dominant imports were gas and oil products (20 percent), medicine (6 percent), machinery (6 percent), sugar (4 percent), cigars and cigarettes (4 percent). Most of these imports are for consumption purposes, showing the dependence of Georgia on foreign import, in particular for energy. Georgia's main import partners were its close neighbors Turkey (15 percent), Russia (13 percent), Azerbaijan (10 percent), together with Germany (10 percent).

Georgia has a liberal trade regime with an IMF ranking of 2 on the 1-10 Trade Restrictiveness Index scale. The country was admitted to the WTO in June 2000. The weighted average applied tariff rate to imports is around 12 percent in agriculture and 10 percent in industry. Imported goods are also subject to a 20 percent VAT. Excise taxes apply to alcoholic drinks, petrol for cars, cigarettes, tires, caviar and jewelry. A customs service fee of 0.15 percent applies to all trade transactions (minimum of 50 Lari; maximum of 2000 Lari). Six free trade agreements are in force with Russia, Armenia, Azerbaijan, Ukraine, Turkmenistan and Kazakhstan, but have failed to date to increase trade volumes. Georgia also has a bilateral trade agreement with Turkey. In April 1999, Georgia became member of the Council of Europe and established the progressive integration into EU models and standards as a primary target.

**Table 1- Indicative Transport Costs compared to Total Consignment Costs for various Commodities**

Commodity	Transport costs as a percentage of total costs
Luxury passenger cars (Armenia)	4
Alcoholic beverages (Armenia)	17
Seafood (Armenia)	34
Spring water (Armenia)	52
Fruit preserves and jellies	16
Computer equipment (intra region)	20
Computer equipment (Georgia)	10
Vegetable paste (Armenia)	29
Hi-tech equipment (Armenia)	2
Medicines (Region)	2
Wooden tile (Armenia)	22
Baby food (Georgia)	20

*Source: Halcrow (2002)*

### A-3. Transport Situation

Transport and communications accounted for 14 percent of GDP in 2001, making it a major economic sector. This sector has registered a steady annual growth of 13 percent on average since 1997. This reflects to a large extent the sharp increase in oil transit from the Caspian Sea. Out of 13 million tons transported by the Georgian railways in 2001, about 75 percent was transit related. Transit dominates international transport for Georgia with more than 10 million tons of transit goods compared to about 2.6 million tons<sup>15</sup>

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<sup>15</sup> Export 1.2 million tons; imports 1.4 million tons.

of import and export. According to the TRACECA database<sup>16</sup>, in 2000, 30 percent of exports were sent by road, with the remainder moving by rail; import transport was equally distributed between the rail and road mode.

**Transit.** The TRACECA Corridor has not yet succeeded in capturing potential transit traffic from Central Asia and the Caucasus except for oil. The multiple borders that transporters have to cross to reach Central Asia through the Caucasus and the number of times cargoes need to be handled, together with the associated legal and illegal payments and delays, explain to some extent the TRACECA challenge compared to alternative routes. Furthermore, shipping costs<sup>17</sup> across the Caspian Sea are high by international standards<sup>18</sup> and create in themselves an additional barrier. As an example the shipping freight rate of a TEU container between Baku and Turkmenbashi costs US\$400 for 305 km, compared to US\$925 from Rotterdam to Poti for 6,000 km. At present, Georgia's transit comparative advantage is primarily limited to close markets such as Azerbaijan and Armenia. Nonetheless about 30 percent of Caspian oil uses the TRACECA Corridor instead of its Russian pipeline alternatives. Currently, metals are the only other significant cargo transiting through the region.

**Ports.** The two major ports of Georgia, in Poti and Batumi, handled<sup>19</sup> respectively 3.4 and 8.4 million tons in 2001. These ports are the main external gateway for Armenia and Azerbaijan. The port of Poti can service almost all types of general, bulk, and liquid cargo. The construction of an oil terminal by a UK-based investor in partnership with EBRD will expand the facilities in Poti. Up to 90 percent of traffic through Batumi is crude oil and oil products from Azerbaijan and Kazakhstan. A recent comparison of tariffs<sup>20</sup> for non-oil commodities in the ports of Poti and Batumi with regional and international benchmarks indicates that overall tariffs are reasonably in line with international tariffs<sup>21</sup>. Nonetheless volumes of containerized cargo coming through ports in the region are low, in international terms, at 50,000 TEUs a year<sup>22</sup>, and are primarily destined for the Caucasus. The overall port capacity is not fully utilized, but in some specific segments, such as containerized cargo, capacity and handling speed are too limited in both ports to offer good services. Additional competition within the ports would be instrumental in further improving their efficiency. The port of Batumi can accommodate the two main types of rail gauge and allow the shift from one type to the other, a useful feature for ferries carrying wagons.

**Pipeline.** Over 70 percent of pipeline oil exports from Azerbaijan are routed through the Baku-Supsa pipeline (5 million tons in 2001) going across Georgia, with the remainder transported by the Baku-Novorossisk Russian-state controlled pipeline. The present capacity is sufficient for present oil flows when combined with rail, but an expansion in flows is foreseen, based on new developments on the Caspian Sea. The capacity of the Baku-Supsa pipeline is increasing rapidly (from 110,000 b/d in 2001 to a projected 165,000 b/d in 2003). While the pipeline through Russia could be expanded, higher transit fees, quality

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<sup>16</sup> See detailed Table in Halcrow (2002).

<sup>17</sup> UScts2.3 to 2.6/ton-km for bulk and dry bulk and UScts 7-11/ton-km for a TEU container.

<sup>18</sup> An estimated Uscts1.5/ton-km to Uscts2.5 for a TEU container.

<sup>19</sup> With on average four vessels and two vessels a day.

<sup>20</sup> "TRACECA: Unified Policy on Transit Fees and Tariffs – Monthly report June 2002".

<sup>21</sup> The handling and port dues in Poti-Batumi for a twenty-foot container cost about \$74, against a typical average international tariff of \$110.

<sup>22</sup> 2002 figure provided by TRACECA in private communication dated October 2003

issues related to oil blending, and frequent closures have made this option less attractive. The Azerbaijan International Operating Company (AIOC) exported all of its oil through the Baku-Supsa pipeline. The construction of a major export pipeline, the Baku-Tbilisi-Ceyhan pipeline through Georgia and Turkey, has recently started. Upon completion, it will enable a bypassing of the congested Bosphorus Straits and will offer a highly competitive mode for the transit of crude oil from the Caspian Sea.

**Rail.** Rail transport dominates the transport of freight in Georgia, with the exception of the oil transported to Supsa by pipeline. After dropping by 90 percent between 1989 and 1994, rail transport increased 300 percent to 4 billion tons/km in 2000 (ECMT). Georgia's fully electrified railway network covers 2,554 kilometers of track, of which 1268km is single track and 297km is double track<sup>23</sup>. The main route runs across the country, starting from Baku in Azerbaijan, via Tbilisi to Samtredia and then on to the Batumi and Poti ports, as well as into Russia via Sukhumi. A new line is planned between Tbilisi and northern Turkey, but the engineering obstacles, the low subsequent line speeds and the concomitant cost, are likely to undermine the viability of this route. While the Georgian Railway has managed to improve significantly over the past seven years and generate a profit, users voiced the need for further restructuring to enhance the commercial orientation of this key player in transit. The construction of the Baku-Tbilisi-Ceyhan pipeline could have an impact the cargo mix transported by the railways, forcing the latter to seek new markets.

**Road.** Georgia's roads consist of international motorways (1,474 kilometers), state highways (3,326 kilometers), and local roads (15,429 kilometers). The poor condition of much of the network in Georgia, caused by a lack of financing and maintenance, represents a significant barrier to investment and growth. Roads in Georgia often lack shoulder markings and centerlines, increasing the risk of accidents. Georgia spent on average only US\$625 per kilometer in 1999, compared to US\$4,000 per kilometer in the Baltic countries. It is estimated that in 2002, the maintenance budget was 30 percent below the 1999 level. According to Georgian MoTC, 80 percent of road maintenance, 100 percent of road construction and 90 percent of the road transport industry are privatized. Fees on freight and passenger transport are set by the carrier without any Governmental intervention.

**Telecommunications.** Telecommunications is one of the fastest growing sectors of the Georgian economy. Between 1997 and 2001, US\$170 million, mostly from foreign sources, has been invested into this sector. Service provided to customers is fairly advanced. Today Georgia has a relatively high level of telephone density with 25 fixed lines per 100 people in urban areas and 10 lines per 100 people in rural areas. Poor line quality and frequent line disconnection over fixed lines have promoted the development of four major cellular telephone systems, which provide better service, but at a much higher cost. By the end of 2000 there were 76,500 mobile phone users in Georgia, representing 12 per cent of the population. In addition, TRACECA have funded, in an investment worth Euro 15 million, the installation of a fibre-optic link along the main rail network in the region.

**Air Transport.** In 2001 Georgia had 35 international air routes with 14 countries. The annual volume of air cargo is low at 2,300 tons in 1999. Tbilisi airport has been rehabilitated with EBRD financing with a

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<sup>23</sup> Private communication from the Ministry of Transport and Communications dated October 2003

focus on passenger handling capacity. There are smaller airports at Kutaisi, Batumi, Poti and Senaki all near Black Sea Ports. Both airport passengers and airfreight volumes declined in recent years. Air cargo transport capacity has not been expanded, even at major airports.

#### A-4. Prospects

**Potential exports.** Though agricultural exports have dropped considerably since 1990, Georgia has the potential to become a net exporter of some relatively high value products such as wine, nuts, tea, mineral water, spices, citrus and fruit juice. This would require external investments to increase quality and volumes, rebuild suitable irrigation infrastructure, obtain access to credit, and upgrade the overall logistic processing services available locally to access both local and international markets. For agricultural exports, even modest savings in the time, quality and cost associated with consignment movements, could lead to a significant increase in demand in the target markets.

**Transit.** Among potential transit cargoes for the TRACECA Corridor, six types stand out: (i) equipment for the oil industry active in the Caspian area; (ii) humanitarian support and reconstruction material to Afghanistan; (iii) containerized consumer goods to oil exporting countries starting with Azerbaijan; (iv) containerized equipment required to sustain SME-led growth in Azerbaijan and Armenia; (v) cotton exports from Uzbekistan and Turkmenistan; and (vi) more oil and gas from the Caspian Sea. All six types offer significant opportunities as described in Box 1 but also face significant competition from five alternative corridors mentioned in the draft Transit Strategy prepared by the Ministry of Transport and Communications: Trans-Siberian, Northern corridor of the Trans-Asian railway, TRACECA corridor, maritime corridor from China to Europe, and the North-South Corridor (India, Iran, Russia).

The TRACECA country governments worked closely in recent months to improve their ability to deliver the large quantity of humanitarian aid to Afghanistan on a competitive basis. The outcome of this collective effort will be a credibility test for the expansion of transit via the Caucasus and a potential starting point to systematically improve the corridor.

Designed at a time of much higher traffic, Georgian transport infrastructure can handle significant additional traffic with limited new investment, in particular in the rail sector, although rail, road and port infrastructure requires significant periodic maintenance. Most of the rail network operates at a speed of 60km/hour for freight, although technical limitations exist both on the section to Armenia and in the mountainous segments of the East-West corridor. The road sector has suffered from substantial delays in maintenance and requires further investments to satisfy sometimes even minimum quality requirements, in particular between Georgia and Armenia (being upgraded under a World Bank project). Traffic levels, at main road border crossing points are low; typically below 30 trucks a day toward Armenia and about 80 trucks a day toward Azerbaijan.

Very low traffic volumes, if oil is excluded, tend to demonstrate, however, that Georgia has not yet succeeded in turning its geographic location into a comparative advantage. Transit and transport in the region are seriously impacted by a series of institutional, administrative and physical impediments hindering

the development of the corridor and of the region<sup>24</sup>. The TRACECA country governments worked closely in recent months to improve their ability to offer competitive services to deliver the large quantity of humanitarian aid to Afghanistan. The outcome of this collective effort will be a credibility test for the expansion of transit via the Caucasus and a potential starting point to systematically improve the corridor.

Georgia adheres to a number of major conventions related to transit including the International Convention on the Harmonization of Frontier Control of Goods (Geneva 1982) and the Convention on Transit Trade of Land-Locked States (New York July 1965), indicating its willingness to stimulate trade. Georgia also signed the Baku Multilateral Agreement in 1997 laying the basis for regional cooperation on the TRACECA corridor.

## B. Broad Impact of Impediments

One of the most prominent impediments to the integration of the Caucasus into the international trading community is the total logistical cost of consignment movements into, out of, and through Georgia. The total logistical cost of moving a generic consignment includes what can be termed the pure transport costs for both the domestic and international legs of a consignment movement, the official and unofficial facilitation costs, again by journey stage, the costs of accessing the requisite information, and those additional transport costs that are engendered by diseconomies of scale due to low volumes of international trade or the small size of the domestic market.

This section, based on a survey of forwarders in the three South Caucasus countries (Halcrow 2002), provides an overview of these logistical costs in the region in the Spring of 2002. The significance of the national and regional elements of the total logistical cost, despite their modest part in the total logistics chain, is high (Table 2). In particular, for a generic containerized consignment from Northern Europe to Tbilisi, the Georgian leg of the movement on the road mode accounts for nearly 46 percent of the total costs, with the leg between Poti and Northern Europe accounting for the remaining 54 percent. The unofficial fees, based on interviews, vary quite markedly between 7 and 40 percent of the total costs on the road mode and 6 and 35 percent using the rail mode, with the most significant element being the unofficial payment to Customs at clearance. Box 2 provides a broad description of illegal charges as they arise.

Transport costs in the Caucasus are relatively competitive when one considers only official monetary tariffs, but relatively high when taking the standpoint of a shipper and integrating all unofficial monetary expenditures and the time required. Transport of a container (TEU) by road from Baku to Bandar Abbas (2,800km/US\$1,500) costs only slightly more than the same transport from Baku to Poti (950 km/US\$1,300), despite a distance three times higher. Transport of a container (TEU) by road from Poti to Yerevan costs US\$1,545 for only 650 km compared to US\$1,700 for 2,800 km from Yerevan to Bandar Abbas. There are considerable differences in the physical and institutional contexts of these estimates which qualifies their direct comparability, but they do offer an indication of significant variation in unit costs by corridor.

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## **Box 1- Potential Transit Cargo and Alternative Corridors**

### **West-East Transit**

**Oil equipment.** Large increases (estimated at more than 10 billion dollars over the next five years) in oil-related investment on the Caspian Sea will lead to the transport of large volumes of equipment. The odd shape of oil equipment makes it more suited for transport through the Volga-Don canal, as shown by present traffic. Nonetheless the canal suffers from serious limitations and in particular limitations on vessel size, icy conditions during winter months, high transit fees, special permit requirements issued by Russia in each case, and lack of shipping service competition. The economic impact of capturing part of this transit would be very large, but require the entire chain of transport operators to demonstrate its ability to deliver complex shipments on time, in good condition and with minimal hassle by border agencies. Foreign investors are considering a partnership with the Azerbaijani railway to transport such equipment.

**Humanitarian Aid and Reconstruction Support to Afghanistan.** TRACECA countries agreed during their Tashkent meeting (April 2002) to facilitate transit of humanitarian goods and reconstruction material to Afghanistan. This approach has been closely concerted with major forwarding companies to offer an attractive solution, cost-wise and quality-wise. Results of these efforts will become available in the near future. While the associated transport volume may not be very large or sustainable in the long term, attracting this type of cargo will demonstrate the capacity of the TRACECA countries to act within the framework of a common strategy.

**Containerized Consumer Goods.** The impact of oil exports is likely to result in a significant increase in demand for consumer goods, in particular in Azerbaijan and Kazakhstan. Russia currently dominates the market to Central Asia using low tariffs for its railway services (Riga-Almaty-US\$1100/TEU container for 5000 km). Time sensitive goods also tend to be transported by road from Turkey and through Iran. The Azerbaijan market provides, however, reasonable potential if the quality of the logistic chain through Georgia is improved. The interest of Azerbaijan in becoming a regional consolidation center for the region would also lead to the emergence of additional flows.

**Machinery and Equipment for Azerbaijani/Armenian/Central Asian SMEs.** A major economic priority for Azerbaijan and Kazakhstan is to diversify their source of revenues by stimulating the emergence of SMEs and restructuring their production. As a direct consequence, these countries are likely to increasingly import machinery and equipment for their emerging industry as well as for the modernization of their agro-processing capacity. Expensive and sensitive pieces of equipment will be required in that regard, calling for high quality integrated transport services and consolidation of shipments. The same SME focus applies for Armenia and most of Central Asia.

### **East-West Transit**

**Cotton export.** Cotton transit through the Caucasus has failed to materialize. The historic route via Russia and the port of Riga (Latvia) has progressively been replaced by a new route using the highly competitive ports of Bandar Abbas (Iran) and Dubai (UAE) from where extremely low shipping rates can be obtained. This traffic exceeds one million tons. With the impediments linked to crossing the Caspian Sea and the less competitive shipping services from Black Sea ports, it is unlikely that Georgia will attract this transit activity.

**Oil and Gas (LPG) Export.** For the foreseeable future, oil and gas transit export are likely to accelerate and generate additional transit revenues for Georgia. The existing transit capacity (Russian Druzhba and Tengiz-Novorossiysk pipeline and gas pipeline, Baku-Supsa pipeline, rail) will not provide sufficient capacity when new oil fields are developed until the Baku-Tbilisi-Ceyhan pipeline is built. As such, oil transit is expected to remain a major contributor to the Georgian economy in the short-term especially given the need for oil exporters to maintain competition in oil transit alternatives to avoid being held hostage to large variations in transport tariffs on one route. LPG transport from Kazakhstan through the Caucasus provides the shortest potential route.

Source: Survey, Halcrow (2002), TRACECA (2002)

A review of estimated money and time expenditures for a range of other origins and destinations for one TEU, using the road mode, containing general effects delivered to the ‘door’, underlines the high costs related to the Caucasus. The summary table indicates greater cost for journeys of comparable length, with the cost of moving a container from Yerevan or Tbilisi to Moscow costing twice a journey of comparable length between Yerevan or Tbilisi and Bandar Abbas. A broader assessment taking into account the value of time for high value cargo and low value cargo highlights the significance of time requirements when assessing transit services through Georgia (Halcrow 2002). (see Table 3 for more figures).

**Table 2- Estimated Logistical cost for one TEU<sup>25</sup> from N. Europe to Tbilisi, by road/rail, via Poti (2002 prices)**

Expenditures	Road			Rail		
	Money (US \$)		Time Hours	Money (US \$)		Time Hours
	Official	Unofficial		Official	Unofficial	
<b>Transport &amp; handling</b>						
Terminal to final destination	50		2	50		2
Handling charges, final terminal	50		3-4	50		3-4
Handling charges, Poti port	75	10-20	24-48	75	10-20	24-48
Georgian transport leg	450 <sup>27</sup>	20-60	24-48	375	5	12
Ocean leg <sup>26</sup>	925		480	925		480
Georgian Traffic police		10-30				
<b>Cross border processing</b>						
Georgian Customs inspection		30-50			30 – 50	
<b>Clearance procedures - Georgia</b>						
Terminal fees	27		1	27		1
Declaration completion	12	50-250	1	12	50 – 250	1
Valuation			1			1
Inspection			2-3			2-3
<b>Total logistical cost</b>	1589	120-410	543-594	1514	95-325	526-552

Source: Freight forwarder survey, Halcrow (2002)

<sup>25</sup> Estimate assumes container holds general effects, the quote is one way and a Georgian plated truck is used.

<sup>26</sup> Assuming 20 days from Poti to Rotterdam, this can be reduced by a higher fee and excludes port handling charges in Poti.

<sup>27</sup> Including the costs of the VVT and the convoy service

**Table 3- Time and money expenditures to move one TEU between specified origin and destination**

Origin	Destination	Distance	Road		Rail	
			Kms	US\$	Hours	US\$
Poti	Tbilisi	350	450	24-48	375	12
	Yerevan	650	1545	48-72	885	24
	Baku	950	1700	48-72	875	24-48
Baku	Moscow	2500	2300	120	1100	288
	Bandar Abbas	2800	1500	168	-	-
	Poti	950	1300	48-72	875	24-48
	Tbilisi	600	970	24-48	-	-
Tbilisi	Moscow	2500	3500	120	1500	360
	Bandar Abbas	3300	1800	192	-	-
	Poti	350	450	12	375	
	Yerevan	300	660	24	-	
	Baku	600	970	24-48	-	
Yerevan	Moscow	3000	3800 <sup>28</sup>	140	2100	480
	Bandar Abbas	2800	1700	200	-	-
	Poti	650	1000	48-72	885	24-48
	Tbilisi	300	660	24	-	-

*Source: Freight forwarder survey, Halcrow (2002)*

In addition an independent performance measurement<sup>29</sup> revealed that operators experienced delays of about one day at the port of Poti, resulting from organizational issues and the non-availability of Customs services at the time of arrival. Processing at border crossing points (Sadakhlo and Red Bridge) took about one hour during the measurement periods; although, waiting time before the processing starts are frequently experienced. Clearance at Lilo terminal required about 10 hours, although pure processing took a little under 4 hours. These performances show room for improvement compared to Southeast Europe<sup>30</sup>, especially when put in perspective by considering the very low level of traffic experienced in Georgia. The transit time is significantly increased by the mandatory convoy system, which commonly leads to days of delays.

<sup>28</sup> This figure assumes a Georgian plated truck is used, so excludes the cost of the “02” service.

<sup>29</sup> “Report on Performance Measurement in the South Caucasus” (September 2002)

<sup>30</sup> Border crossing in about 30minutes and clearance in about 1-3 hours on average at major sites.

## **Box 2- The official and unofficial costs of importing to Georgia: the user's perspective**

The content of this box builds on a mix of surveys and interviews carried out in the Spring 2002. While perceptions of users are always somewhat biased, investors and companies select the countries they do business with based on their perceptions of the environment. Implementation of reform, improved transparency, public-private interactions and marketing are necessary tools to help change those perceptions.

**AT THE PORT** - The chain of activities at Poti port starts, after the ship has docked, with the Customs Broker receiving a statement from the shipping agent to allow the consignment to cross the border. This document needs to be approved by Customs, and the agent, who is usually dealing with multiple statements at any one time, needs to queue, with all the necessary documentation, to receive the official approval. This process can take 4-6 hours, but 'favored clients', who pay an unofficial payment in advance, may go to the front of the queue. **The unofficial rate was estimated at US\$ 5 per statement.**

After approval, the Customs Broker can return to the Line Arrangement and collect the container; the terminal service issues the CMR, to allow the carriage of the container, which is officially free, but may require a small 'gratuity' of US\$ 5-10. The Customs Broker returns to Customs with the CMR, and the latter will then provide the internal transit document (VVT). The official fee for this is GEL 10 per document. This requires stamping by the Operating Department, the Finance Department and the VVT Department.

The Customs Broker will issue a Customs Declaration for Transit, which is completed and printed by the Broker, as an official cost of US\$45 for a road movement, and US\$90 for a rail movement. **There is an occasional unofficial charge of US\$11.** Either a Customs Broker, or Customs itself, then has to issue a special license, Customs Carrier Documentation in two hard copies, one of which goes to the regional customs house in Poti, and the other goes with the Driver. At this point, the truck is authorized to leave the port in one of two daily slots; 4pm or 7pm in a convoy of not more than 30 trucks, but in reality the last condition is frequently breached. **The unofficial charge to avoid the convoy system was estimated at US\$ 50.**

The Customs convoy takes a hard copy of the VVT from the driver, and stays with the convoy until the first checkpoint, when it departs and makes its own way to Tbilisi. The convoy continues, getting stopped at all intermediate checkpoints, **frequently making unofficial payments of US\$ 5-10 to the traffic police**, prior to being forced to spend the night at Agara, 80 kilometers west of Tbilisi. It arrives at Lilo Terminal, the following day, and frequently has to wait for arrival of the VVT.

**AT LILO Terminal** – The customer usually arrives at the terminal at the same time as the truck, and the consignee, or a Customs Broker undertakes the procedures. The declaration is made, with an official fee of US\$9-14, **and occasional unofficial fees in the range of US\$ 50-250.** The consignment is valued and the consignment is inspected. After inspection, the Customer is authorized to pay the relevant taxes and duties, and obtains the requisite stamps, and the consignment is cleared and can be taken away. There is an official fee of GEL 60 to the terminal. About 90 percent of consignments are cleared the day of arrival.

*Source: Survey and interviews; Halcrow (2002)*

## C. Trade and Transport Issues and Recommendations

A survey of international transporters<sup>31</sup> in Georgia, carried out as part of the TTFSC work, led to a delineation of the main issues<sup>32</sup> and impediments in Georgia causing the excess cost described in the previous section. Georgia is affected by some remaining weaknesses in its legal system, the relatively weak administrative capacity of its border agencies to implement procedures designed nationally and related requests for unofficial payments, the lack of equipment, procedures designed with limited consideration for their user impact and applied with large discretion, infrastructure in need of maintenance and new investments, and a recent private transport industry in need of training and support. This is confirmed by parallel studies (see Box 3). The overall environment, such as the lack of State power on part of the territory, contributes to these issues by introducing opportunities for smuggling. This section is centered on Customs reflecting the outcome of the surveys.

### **Box 3- Transparency International: “Promoting Transparency at Regional Customs”**

The Center for Regional Development (Armenia) and the Association of Young Economist (Georgia) surveyed 167 companies in a regional effort, under the umbrella of Transparency International and in partnership with the Eurasia Foundation. About 32 percent of business entities had a negative image of Georgian Customs. Overall behavior, excessive paperwork, clearance of perishable goods, classification and determination of the value of goods, effectiveness of the appeal system, information accessibility were all rated above 2.75 on a scale of 4 (4 being very problematic), scores that were in most cases worse than the ones obtained by the Armenian Customs. The 43 companies involved in manufacturing and commerce stated that they paid an average of US\$560 for crossing the Georgian border crossing point and an average of US\$1,950 to cross Armenian points. In Georgia, clearance was reported to cost an unofficial US\$62 and required 13 hours (versus US\$152 and 49 hours in Armenia). The primary goal of these payments was to accelerate the process (94 percent) and to avoid high official payments (16 percent).

From the user perspective, other agencies such as the traffic police in Georgia do play a major role in hindering transit (as witnessed during a recent Bank mission). Companies suggested as major solutions to the existing problems: improvement in the legal basis (84 percent), simplification of procedures (79 percent), increasing the technical capacity (32 percent), and increasing salaries and human resources management (>30 percent).

The Customs management has produced a development strategy based on recommendations from the IMF, the World Bank, TACIS, the US Customs, and other international organizations. This Strategy is accompanied by an implementation plan with clearly specified target dates. The main priorities identified under this plan are as follows: (i) definition of the Customs territory; (ii) finalization of the organizational structure; (iii) improvement of the information system; (iv) improved human resource management; (v) continuous involvement of the society in the definition of solutions; (vi) improved revenue collection and protection of the economic borders; and (vii) combating corruption. The Georgian Customs will be supported by external consultants (TACIS) in the refinement of its strategy and management of the implementation plan.

<sup>31</sup> About 30 forwarding companies and 10 drivers.

<sup>32</sup> A detailed description of procedures themselves is available in the Halcrow and the FIAS reports.

The Commission for the Collaboration (CCI) with Investors jointly with the World Bank Foreign Investment Advisory Service (FIAS) has carried out a special study in order to reveal the administrative barriers impeding entrepreneur activity in Georgia. The findings and recommendations of this study have been reflected in the Action Plan approved by the Decree of President of Georgia N729 of June 8, 2002. The Action Plan is intended to remove administrative barriers for improvement of business environment and includes particularly the following aspects: (i) publish normative acts related to Customs procedures and ensure its availability; (ii) simplify customs clearance procedures, in line with EU requirements; (iii) reconsider valuation rules and align them to GATT requirements; (iv) broaden the use of the automated system of Customs data (ASYCUDA); (v) improving the system of collecting processing and disseminating information; (vi) use risk assessment in Customs procedures; (vii) set up a Customs valuation database; and (viii) initiate proceedings against unlawful conduct of Customs/Tax officials.

Currently CCI in close collaboration with FIAS is monitoring the implementation of the Action Plan and is working on preparation of updated report on administrative barriers, to be done in 2004.

### **C-1. Legal Framework: Issues and Recommendations**

The legal framework related to trade has improved significantly over the past four years, bringing Georgia closer to international standard<sup>33</sup>, in part due to the efforts of the Georgian forwarders' association. The legal framework now includes a Customs Code, and its implementing regulations, a Law on Tariff and Duties, a Law on Customs Fees and a series of Regulations related to Customs Brokerage, Customs Carriers, as well as a Code of Conduct for Civil Servants. A law on Free Trade Zones is under preparation. A TACIS/EUROCUSTOMS assignment (US\$850 k) has recently completed the harmonization of the Georgian Customs legislation to EU standards.

A number of further improvements in the legal framework are, however, warranted. The present Customs Code (1998) focuses on road transport and limits the Customs power for shipments arriving through ports and airports. Customs did not have access until recently, for example, to areas of unloading in port areas or to incoming airplanes, which allowed for un-monitored movements of goods in and out of the ports and airports. This prevented an adequate supervision of transit flows. This issue is being addressed, following a recent Presidential Decree. The draft Transit Strategy highlights in details the various decrees that require amendments.

Georgia signed a number of important conventions related to transport and trade facilitation, but has had difficulty integrating those in its legal and regulatory framework and applying them in practice. The recent membership in the Council of Europe and in the WTO will push for further upgrading of the legal and regulatory framework taking into account the Kyoto Convention<sup>34</sup> on the simplification and harmonization of Customs procedures. The significant volume of dangerous goods transiting through the country also calls for Georgia to become party to the ADR Convention on the International Carriage of Dangerous Goods by Road.

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<sup>33</sup> A number of changes suggested in the earlier Trade Facilitation Report (COWI 2000) have been implemented. The legal basis for the freight forwarding industry has been established.

<sup>34</sup> <http://www.unece.org/trade/kyoto/ky-01-e0.htm>

The consistent application of new rules and regulations throughout the territory, even in non-computerized areas, represents another major challenge. Rules and regulations are rapidly evolving, and the training needs are significant. The absence of an official publication with all applicable laws, rules and procedures, in Russian and English, in addition to the existing ones in Georgian, generates opportunities for discretionary decisions and requests for petty payment. The Customs administration published a set of Customs Regulations of Georgia and intends to supplement it through its website ([www.customs.ge](http://www.customs.ge)). This problem was exacerbated until recently by the lack of comprehensive consultation and training of users. From the user side, the freight forwarder's association, in partnership with the Eurasia foundation, has recently developed a compendium related to trade and transit. Keeping it up to date and sufficiently reliable to oppose discretionary decisions will prove challenging and require a public-private partnership.

The asymmetry between information provision and information required, primarily from the public sector organizations, is a major impediment for many firms in Georgia, with significant direct cost implications in some cases (Halcrow 2002). While the problem is not generally applicable across all sectors and sizes of firms, SMEs appear to suffer disproportionately from the impediment of asymmetric information. The primary difficulties relate to the customs procedures, taxes, new laws and decrees etc.

#### ***Short-term recommendations***

- Allow changes in the legal and regulatory framework to be introduced only at a pre-defined period, or periods of the year, preferably once or twice a year, after a series of training and seminars in Georgian, Russian and English for own staff and users. This would supplement the existing publication of legal and regulatory amendments on a periodical basis and in electronic information databases. Use distance-learning tools to facilitate the delivery of this training (estimated cost: US\$300 k).
- **Provide transparently all border agency requirements to users.** It is recommended that all governmental entities involved in the movement of consignments systematically cooperate at national and regional levels (with Armenia and Azerbaijan) to provide, in a uniform and user-friendly format, all official requirements related to trade and transport in their respective countries, using both a website and a booklet (see Box 4). The website launched by Armenia ([www.ttfsc.org](http://www.ttfsc.org)) could provide a suitable starting point to present jointly information. Particular attention should be paid to transit, with the issuance of a separate booklet covering all transit and corridor aspects (estimated cost: US\$150 k).

#### **Box 4. Instruments to disseminate laws, rules, and procedures from the various border agencies**

The main recommended mechanism is a website, that would provide all requirements related to the movement of a consignment, in particular, through border crossing points and clearance terminals, as well as in transit. This would include, in particular, the applicable laws such as Customs and tax codes, regulations, documents, procedures, logistic information such as opening hours, frequent mistakes leading to delays and frequently asked questions. A full outline of the potential structure of the website, together with information requirements is provided in Halcrow 2002 (Appendix IV). An example of a similar mechanism in Southeast Europe is available at [www.ttfse.org](http://www.ttfse.org).

This type of website requires active cooperation and coordination across border agencies to present the user (trader, transporter, forwarder) with a single information window including all the requirements to fulfill. The website technology would then enable automatic notification of a registered user when a change takes place, reducing the level of frustration and confusion usually connected with fast changing environment. In itself, this type of website represents both a challenge and opportunity: A challenge to interact among historically segregated agencies, and an opportunity to enhance transparency, realize that there is duplication of efforts in several areas and provide enhanced services to users. AZERPRO, ARMPRO and GEOPRO (see Box 5), or their respective members (Freight Forwarders' Associations, road transport associations) could play an essential role in setting up such a structure. The website should be supplemented by the publication of booklets and CD-Rom, to be made available to the trading community online and at point of use. A specific booklet on transit to and though Georgia would be warranted.

- Conduct **independent spot audits** on the application of the legal and regulatory framework at border crossing points and clearance facilities, inclusive of aspects implied by international convention to which Georgia adhered (Estimated cost: US\$50 k).
- Address existing deficiencies in the legal framework to ensure a sound distribution of responsibilities among border agencies (being addressed with EUROCUSTOMS).
- **Harmonize the taxes related to trade and transport** with neighboring countries, to raise sufficient revenue based on road user charges to maintain the road network, and design a plan to fight smuggling of oil in the country, including chemical tracers, in cooperation with the private sector. This should build on the TRACECA Project on Unified Policy on Transit Fees and Tariffs and the AMCHAM working group (Estimated cost US\$50 k).
- **Align railway tariffs with regional partners.** This activity, to a large extent covered under the TRACECA Project on Unified Policy on Transit Fees and Tariffs, would be essential to facilitate transit in the region. It would be part of the corporate restructuring of the Georgian railways.

### **Box 5- Trade and Transport Facilitation Committee -GEOPRO**

Three committees for trade and transport facilitation (GEOPRO, AZERPRO and ARMPRO) have been created over recent months in the three Caucasian countries. These committees benefit from a membership drawn from the trading and transport community, from the public sector organizations involved in trade and transport and from TRACECA (National Secretary). Their overall objective is to improve the dialogue between the different bodies involved in trade and international transport, define solutions to remove impediments to consignment movements at an operational level, support the implementation of these solutions, and hence achieve significant reductions in the costs of clearance, transit or border crossing. This continuous process of monitoring and feedback, supported by *ad hoc* working groups, maintains the focus on improved services.

*See: Halcrow (2002) and ARMPRO Annual report ([www.ttfc.org](http://www.ttfc.org))*

## **C-2. Administrative Capacity: Issues and Recommendations**

The responsibility for Customs operations in Georgia is, presently, delineated between several agencies (Customs Department, Special Legion, Border Guards), which hinder any objective assessment of the efficacy, or cost effectiveness, of the Customs Department itself. The Customs Department has a staff of 1350, and reports to the Ministry of Revenue (which is also responsible for inland revenue and excise, and includes an Inspectorate General and the 350-strong Special Legion), and which has recently merged with the Ministry of Finance. Customs no longer have law enforcement or investigative powers, and officials within the Department consider it to be, essentially, a statistical agency. The Special Legion has responsibility for all anti-smuggling activities, including enforcement and investigation, although the creation of a Financial Police is being considered. The Ministry of Finance is reviewing alternative options to strengthen the organizational setup and started restructuring Customs management during the summer 2002. This description reflects the situation and responsibilities at the time of writing this report, but the institutional set up is experiencing rapid changes.

**Performance.** The national performance indicators, contained in Table 1, illustrate that on some of the measures, the performance of Georgian Customs service is comparable to the standards pertaining to Southeast Europe, particularly, with respect to the ratios between revenue, cost, staffing, and salaries. However, if the costs of the other agencies, involved in Customs activities, are taken into account, the apparent cost-effectiveness of the Customs Department is reduced significantly. The ratio between staff and declarations processed is a basic productivity indicator. For 2001, it represents 45 in Georgia, one sixth of the average Southeast Europe (SEE) figure. It does not affect general cost-effectiveness, as average staff costs are low (about US\$ 91 per month), and each Customs officer only costs 1.2 percent of what he collects for the Treasury, but the overall processing cost per declaration is significantly higher than in Southeast Europe (61\$ versus 28\$). It does indicate potential efficiency gain through further computerization, and rationalization of tasks.

**Table 4- Customs Productivity figures in the South Caucasus compared with Southeast Europe**

	<b>Georgia</b>	<b>Armenia</b>	<b>Azerbaijan</b>	<b>Southeast Europe</b>		
				<b>Average</b>	<b>Minimum</b>	<b>Maximum</b>
Total Customs revenue (US\$)	131,280,147	150,437,780	179,700,000			
Total Customs cost (US\$)	3,836,600	1,598,611	4,100,000			
Total Customs staff	1,387	800	1,590			
Total Customs Salary Costs (US\$)	1,522,800	926,337	1,400,000			
Annual number of declarations	62,436	31,697	69,716			
Value of recorded imports (Million US\$)	761	684	1,434			
Value of recorded exports (Million US\$)	320	264	2,318			
Trade volume (Million US\$)	1,081	948	3,752			
				<b>Southeast Europe</b>		
Revenue collected/Customs staff	94,650	188,047	113,019	<b>308,668</b>	85,597	745,548
Total Customs cost/Revenue collected	2.9 percent	1.1 percent	2.3 percent	<b>1.5 percent</b>	1.2 percent	5.8 percent
Salaries/Revenue collected	1.2 percent	0.6 percent	0.8 percent	<b>0.9 percent</b>	0.5 percent	2.6 percent
Trade volume/Staff (US\$ millions)	0.78	1.2	2.4	<b>2.8</b>	1.1	7.2
Declarations/Staff	45	40	44	<b>250</b>	80	422
Cost per declaration	61	50	59	<b>28</b>	11	49
Average monthly staff cost	91	81	73	<b>362</b>	194	757

Source: National Customs Administrations and World Bank calculations<sup>35</sup>

**Impediments to reform.** The Georgian Customs Administration has suffered from significant management instability with a total of eight Chairmen of Customs in four years, with the latest change in the summer of 2003. This frequent rotation of senior management, and the associated impact on middle management, has had corrosive effect on the proposed attempts to improve its services, often leaving development plans and technical specialists inactive, until the members of the new management team have familiarized themselves with their individual roles and responsibilities. A significant number of technical reports produced by foreign consultants (Crown Agents, Intelligent Transportation Systems, US Customs) with (similar) technical recommendations to modernize and strengthen the Customs administration have been developed over the past five years. A Customs Reform Committee, established under Presidential Order 1325, defined a comprehensive strategy in 2001, but there has been little follow-up and implementation of these recommendations by Customs. A new strategy was recently presented to donors and IFIs and includes a timed action plan. The CCI also defined a number of critical reforms to be implemented, but management stability is a basic requirement for any reform plan to be effectively implemented.

The service is also lacking professionalism, with the staff dressed in casual clothes, despite the assistance of the US government in donating US\$ 300,000 worth of uniforms, which are still in a warehouse. In addition, the operational staff is reported to often behave in manner incompatible with their office, further enhancing the unprofessional image. This is despite extensive assistance in the area of training from the United Kingdom and Austrian Governments. The new Customs management has announced a series of measure to address this, through the establishment of a clearer hierarchy, the mandatory use of uniform,

<sup>35</sup> The table displays the basic productivity ratios, as used by the countries of Southeast Europe for establishing regional comparisons. The performance of Customs is comparable to SEE countries in terms of salaries compared to revenue collected. It is above SEE standards in terms of cost compared to revenue.

reduced hours in shifts, the use of systematic competence testing, and the implementation of staff rotation. All these measures are positive in principle.

The information system used for Customs operations (on the basis of the ASYCUDA++ software) is being extended to the overall territory with the support of USAID, with an expected completion by the end of 2003. This rollout will increase the consistency in the application of procedures across the different locations and will enable the progressive introduction of advance processing based on selectivity criteria.

**Corruption.** The overall environment in Georgia, as perceived by users, makes a significant contribution to the problem of administrative corruption as shown in the survey mentioned above and in the recent FIAS report<sup>36</sup>. This was supported by the qualitative evidence collected during the course of the facilitation survey, with widespread reports of demands for unofficial payments from numerous public sector bodies, including Customs, Traffic Police, Utility Companies and the Tax Authorities. Users felt the absolute level of administrative corruption was not necessarily the highest, regionally, but was very erratic. Unofficial payments result both in smuggling and revenue evasion, which lead to lower State revenue collection. AMCHAM estimated that close to 350,000 tons of gasoline in transit by rail disappeared in Georgia (a revenue loss of US\$66 million) and that only 30 percent of diesel was legally imported.

Staff costs in Customs, on average US\$91 per month<sup>37</sup>, are insufficient to allow a family to live reasonably well. Furthermore there is a high level of staff turnover. As such, border officials, who are given direct access to tangible wealth, are faced with a high degree of temptation that is in line with their survival needs. The same applies to other border agencies and the traffic police. Since the procedures change rapidly and communication with traders or transporters is still limited, the opportunities to create real or undue obstacles are substantial.

Furthermore several studies show that the perception by the population of State capture is high in Georgia<sup>38</sup>, providing even less incentive for integrity. The insufficient mid- to long- term career prospects are not conducive to a real commitment of employees to values such as customer service or efficient service. This issue represents a significant impediment for the economic development of a country. Recent studies have shown that corruption hinders investment (both domestic and foreign), reduces growth, distorts the size and composition of government expenditures, and reduces the efficacy of foreign aid. It acts as a highly regressive tax, and thus a particular impediment to growth, on small and medium sized enterprises.

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<sup>36</sup> In the WB Administrative and Regulatory Cost Survey, average informal payment was reportedly: US\$470 for clearance; US\$375 for storage at the Customs terminal; US\$110 for insurance; and US\$360 for various stoppages on Georgian territory.

<sup>37</sup> A lifestyle survey undertaken by GORBI in 2000, revealed that more than 63.6 percent of the sampled population reported that their monthly household income was less than US\$50, with a remaining 19.6 percent reporting that their income fell within the range of US\$50 –100. The Customs staff cost of US\$91 includes social charges.

<sup>38</sup> Cited in The World Bank, (2000) “Anticorruption in Transition – A contribution to the policy debate”, Washington DC

The Government launched in 2000 a number of anti-corruption measures and created and Anti-Corruption Coordination Council including NGOs in 2001. This has been followed by two Presidential Decrees in 2001, however progress as monitored by those NGOs has been disappointing in most areas. The PREGP notes that the “creation of effective and uncorrupted state administration is one of the most important conditions for the success of reform. Public employees should be highly qualified and well compensated.”

**Interactions with the Private Sector.** The border agencies in Georgia have made progress in interacting with the private sector and in informing companies about procedures and requirements; although, further focus on implementation follow up is warranted. A systematic dialogue across agencies and across private stakeholders as represented by NGOs (freight forwarders, road transport companies...) was launched in the spring 2002 as part of this effort, through the creation of a public-private committee on trade and transport facilitation, GEOPRO (Box 5). After a year of interactions, GEOPRO was formally established by the Ministry of Finance, Ministry of Economy, Trade and Industry, by the Ministry of Transport and Communications and by the Georgian Business Confederation in May 2003. The creation of GEOPRO was followed up by a letter sent to the various donors and international financial institutions indicating that GEOPRO would take a coordination role on trade and transport facilitation matters. GEOPRO cooperates with the Commission responsible for collaboration with investors.

#### *Short-term recommendations*

- **Implementation of the Customs Development Strategy.** The 2003 Customs Development Strategy and the action plan created by the CCI offer a good initial basis to make progress in trade and transport facilitation. It would need to be supplemented by a series of measures to strengthen an integrated border management, and the development of new procedures as described in section C-3. The establishment of a reform committee with private sector/GEOPRO representation would ensure that the strategy focuses on new procedures in addition to new instruments (equipment, facilities, better staff...) (estimated cost US\$500 k).
- Create an incentive for border agency management to modernize their administrations by defining the strategic framework that should be adhered to and by avoiding the unfounded firing of management; this could be introduced as an amendment in the Customs legislation.
- **Definition of a comprehensive solution for the integrated management of transit.** As highlighted in the Transit Strategy, the definition of a comprehensive solution for the integrated management of transit will be required to capture more traffic. While details of such a solution, adapted to Georgian realities, demand a specific study and analysis, the guiding principles of such a solution would be as follows. Integrated management of transit should include a single interface with users. This would entail the delegation of responsibilities for transit among border agencies to one of the existing border agencies, which would become the transit-leading agency. Other border agencies would have the right to intervene only under the control of the leading agency, in the spirit of integrated border management. Users should be encouraged to transfer information about incoming transit cargo in advance. This would be supplemented by a cross border information exchange with neighboring countries. The leading public agency should process any advance information ahead of the arrival of a vehicle/carrier based on risk management and selectivity

principles. The few shipments requiring additional review would have been pre-identified by the system, enabling agency staff to focus on those only. The performance of the leading agency would be monitored by a group of public and private sector representatives, potentially through GEOPRO. The leading agency, with the support of GEOPRO, would also have the responsibility to make proposals to systematically simplify procedures, documents and requirements related to transit through Georgia, and ensure compliance with international conventions Georgia adhered to. The study, building on the Transit Strategy, would review various institutional alternatives and define the related legal, operational, technological, and human requirements associated with each alternative as well as the related costs (estimated cost: US\$200 k).

The creation of interfacing services hosted in the Customs Services has also been suggested in Azerbaijan and in Armenia to ensure a good coordination from the port of unloading to the final destination.

- **Systematically measure service quality.** The Transit Leading Agency (TLA) would measure systematically the transit time performance from arrival at the border to exit. It would regularly consult with the shippers to define acceptable transit targets, declining over time. The TLA would issue explanatory notes each time a consignment exceeds this target and share it with the shipper, the transport company and the border agency concerned. The TLA would identify the reason(s) for delay and the responsible parties. On a regular basis, to be determined, the TLA would prepare a report reviewing the overall transit performance, identifying systemic issues, and making recommendations for improvement. The TLA would present this report to the Cabinet of Ministers and to GEOPRO, and issue it on the internet, once approved. A specific incentive scheme, based on performance indicators could be built into the system. This could be combined with the proposed GSM-based tracking system proposed under TRACECA and its **hotline initiative** (Estimated cost: US\$200 k).
- **Definition of an integrated computer system for transit and border management.** The TLA would build on the existing ASYCUDA application in place and expand it to include a transit module, in cooperation with all the border agencies. The system design would include the extension of the local area networks and wide area telecommunication networks to cover the full territory of Georgia, and to enable information exchange with the Armenian and Azerbaijani counterparts. It would also improve the quality of statistics available by providing a single system for all parties involved and introduce tracking systems for transit cargo such as the UNCTAD Advance Cargo Information System (ACIS). (estimated cost: US\$90 k combined with the preparation of technical specifications building on the new Customs information system).
- **Strengthen the Public-Private Dialogue and cooperation using the GEOPRO Committee.** The need for strong and systematic public-private dialogue comes out clearly from the impediments identified above. Implementation of reforms requires continuous pressure and strategic focus, which the private sector can bring. It also reflects the experience under a similar

initiative in Southeast Europe (TTFSE<sup>39</sup>). It is recommended that governmental entities, donors/IFIs and NGOs systematically use or cooperate with the trade and transport facilitation committee, GEOPRO, to: (i) conduct the trade and transport facilitation dialogue; (ii) consult business representatives prior to introducing new laws and regulations; and (iii) deliver programs of technical assistance affecting the trade and transport environment. The PRO-Committee will require, in particular, direct support to formulate concrete proposals, generate momentum and follow up on the implementation of proposals (estimated cost: US\$150 k over three years).

#### ***Mid-term recommendations***

- Implement the integrated transit management solution, performance measurement and transit information system (estimated cost: to be estimated based on the selected alternative).
- Increase the compensation package of border agency staff by restructuring the incentive and bonus system based on performance appraisal and on improved border agency efficiency (self-financing with efficiency gains offsetting additional payments).

#### **Box 6- Public-Private Partnership – FIAC, CCI**

On March 30, 1997, according to presidential decree #87, Foreign Investment Advisory Council was created under the supervision of the President of Georgia, intended to assist development of the private sector and improve investment environment in the country; to coordinate donors and donor funding projects' monitor those projects and ensure transparency and accounting of foreign aid inflow in Georgia.

FIAC operates through its Secretariat, which is responsible for fulfillment of responsibilities be the FIAC. The Secretariat of FIAC works in three main directions: (i) Prepares the Council's meetings and ensure their smooth procession; (ii) Cooperates with donors and donor funded projects; (iii) Assists private sector.

To fulfill the obligations related to the private sector according to the presidential decree #1324, a special commission – Commission for the Collaboration with Investors (CCI) under the FIAC was created in the year 2000.

By tight cooperation of CCI and FIAS of the World Bank, it became possible to contemplate administrative barriers to investment. Based on the results of this study recommendations were drafted and an Action Plan was complied, that was approved by the presidential decree #729, June 8, 2002. CCI conducts permanent monitoring of implementation of the Action Plan, appraises its fulfillment and prepares relevant recommendations.

#### **C-3. Procedures: Issues and Recommendations**

The present system suffers from: (i) a duplication of efforts across border agencies and of documentary requirements (e.g. transit form and TIR Carnet); (ii) discretionary application of procedures with related unforeseeable delays; (iii) organizational weaknesses; (iv) insufficiently trained officials leading to mistakes in processing documents; and (v) lack of objective selective processing at locations not connected to the Customs management system. The high staff rotation makes training on applicable procedures very

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<sup>39</sup> see <http://www.seerecon.org/RegionalInitiatives/TTFSE/> for details

challenging. Mistakes in processing documents happen rather frequently<sup>40</sup>. In the particular case of international documents, this may lead to a re-issuance of documents, a costly and time-consuming process.

An on-going TRACECA program is reviewing the requirements in terms of simplification and harmonization of the control of goods and vehicles at the border.

**Unloading and processing in Ports.** At the port of Poti, the main issues seem to be (i) procedural (goods are examined before even having been declared, which somehow limits the detection of irregularities and the object of the inspection); (ii) organizational (there is no clear distinction between different regimes); (ii) bureaucratic (importers must produce with each declaration: the passport of the consignee, a copy of the contract, a standards certificate, phyto-sanitary and veterinary certificates as appropriate, the bill of lading, an invoice, an import license, and the preliminary shipping document), and (iv) administrative (importers must go to Tbilisi to obtain several of the required documents, or must report to different services in the port, then have to go to Customs<sup>41</sup> to pay, then go back again to the services to obtain the adequate documents). All these translate into additional expenses to transporters.

The unloading of ships can only start after a boarding commission, consisting of Customs, border guards, phyto-sanitary authorities, and the ministries of health and agriculture, have approved the ship. This process takes on average two hours. As the port area was not considered a Customs zone until recently, the Customs authorities had little possibility to check the actual unloading of goods or vehicles, or the illicit removal of goods from the port area, and therefore felt compelled to re-process fully each shipment upon their exit of the port to prevent smuggling. A Presidential Decree authorizing the presence of Customs in ports and airports removes this issue.

The processing by Customs of incoming shipments and vehicles requires between one and two days on average<sup>42</sup>, with very few trucks being able to leave the port on their day of arrival. Customs usually focuses on outgoing vehicles during the day of vessel arrival and only start the processing of incoming vehicles late in the day. Shipments subject to phyto-sanitary controls regularly face additional delays.

An additional cause for bottlenecks is the multiplicity of administrations and agencies involved in the clearance of goods. As many as 20 agencies are mentioned (including the transport police, state security, prosecutor, anti-corruption units...), but they seldom exchange any information unless there is a court decision.

Cargo entering Georgia through the Port of Batumi is hindered by the unclear definition of revenue collection responsibilities between the Georgian Customs and the authorities in Adjara. Shippers face occasionally difficulties since both have claims regarding the payments of duties and taxes.

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<sup>40</sup> Typically misplaced stamps, improperly filled fields.

<sup>41</sup> Customs is inconveniently located outside the port area, although new facilities in the port have recently been offered.

<sup>42</sup> The performance measurement survey provides an average stay of 23 hours.

**Processing at land borders.** The characteristic of land border processing is that every vehicle is inspected by a multiplicity of agencies, not always readily identifiable. Controls are frequently duplicated by the various agencies, regardless of their official responsibilities. The processing of a truck takes between one and two hours, although the lodging of a compulsory declaration for all trucks entering the country (at a cost of GEL100, or approximately US\$45) and the preparation of an inland transit document, or VVT, for all trucks would normally take longer.

One particular problem for drivers of all nationalities transporting liquor is that they must leave their trucks at the border to go to Tbilisi to obtain the necessary permits. The border guards, however, play a useful role in matching all road merchandise certificates (CMRs) with Customs documentation, thus ensuring at least minimal control over reporting procedures. The 24-hour shift system is inefficient, because no Customs officer can concentrate on the work for that period of time.

The large volume of either unofficial or “suitcase” traffic, covering up to 30 percent of traffic with all neighboring countries, according to Customs, make the formal application of procedures difficult. Every day several thousand people commute across the border between Georgia and Armenia to trade at the Sadakhlo-Bagratashen duty free market. A similar market is under operation at the Red Bridge border crossing between Georgia and Azerbaijan, and cross border trade is also very active at the border crossing point between Turkey and Georgia (Sarpi).

Under current arrangements, these markets are often supplied by villagers, but there is also evidence<sup>43</sup> of trucks unloading their goods in these markets, which are then imported to the neighboring countries in small quantities, using cars and small trucks, and avoiding payment of duties and taxes. These markets are not subject to any serious form of fiscal or Customs control. Exit from the market into the main customs territory is only subject to a cursory review of identity, with little concern for the enforcement of the legally provided restrictions (maximum amount and periodicity of purchase). This traffic is largely unreported in official statistics and creates unfair competition in the region. It offers a large potential for fraud, smuggling and requests for unofficial payments. These markets play, however, an important role in providing supplies and job opportunities to the poorer segments of the population.

**Transit procedures.** The transit procedures currently in place appear in contravention with the 1975 TIR Convention and related system<sup>44</sup>. The Customs requires transit cargo transported by trucks under a TIR carnet to be accompanied by an internal transit form, the so-called “VIT”, as well as a Customs declaration for each cargo consignee. In some cases, up to three transit documents are thus required for each CMR, at a cost of GEL 25 (approximately US\$ 11) per transit form, although the CMR are manifested on the TIR carnet. This unnecessary requirement goes against the TIR approach of avoiding impediments or

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<sup>43</sup> In particular the discrepancies in traffic exiting Azerbaijan and entering Georgia.

<sup>44</sup> The TIR Carnet system is an international road transport transit system. It is based on the recognition of inspections made at the initiation of a trip in a TIR signatory country, following which the door is sealed by the originating Customs administration. With this system trucks do not need further inspection while in transit. A pool of guarantee offers a revenue safeguard for the transit countries in case the vehicle unload its cargo before reaching its final destination. Opening a truck under TIR carnet and seal goes against the overall approach of the system.

duplication of documents. The internal transit system particularly impacts SMEs, which trade in less-than-truck-load quantities.

In addition, seals from other countries are frequently not recognized, so excisable goods, as well as other types of goods, are escorted in convoys by Customs officials from Poti. The use of mandatory convoying for trucks transiting from Poti through Georgia imposes significant delays in road transportation that are counted in days. Drivers have to wait for the convoys, organized by Customs that depart twice a day. The Customs officers take the hard copy of the internal transit form from each truck and travel with the convoy up to the first road checkpoint. When they leave, they take the transit document with them and making their way separately to the inland terminal, often arriving after the truck the next day. The convoy is usually held overnight in Agara, about 80 kilometers to the west of Tbilisi. Anecdotal reports indicate the need for occasional facilitation payment (US\$0-50) to avoid the convoy service. Numerous informal checkpoints, manned by the traffic police (including immediately outside the port area) duplicate the verification of documents, to ensure that no truck is allowed to go astray.

Since Georgia has not yet been accepted in the Green Card system, transporters are presently required to purchase additional insurance for the purpose of crossing the Georgian territory. The World Bank Administrative and Regulatory Cost Survey (2001) indicated that informal payment was associated with this step. An application by Georgia is under review by the Council of Bureaux, managing the Green Card system to include Georgia in the system.

Similarly the SMGS waybill, which accompanies goods transported by rail, is considered insufficient by the Georgian Customs, who require a special transit form and Customs declaration even for transit purposes. Discussions are on going to remove this requirement.

**Clearance procedure.** The clearance procedures vary considerably between that followed at the Lilo Terminal and that at other sites. The Lilo terminal, close to Tbilisi and accounting for 50 percent of clearances, was, in the Spring of 2002, the only location where a comprehensive Customs management system (ASYCUDA++) had been implemented. Processes have been streamlined in line with the computerization, although direct trader input into the system has been limited to a few brokers. Others need to use the service of registered brokers. There are frequent direct interactions and negotiations between Customs officers and users. At other terminals, the Customs does not have the support of a computerized management system and does not apply formal selectivity procedures, leaving the selection of shipments to inspect to the discretion of officers, with little reporting on findings. The indirect powers of Headquarters on Regional Offices also precludes the establishment of a consistent approach.

A number of practices also hinder facilitation or appear conducive to personal negotiations. Importers are required to clear shipments at the Customs office that has jurisdiction over the area where the physical or legal activity is located. This practice occasionally imposes costly additional transport for operators. On the other hand, the Customs offers clearance on importer's premises, a valuable facilitation instrument in some cases, but also an opening to side arrangements in an environment where non-compliance is common.

With the end of Pre Shipment Inspection (PSI), the Customs will need to build its capacity to apply valuation procedures in accordance with WTO requirements. The PSI company provided this type of data until April 2002, but the non-renewal of its contract, means that the small existing valuation unit will require to be extended and to receive appropriate training in this core Customs function.

**Mobile Preventive and Enforcement Unit.** The progressive move toward selective controls and facilitation of legitimate trade needs to be combined with efforts to prevent smuggling with strongly deterrent penalties for offenders. In addition to the computerized system and the post release controls mentioned above, the strengthening of existing mobile units under the Special Legion with authority to control vehicles and goods on the full territory will be needed to create a virtual net to catch suspicious vehicles on the basis of intelligence and to act as a deterrent for smugglers.

#### ***Short-term Recommendations***

- **Introduce needed procedural changes to facilitate trade.** (estimated cost: US\$700 k) Simple changes can have a large impact on trade facilitation, as demonstrated by the experience in Southeast Europe. Training should support these changes and regular independent audit should verify their application. Changes impacting users directly should take place at well-specified points in time, after proper training. The ongoing TRACECA consulting assignment to simplify and harmonize the control of goods at border crossing points in the region offers a good instrument to support these changes. Among needed procedural changes, the following would have a significant impact on the situation in Georgia:
  - Use the TIR Carnets and SGMS waybill for goods in transit as the only documentary requirement for transit.
  - Allow the transit of trucks transporting non-excise goods without escort using the TRACECA Hotline and GSM tracking system to improve prevention and allow truck travel at any time, at the truckers' own risk.
  - Ensure that the opening hours of all border agencies are aligned with traffic flows and consistent within each border station and across the border.
  - Enable transporters to obtain all necessary permits in their country of origin, prior to arriving at the border, or at the border, especially in the case of neighboring countries.
  - Designate a single payment window (cashier/electronic transfer) for payments of duties and fees for all border agencies.
  - Introduce an advance declaration system to allow for pre-clearance of goods. The system would allow advanced processing of information and selection of the degree of examination required for a given declaration in advance of the arrival of the goods at a clearance terminal. Pre-cleared declarations would be immediately released without further inspection (apart from selective post-entry inspection).
  - Traders' entitlement to clear imported goods at different clearance facilities in the country, based on their business needs, with proper management control.
  - Introduce selective control rules even in locations with a low level of automation.
  - Simplified procedures for consolidated shipment, typically used by SMEs.

- Harmonize control mechanism and procedures for vehicles, cargo and passengers across the three Caucasus countries and by extension to Central Asia. Procedure should be as simple as possible taking into account the administrative capacity of the agencies involved. This is being addressed with the support of TRACECA.
- **Introduce needed procedural changes to fight request for unofficial fees and illegitimate trade.** These new procedures, not necessarily visible from the users perspective, would make smuggling or petty corruption more risky, breaking the collegial relationship between some users and some border officials. It would include several of the measures recommended under the Customs Development Strategy. Interactions between private parties and civil servants should be limited as much as possible during transactions, with submission of the documents without direct interactions with the officer in charge of processing. Assignment allocation should be made at random among processing staff, with the identity of assigned staff unknown to the trader, while maintaining the same procedure. The control chain could be increased to split internally<sup>45</sup> the verification of a transaction between different segments of the Customs Administration, with independent random audits. Sanctions for both the corruptor and the corrupted should be immediate and clearly displayed at border agency locations, with enforcement. (estimated cost: US\$ 150 k)
- **Define measures to strengthen mobile preventive and enforcement units and post-release controls.** While the Special Legion does have the authority to control vehicles and goods over the full territory, the overall effectiveness of these controls and controls of other border agencies remains very limited judging by the high level of smuggling taking place and the overall perception that the wrong users are targeted. This study would review the present situation and make recommendations adapted to the Georgian context to reinforce the effectiveness of these mobile preventive and enforcement units. It would also include the definition of adapted post-release controls procedures to supplement the trade facilitation efforts and selective processing (estimated cost: US\$60 k)

#### ***Mid-term Recommendations***

- **Computerization for various border agencies.** The Customs information system, based on ASYCUDA, is being upgraded and expanded nationwide (network, application, hardware), with the support of USAID. The platform put in place for Customs will need to be extended to other border agencies to allow for consolidated controls (also referred to a single window processing). The system would integrate the data necessary for processing by the various border agencies and integrate tools required for interactions with the transport sector. Computerization allows for a better capture of information (advance declaration/direct trader input), followed by systematic processing based on well established rules to define which shipment to inspect (selectivity), automated payments, and goods reporting on the results to improve progressively the previous steps. It enables the border agencies to focus on risky shipments while acting promptly on

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<sup>45</sup> But this should not be perceptible from the user point of view.

legitimate trade. The use of post release audit and mobile enforcement units create safeguards in the system. A specific project would be warranted to further the computerization process, supported by the necessary infrastructure (estimated cost: US\$200 k for software upgrade and US\$2 million for hardware and networking).

- **Build up the classification and valuation capacity of Customs.** These functions are an essential part of Customs operations and are no longer supported by on-going Pre-shipment Inspections. As a WTO member, Georgia needs to align its procedures and strengthen its valuation capacity supported by post release audits. (estimated cost: US\$300,000)
- **Improve coordination locally: Pilot Sites and performance measurement.** Georgia has already started implementing the concept of integrated border crossing management at border crossing points both formally and informally. Further efforts in that regard would be warranted to offer a fully integrated system aiming at minimizing the impact on the legitimate end-user. It would require active cooperation to avoid a duplication of efforts among agencies, the creation of a Single Window, covering both document processing and payment for all border agencies using a common payment center (cashier/electronic transfer). This approach provides an incentive to build strong synergies among border agencies and to introduce a concept of integrated management of border crossing points, based on the essential tasks to be accomplished instead of being based on the need to define mandates for various institutions.

It is recommended that Georgia establish at the main border crossing points and clearance facilities, teams of selected representatives of governmental entities involved in the processing of vehicle and consignments. These teams would be given the mandate to monitor the implementation of approved action plans as experienced from user perspective. The Pilot Site teams would also make further recommendations to the national authorities to simplify procedures in order to both increase revenue collections and facilitate transport. External expert support would provide guidance to those teams and would support the measurement of processing performance. (estimated cost: US\$120 k)

- **Allow for advance declaration and direct trader input for all legally registered entities,** against a fee. This would include the extension of the system listed above.
- **Rollout measures to strengthen the mobile units and post-release controls.**
- **Regulate suitcase trade.** Although the regulation of suitcase trade and border markets should be very cautiously approached, to avoid disrupting local chains of supplies, it is also essential that the arbitrary powers of border officials and the present gray operations are checked. Administration could be improved through transparent and easily understood rules that would be established and advertised. Market traders could be registered to prevent abuse. The personal allowance should be limited to a specified number of times per year for individuals. A special access authorization and verification could be introduced, possibly managed by the municipalities near the border markets. A strong enforcement capacity would also be necessary to check the leakages (transport through

the border and reconsolidation in trucks to avoid payment of duties), and introduce a deterrent effect. (estimated cost: US\$50 k)

- Strengthen cooperation mechanisms and revenue-sharing arrangements with Adjara to eliminate the double jeopardy and risk for traders.
- **Give incentives to the private sector players to create a level playing field.** Representatives of each trade sub-sector should be encouraged to gather with the other members of the sub-sector and devise anti-smuggling solutions to legitimize the business in their sub-sector, under the umbrella of GEOPRO. Their recommendations would then result in necessary changes in laws and procedures. (estimated cost: US\$50 k)

#### C-4. Infrastructure: Issues and Recommendations

While Georgia does have reasonable transport infrastructure in terms of pure coverage, it fails to meet in many instances what an international transporter would expect, even in a transition economy, in terms of safety, speed, comfort, and reliability. In a context where the railways need to diversify its operation due to the foreseen competition of the BTC pipeline, the improvement of rail infrastructure and rolling stock is critical. The deferred infrastructure maintenance is one of the most visible elements for operators, after border agency impediments, particularly on secondary roads.

The physical rail and road links to Armenia, which account for 70 percent of Armenian trade, are in poor condition as a result of major delays in maintenance. Sleepers suffer from structural damages, rails show signs of fatigue and deformation, and contact cables are in poor condition. The rolling stock will also require some much delayed maintenance to remain operational. A similar situation applies to the road link between Armenia and Georgia, which offers a succession of potholes, leading to very high operating costs for modern vehicles. Improvement on these sections is underway.

Additional investment would be particularly required to continue the upgrading of the Baku-Poti corridor (road/rail), to develop airports (Tbilisi-runway and cargo terminal; Batumi-runway and air traffic control), to remove some of the existing bottlenecks for railways, and to upgrade the breakwater at Poti. It is beyond the scope of this note to establish a priority order among these items, but the preparation of a multi-annual investment plan for transport is a priority to ensure proper resource allocation.

In a number of instances, additional new investments are required. Infrastructure at road border crossing points (apart from the well equipped facility at Sarpi) provides only the most basic facilities and almost no equipment to perform a professional search. The lack of reliable power supply reduces the effectiveness of Customs and immigration controls and their ability to track transit traffic. It also limits the operating hours. USAID is targeting a series of critical intervention to support the upgrade of main border crossing points to a functional level. The lack of facilities and equipment for multi-modal transport and in particular containerized cargo, throughout the chain (Poti port, Tbilisi railway station) limits the potential competitiveness of the Caucasus route to provide high quality transit services to the Caspian Sea. The

shortage of power supply in winter slows down the productivity in ports since the available electric generators are not large enough to supply power to all the cranes.

With the increased flow of traffic on the Black Sea and through the Bosphorus, particularly of oil and derivatives, it would be warranted to prepare a feasibility study for a maritime electronic highway, with a view to improving maritime safety and developing a modern regional environmental management information system. The ultimate goal of a Maritime Electronic Highway would be the establishment and utilization of innovative maritime safety and environment management information technological tools to create, network and maintain a marine information infrastructure. The main benefits expected from an MEH: (i) oil spill prevention through marine accident avoidance; (ii) vessel tracking and management; (iii) protection of rare natural resource through real time monitoring of fishing vessels; and (iv) sustainable databases for natural resource managers, mainly financed by shipping lines.

#### ***Short-term Recommendations***

- **Define Transport Investment Needs.** The definition of transport investment priorities in Georgia remains ad hoc with limited use of economic criteria, and limited comparison of priorities across modes. Given the budgetary constraints affecting Georgia and the limited external sources of financing available for transport, it is recommended that the Ministry of Transport and Communications prepare a multi-annual and multi-modal investment plan based on traffic forecast, economic evaluation and impact on the Poverty Reduction and Economic Growth strategy. (Estimated cost: US\$150 k in addition to TRACECA feasibility study)
- **Conduct a feasibility study for the establishment of a Maritime Electronic Highway.** This multi-country study would include two phases: (i) data and information gathering; and (ii) diagnostic and recommendations for the preparation of a possible Black Sea Maritime Electronic Highway project. A request for such a study has been submitted for funding to the Canadian Trust Fund (Estimated Cost US\$100 k).

#### ***Mid-term Recommendations***

- **Upgrade infrastructure.** Road, rail and port infrastructure requires further investment both to increase capacity to handle containers and to carry out much needed periodic maintenance, particularly in rural areas, linking villages to markets. The financing for these could come from user charges, concession arrangements (port, rail) and IFI lending (road, rail). The on-going TRACECA work to produce a Unified Policy on Transit Fees and Tariffs and its feasibility study on road infrastructure needs will be instrumental to define charges and fees that can be sustained by the market demand and any short-term cash-flow constraints that would necessitate donor or IFI support. At road crossings, co-located border facilities, reliable dedicated communication links, and the introduction of dedicated lane for specific traffic (border residents, pre-approved vehicles, fast-tracking of low risk consignments) would also expedite border station throughput.

- **Continue the Transport Sector Restructuring.** Under the World Bank project to restructure the Ministry of Transport and Communications in Georgia, the capacity of the Ministry to formulate policies has been considerably strengthened. Further support will be required in the various transport modes to ensure that the benefits of the first phase are felt by users. The following aspects require special attention: (i) the commercialization of railway services, to capture new types of commodity flows; (ii) the strengthened collection of fuel taxes and enhanced resource allocation based on economic criteria; (iii) the stimulation of competition in the ports (estimated cost being defined by the MOTC).
- Initiate discussions between Georgia and Azerbaijan and between Georgia and Armenia to establish joint border crossing facilities designed to allow for integrated border management and non-duplication of work across agencies.

#### **C-5. Industry Competitiveness: Issues and Recommendations**

Services offered by commercial entities in Georgia are frequently below what international operators expect. The domestic freight-forwarding sector in Georgia appeared only recently and only a limited amount of training has taken place. A training center has been created in Georgia for the training of Transport Managers under the TRACECA program. The local freight forwarders' association has also defined a good conventional training program, recognized by the international federation of freight forwarders, FIATA. The absence of legal requirements of professional competence and certification to enter the profession has however limited the number of participants in these programs. The need for training is still considerable. Operators in the transport of dangerous goods would notably necessitate further training, preferably with industry certification, in line with international practice.

The large shadow economy in Georgia, and in particular the intense smuggling of goods, presently create a strong incentive for most companies to act illegally, if only to survive. Companies simply cannot prosper and fulfill the legal requirements when faced with competing companies, who pay no taxes on imported products, or profit taxes or income taxes for their employees. The absence of a level playing field precludes the viability of legal firms and de facto access to financing for SMEs, a major element in an SME-driven growth strategy. This applies in particular to IT equipment, cigarettes, oil products and other excise goods.

Smuggling channels are well known by all the large trading firms in the country, since their competitiveness depends on this. A majority of these firms would be willing to play by the rules if all participants, or at least the wide majority of them, were ready to act similarly.

#### ***Short-term Recommendations***

- **Give incentives to the private sector players to create a level playing field.** Representatives of each trade sub-sector should be encouraged to gather with the other members of the sub-sector and devise anti-smuggling solutions to legitimize the business in their sub-sector, under the umbrella of GEOPRO. Their recommendations would then result in necessary changes in laws and procedures.

- Stimulate the emergence of a **Certificate of Professional Competence** delivered by international professional associations such as the International Road Transport Union or the FIATA, in partnership with local professional associations and require such a Certificate for providers of international transport services (estimated cost: US\$150 k).

## **D. Proposed Strategy and Recommended Actions**

The proposed trade and transport facilitation strategy for Georgia covers three dimensions: (i) better exploitation of the business potential brought by transit activities; (ii) improved conditions and milieu for traders; (iii) a reduction in the evasion of duties and taxes. The strategy offers a segmented yet complementary approach to act on these dimensions by defining strategies corresponding to three broad types of traffic: international transit traffic, legitimate trade and illegitimate trade.

### **D-1. Strategy**

1. **Attract additional transit traffic and maximize the economic impact of transit activities, in partnership with Armenia, Azerbaijan and Central Asian countries.** To accomplish that goal, (i) develop a no-hassle, price competitive, high-quality integrated transit system through Georgia to Azerbaijan and Armenia, coordinated by one of the existing border agency, with independent monitoring, in cooperation with the State Customs Committees in Azerbaijan and Armenia; and (ii) upgrade transport infrastructure for both local and international traffic, based on economic selection of projects, in support of the Poverty Reduction and Economic Growth Strategy. The approach should build on the draft Transit Strategy designed by the Ministry of Transport and Communications.
2. **Reduce logistical costs to contribute to increasing competitiveness of Small and Medium Enterprises (SMEs).** To accomplish that goal: (i) emphasize facilitation of legitimate trade in the mission of border agencies by eliminating any unnecessary or duplicative requirement, complete the border agency computerization throughout the territory, and measure performance from a user perspective, with special attention to the needs of SMEs in terms of small loads; and (ii) continue the strengthening of the transport policy formulation capacity encompassing all modes and aiming particularly at facilitating the development of multi-modal logistic services. These activities should take place in close consultation with the private sector. The reduced logistical cost will lower the cost of intermediary inputs for SMEs, increasing their competitiveness first on the local market and progressively enabling them to export.
3. **Fight excessive fees and eventual cases of requests for unofficial payments and smuggling to create a level-playing field for all companies in Georgia and increase revenue collection.** To accomplish that goal, define and implement a series of organizational measures, in addition to the ones directly targeted at trade facilitation and long-term development of border agencies to directly combat unofficial payments and smuggling, as described in section C. This would include inter-alia improved transparency of requirements for all agencies, the progressive harmonization of trade and transport practices and charges with neighboring countries, reduced personal interactions between users and border

officials during transactions, and the strengthening of post release checks and of existing mobile preventive and enforcement units.

There are a number of complementary activities with the TRACECA/TACIS program under (i), (ii) and (iii), requiring close coordination. TRACECA has agreed to interact with the PRO Committees in the Caucasus, established under the TTFSC dialogue, as a vehicle for regular user feedback. A constant exchange of information takes place between TRACECA and the TTFSC. These mechanisms will ensure a constructive approach to facilitation in the South Caucasus.

## **D-2. Priorities**

The large number of recommendations listed in section C can be overwhelming. As such identifying key priorities is essential. The priorities can be established by defining the instruments that would have the highest impact on the strategic objectives above considering both institutional and resource constraints.

Among the recommendations, the ones expected to have the highest immediate impact in Georgia are: (i) strengthened dialogue and partnership with the private sector on trade and transport facilitation, using particularly GEOPRO (estimated cost US\$50k per year) and CCI (Box 6); (ii) definition of a priority list of investment across transport modes to facilitate access to markets, locally and internationally (US\$150 k/TRACECA) with support from the private sector; (iii) introduction of systematic targeting, selectivity and advance processing of information supported by the computerization of border agencies, starting with the Georgian Customs, expanding the currently used software package, ASYCUDA (estimated cost: US\$0.2 million for technical assistance plus US\$2 million for hardware in the first phase); (iv) immediate measures to reduce personal interactions between Customs and users during clearance and to fight requests for unjustified additional fees (estimated cost: US\$150 k); (v) improved transit procedures and management (US\$700 k); (vi) improved transparency regarding procedures and rules for import, export and transit cargo (US\$50 k); and (vii) the harmonization of taxes and tariffs related to trade and transport with neighboring countries, after conducting a study (US\$50k). The Government of Georgia, supported by various donors, has started the implementation of these recommendations.

## **D-3. Financing**

Based on the experience of Southeast Europe and the level of actual and potential traffic, the economic rate of return of most recommendations listed in Section C would be high.

Many of the recommendations can be self-financed through the introduction of cost-recovery user fees. This applies particularly to the computerization process of the Customs and other border agencies, which in accordance with WTO provisions, can be covered through a fee per declaration corresponding to the service provided to users. Users benefit significantly from systems such as advance processing and as such are willing to pay for the added convenience and for the cost savings it generates by enabling an earlier release of goods. A comparison of the present level of road user charges with international practice also indicates that there is a potential for increasing their level in Georgia to improve the maintenance of road infrastructure. Users indicated as well a willingness to pay to receive accurate information on border agency

processing, although the initial development of the information database would require most likely an investment by the State.

Investments to fight against unofficial payments are traditionally more than recouped through the increase in revenue they generate. This is directly linked to the cost of the Customs, which represents only about 3 percent of revenue collected. As an illustration an increase of Customs revenue of one percent, through better enforcement and post-release audit, would fully cover an increase in Customs cost by 33 percent. While the objective is to maintain a reasonable ratio of Customs cost to revenue collected in line with international practice, this illustrates the potential positive fiscal impact of investing in the border agencies enforcement capacity.

Investment in transit friendliness can be linked to user fees but can also be captured through indirect taxation of profits of firms and individuals involved in distribution, transport and transit. The fiscal impact is of second order, while the economic impact is immediate following the generation of additional transit activity.

While cost-recovery mechanisms can be put in place to ensure the sustainability of the effort, initial investments will be required. These could be covered through the regular budget, donor support and IFI financing.

**The proposed solutions, required resources and complementary initiatives are summarized in the following Table 5.**

**Table 5- Proposed Strategy and Recommended Actions (for discussion) (ST: Short Term; MT: Mid Term; Priority; tbd: to be determined)**

<b>1. Attract additional transit traffic and maximize the economic impact of transit activities in partnership with Armenia, Azerbaijan and Central Asian Countries</b>							
Strategic Components and Actions					Financing Needs (US\$ 000)		Complementary Initiatives
	Date of Implementation	Responsible Bodies	Indicators	External	Domestic	Total	
<b>Implement an integrated transit management system</b> -Detailed definition of institutional solution (ST).  -Establish the system and streamline transit processes (MT). -Training involving border agencies and private operators (MT).	2003-2004	MoTrade and border agencies	Proposal	150	50	200	TRACECA Study on Harmonization of Border Procedures
	2004-2005		Improved transit time	1,800	300	2,100	Transit Strategy
<b>Measure transit service quality/TRACECA Hotline</b> -System definition based on users' feedback, including equipment (ST)	2003-2005	MoTC	Monthly Report	180	20	200	TRACECA Study on Harmonization of Border Procedures and Hotline
<b>Upgrading of infrastructure</b> -Define a multi-annual multi modal transport infrastructure strategy/needs assessment based on economic selection and support to the PREG (ST).  -Prepare a Feasibility Study for a Black Sea Maritime Electronic Highway  -Upgrade infrastructure (MT)	2003		Assessment		Trace ca+150k	Trace ca+150k	TRACECA Unified Policy on Transit Fees and Tariffs
	2003		MEH Feasibility St.			100	WB Trade Study
	2004-2006						

			Implementation			tbd	
<b>2. Reduce the total logistical cost to contribute to increasing competitiveness of local Small and Medium Enterprises (SMEs)</b>							
						<b>Financing Needs (US\$ 000);</b>	
Strategic Components and Actions	Date of Implementation	Responsible Bodies	Indicators	External	Domestic	Total	Complementary Initiatives
<b>Continue the transport sector restructuring</b> -modal agencies restructuring	2003-2005	MoTrade, MoTC				tbd	WB LIL to restructure the transport sector
<b>Implement Customs Development Strategy</b> -Meet deadlines in development plan (ST). -Improve <u>human resource management</u> in border agencies in line with this plan (salary, career opportunities...) (ST and MT). -Provide authority of the border agency headquarter on the regional offices and define a formal strategic framework for reform -Introduce performance-monitoring study on a regular basis to identify and address weak links in the chain (MT). -Establish a reform Committee with private sector participation (ST)	2002-2005  2003-2005  2003  2003-2005  2003	Customs, MoTrade  MoTC, MoTrade, Customs, Ports rail, border agencies, Freight	Improving user perception	450	50	500	TRACECA Study on Harmonization of Border Procedures  IMF supported Customs reform program  Dutch technical assistance under TACIS
<b>Strengthen the Public-Private Dialogue using the GEOPRO Committee</b> -Consult GEOPRO about new laws and procedures (ST). -Consult GEOPRO about Trade and Transport Facilitation issues (GEOPRO has already been established and has started to define its work-plan) (ST).	2003-2005	MoTC, MoTrade, Customs, Ports rail, border agencies, Freight	Quarterly report by GEOPRO	100	50	150	TRACECA Study on Harmonization of Border Procedures

to define its work-plan) (ST).		Forwarders' association.					
<b>Introduce needed (legal and) procedural changes</b>  -Review present procedures related to trade and introduce: (i) <u>transit procedures and documents</u> ; (ii) necessary certificate available in advance; (iii) <u>advance declaration processing</u> ; (iv) entitlement to clear goods anywhere on the territory; (iii) <u>simplified procedures for consolidated shipment</u> ; (iv) direct trader input for all users; (v) <u>consistent selective control rules at all locations</u> ; (vi) strengthened valuation and classification capacity in Customs; (vii) harmonized control mechanisms with neighboring countries;(viii) <u>single processing and payment window for all agencies</u> (ST measures underlined and MT).  -Align border agency opening hours to traffic needs (ST).  -Select period of the year when changes in the legal and regulatory framework will be introduced and provide supporting training (ST).  -Conduct regular independent audits on the application of laws and procedures (ST and MT).	2003-2005 (MT)		Implementation of underlined procedures by the end of 2003  Valuation and classification  Training for staff and users  Audits	550  250  250  50	150  50  50  50	700  300  300  50	TRACECA Study on Harmonization of Border Procedures  Potential WCO Training Center in Baku for regional training  IMF supported Customs reform program
<b>Computerize border agency processes</b>  -Outsource the rolling out of an integrated software management system based on ASYCUDA for all border agencies. Prepare technical specifications for the hardware/telecommunication network/training/software and technical assistance requirements for all border agencies (ST).	2003-2006	Customs, Border police, Ministry of Agriculture  Other agencies	Specifications  Fully operational system by mid 2006  Software and TA  Hardware	90  250  1,500		90  300  500  2,000	On-going Customs efforts
<b>Improve interagency cooperation</b>  -Redefine the objectives of border agency controls Georgia and allow for cross-designation of border agencies to carry out these functions (MT)	2004	MoTC, MOTrade, Customs, border		100	20	120	TRACECA Study on Harmonization of Border Procedures

responsibilities (ST).  -Establish multi-agency local project teams to implement at operational level recommendations and make further recommendations to the national headquarters (MT).	2004	agencies					Procedures
<b>Stimulate the emergence of training program to ensure the professional competence of transport operators</b>	2004-2005	MoTC, Customs, FIATA, IRU		120	30	150	
<b>3. Fight excessive fees and eventual cases of requests for unofficial payments and smuggling to create a level-playing field for all companies in Georgia and increase revenue collection.</b>							
				<b>Financing Needs (US\$ 000)</b>			
Strategic Components and Actions	Date of Implementation	Responsible Bodies	Indicators	External	Domestic	Total	Complementary Initiatives
<b>Provide transparently all border agency requirements to users</b>  -Establish a website, with a regional multi-agency information database, produce annual booklet and leaflets for distribution at the point of use in partnership with local professional associations in Georgian, Russian and English. These documents would cover transit, export and import issues (ST) and should be further updated (MT).	2003-2005	All border agencies, MoTC, MoTrade	Availability of these information tools	100	50	150	TRACECA website and “hotline” initiative.  Transparency International is to produce a booklet and leaflets for individuals and organizations that cross the border.
<b>Harmonize trade and transport charges/tariffs/taxes with neighboring countries.</b>  Review/support to implement TRACECA	2004	MoTrade MoTC	-Aligned road user charges		50	50	TRACECA Unified Policy on Transit Fees and Tariffs

recommendations.							
<b>Introduce change in procedures targeting unofficial payments and illegitimate trade</b>  -Introduce <u>internal procedures</u> to: (i) reduce interactions between users and officials during transactions; (ii) assign processing at random; (iii) split the control chain; and (iv) allow for immediate penalties (ST).		Customs MoF		130	20	150	TRACECA Study on Harmonization of Border Procedures  US Export Control and Border Security activities
<b>Strengthen mobile preventive and enforcement units and post release controls</b>  -Detailed review of existing mobile units and recommendations to strengthen those (ST), provision of equipment to ensure their proper functioning (MT), support to strengthen the institutional capacity to implement post release controls.	2003-2005	Customs MoF	Detailed framework 2003, implementation up to 2005		60 tbd		US Export Control and Border Security activities
<b>Regulate suitcase trade</b>  -Review the procedures applicable to suitcase trade; consider the registration of traders, the strengthening of enforcement capacity (to discourage obvious by-passing of duty payments), limitation to the frequency of personal exemption, and penalties (ST).	2003	Customs	New procedures	50		50	TRACECA Study on Harmonization of Border Procedures
<b>Give incentives to the private sector players to create a level playing field</b>	2002-2005		Recommendations enforced	50		50	

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