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1. BACKGROUND AND OVERALL ASSESSMENT

Georgia and the EU first established contractual relations in 1996 through a Partnership and Cooperation Agreement which entered into force in 1999. On this basis, the EU-Georgia ENP Action Plan was adopted in November 2006 for a period of five years. Since then, its implementation has been guided and monitored on the basis of annual implementation tools, which set out comprehensive yearly sets of priorities and timelines, based on the priorities agreed jointly by the EU and Georgia.

Intense institutional co-operation through the EU-Georgia Cooperation Council, the EU-Georgia Cooperation Committee, the Parliamentary Cooperation Committee and sub-committee on trade, economic and related legal issues has enabled both sides to progress with the implementation of the Partnership and Cooperation Agreement and more recently of the Action Plan.

This document reports on progress made on the implementation of the EU – Georgia Action Plan between November 2006 and 31 December 2007, as well as on presidential elections that took place in January 2008, just after the reporting period; developments outside this period are also considered when deemed relevant. This document is not a general review of the political and economic situation in Georgia.

In general, Georgia made progress in 2007 in several areas covered by the Action Plan. Since the “rose revolution” Georgian authorities have been pursuing an ambitious agenda of political and economic reforms. However, the first year of Action Plan implementation was constrained by delays in adopting an implementation strategy and clearly identifying responsibilities, budget and a timeline. Moreover, the implementation of the Action Plan has revealed the difficulties in reconciling the government’s drive for a radical reduction of the role of government in the economy and the EU regulatory approach reflected in the Action Plan.

Good progress on judiciary reform, improving state revenues and the fight against corruption was achieved. Nevertheless, to increase the confidence of Georgian citizens in the judiciary and in the rule of law, the independence and impartiality of the judiciary as well as strengthening the ombudsperson institution remains a crucial objective Georgia should address without delay. Therefore 2008 will be a crucial year for consolidation of the legislative improvements introduced in 2007. Progress has also been recorded in improving the business climate, reforming Customs and Taxation, Vocational Training and Education. Georgia has widely aligned with CFSP declarations and participates actively in regional cooperation projects. Some important legislative improvements were achieved in the area of democracy, the functioning of state and local administrative bodies, human rights and fundamental freedoms. However, events in the latter part of the reporting period demonstrate the need for a proper implementation of this legislation. The introduction of a state of emergency in November 2007, as well as the conduct of the January 2008 Presidential elections, raised concerns, these should be addressed shortly in view of the legislative elections in May 2008.

Economic growth in 2007 has been very strong, despite external shocks occasioned by higher energy and food prices. Georgia has also undertaken important trade and investment related

reforms in 2007. It strengthened investor protections, further simplified the tax code, and simplified permitting and registration procedures.

2. POLITICAL DIALOGUE AND REFORM

Democracy and the rule of law, human rights and fundamental freedoms

Objectives in this area include: strengthening the rule of law especially through reform of the judicial system, including the penitentiary system, and through rebuilding state institutions; strengthening democratic institutions and respect for human rights and fundamental freedoms in compliance with international commitments of Georgia; continuing the fight against corruption.

Georgia's democratic institutions are characterized by a strong presidential system, a weak separation of institutional powers and an ineffective system of democratic checks and balances. Recommendations made by the Venice Commission in 2004 to deal with these inconsistencies have not yet been sufficiently addressed.

Constitutional changes setting the date of parliamentary and presidential elections for the autumn of 2008 (thereby extending by six months the duration of the running legislature) led to civil unrest in November 2007 and calls for the respect of the normal duration of the legislature and the introduction of a parliamentary political system. The demonstrations also highlighted growing social and economic tensions within Georgia's society. The excessive use of force by law enforcement officials, the destruction of the independent TV station Imedi and the imposition of a state of emergency were a source of concern.

The Georgian authorities subsequently lifted the state of emergency and accepted a number of opposition requests, including a public consultation on the date of legislative elections, introduction of political party representatives in central and precinct electoral commissions, a lowered threshold in parliamentary elections and amendments of the legislation on party financing. Early presidential elections were called for within the minimum notice allowed under the law (45 days) which however did not in practice provide sufficient time to opposition parties to prepare.

Presidential elections took place in January 2008, just after the reporting period. The international election observation mission - including ODIHR, European Parliament and the Parliamentary Assemblies of the Council of Europe and the OSCE - stated that these were the first genuinely competitive presidential elections but noted a number of serious shortcomings, including the misuse of State's administrative resources for campaigning purposes, unbalanced media exposure of candidates, reported acts of voters' intimidation, lack of clarity and detail in the election-day procedures, and irregularities in the counting and tabulation. These serious shortcomings need to be addressed in view of the legislative elections in May 2008. The parliamentary majority and the opposition have started a dialogue on redefining electoral rules and reviewing basic institutional arrangements.

The government has taken steps to improve the lives of persons belonging to Georgia's national **minorities**, inter alia through the implementation of a civic integration programme, investment in road and infrastructure rehabilitation in regions inhabited by minorities and the establishment of a Public Administration Institute to train minorities. No progress was reported towards acceding to the European Charter for Regional and Minority Languages.

A new prison was opened in Tbilisi in 2007 and prison facilities were refurbished to address the significant shortcomings regarding prison overcrowding and **detention conditions**. Nonetheless, in the face of an ever-increasing prison population, resulting from the “zero tolerance for crime” policy, urgent measures are needed to increase the use of alternatives to pre-trial custody, alternatives to imprisonment as a punishment for crime and to develop probation and parole systems, in accordance with the recommendations of the Committee for the Prevention of Torture (CPT)¹. A code of conduct for prison administration staff was approved in December 2007.

To create greater transparency, the government authorized the CPT to publish its latest report on Georgia in October 2007. The CPT confirmed the considerable progress made as regards preventing **torture and ill-treatment** of people in police custody, including the effective application of legal safeguards, the recruitment of new staff, efforts in training of law-enforcement officials and the purchase of modern inquiry equipment. The external monitoring of detention facilities was further expanded. However, the investigation and prosecution of allegations of abuse remain largely unsatisfactory and victims of torture and ill-treatment are reported not to have received compensation. Arbitrary detention and the excessive use of force by law enforcement officials remain a matter of concern. An inter-agency coordination council was established to facilitate the implementation of the Optional Protocol to the Convention against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment. The establishment of a national preventive mechanism, due in June 2007, is still pending.

A new two-year programme for **juvenile** probationers was launched in December 2007. The programme aims at addressing the needs of juveniles and their offending behaviour in a holistic manner; reducing the frequency of recidivism; and ensuring that wherever possible young people are able to continue to live with their families during the rehabilitation process. Amendments adopted in May 2007 to lower the minimum age of criminal responsibility from fourteen to twelve years for certain severe crimes (these amendments will enter into force as from July 2008) directly contravene a UN recommendation not to lower the age of criminal responsibility for children.

Several complaints have been filed by private citizens and companies against violations of **property rights**, in particular as regards confiscations for urban renewal or private development.

The mandate of the government commission on **gender equality** was renewed in September 2007 and an action plan on gender equality for the years 2007-2009 was subsequently adopted. This plan calls in particular for the elaboration of a specific legislative framework on gender equality. A new law on combating domestic violence, introduced in May 2006, in cooperation with the civil society, is not yet effectively enforced at court level. An action plan to prevent and combat domestic violence was approved by the government in July 2007 and is in its initial stage of implementation. Enforcement bodies have received targeted training and since 2007 there is an increase of protective orders on the ground of domestic violence, which remains widespread.

The role of the **Ombudsperson** has not been strengthened. Criticism has been made that the reports and activities of the latter were widely disregarded by the authorities. Violent acts by

¹ European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment.

law enforcement officers against the Ombudsperson during the November 2007 events were not properly investigated.

The reform of the **judicial system**, as regards the criminal justice sector, was significantly advanced but achieving full and effective independence of the judiciary remains a crucial objective. The organisation of the judiciary was remodelled and put it in line with systems in other European countries and a technical upgrading of the courts was made. The implementation of the national strategy for criminal law reform, approved in 2005, continued during the reporting period. The strategy is to be fully implemented by 2010.

To further strengthen the independence of the judiciary, the Parliament adopted a law on the rules of communication with judges of general courts in July 2007, regulating *ex-parte* communication of a judge. It also obliges judges to report immediately to the High Council of Justice on any attempt to influence the court. The High Council of Justice was reformed in June 2007, by removing it from under the President's responsibility and integrating it fully into the judiciary. The latter body has also authority over the judicial appointment process.

A High School of Justice was established, and only its graduates are eligible for selection as potential judges. The rules of judicial ethics were revised in line with European standards and adopted by the Conference of Judges in October 2007. The legislative committee of the Parliament drafted a law to unify the common courts and the Supreme Court in November 2007 but this awaits further deliberation.

To meet international standards, more work on definition of objective criteria for judicial appointment and disciplinary proceedings is required. It is also necessary to guarantee judicial independence and to update the legislation on the execution of court decisions.

As regards improving **access to justice** and legal aid, a law was adopted in June 2007. Civil society was involved in its preparation. Public awareness of its existence is however still weak and this requires additional attention in order to encourage citizens to make use of its resources. Branches of the state legal aid service were opened in most regions by the end of 2007.

A comprehensive reform of the **civil service** has not yet started. Changes are yet limited to rationalization, mergers and abolition of existing agencies. A draft code on the public service, creating a unified civil service, was prepared and submitted for parliamentary hearing in late 2007 but has since been stalled. Special attention must be paid to improving training and qualifications of civil servants in order to enhance the quality of the delivery of public services.

To **fight corruption**, the government adopted a new action plan for the national anti-corruption strategy in May 2007 in consultation with civil society, with emphasis on transparency of public finances, development of an enforcement system and harmonization of relevant legislation with international norms. The strategy encompasses the following priority areas: promotion of a corruption-free public and private sector, improving the performance of the judiciary and other law enforcement agents and enhancing anti-corruption legislation. However, no clear deadlines are set within the Action Plan as regards its implementation. Georgia has not yet ratified the UN Convention against Corruption although initial steps were taken in this regard. Specific measures were adopted to eliminate corruption within higher education, by changing the regulations on student admissions and making them more transparent. In November 2007, the Group of States Against Corruption (GRECO) reported

progress made in coming to grips with corruption. Greater efforts are required to involve civil society in formulating and implementing credible reforms. Corruption remains a significant issue in the public sector.

The legislative framework regarding **local governance** was improved, in close cooperation with the Council of Europe. A draft national decentralisation strategy and a draft national work programme for better local self-government were elaborated in January 2007, but have yet to be endorsed by the government. The law on state supervision over activities of local authorities was adopted by the parliament in June 2007. Draft laws aimed at improving the institutional arrangement of local self-governing units, facilitation of citizens' participation in the implementation of local self-governance as well as modification of the equalizing transfer formula defined by the law on budget of local self-governing unit were elaborated in the second half of 2007.

In spite of these legislative efforts, there has however been no significant empowerment of local authorities in practice. The government maintains strict control over self-governing units and there have been limited efforts to improve administrative and planning capacity at the local level.

Cooperation on foreign and security policy

Since June 2007, Georgia has been invited to align itself with CFSP declarations on a case-by-case basis, which it has done regularly.

The agreement on privileges and immunities of the international criminal court has not yet been signed or ratified. The bilateral immunity agreement with the USA is reportedly still in place.

Good cooperation between Georgia and the EU and other international actors on border management and in developing an integrated border management strategy is an indication that Georgia is taking the issues of WMD and illegal arms exports seriously. Georgia also cooperates with the USA on lowering the threat of bio-terrorism and making safe nuclear debris and equipment.

Regional co-operation

In May 2007, Georgia participated with Azerbaijan, Ukraine and Lithuania in a summit of the Heads of States organized by Poland, with the aim of further strengthening, political and economic relations, including the energy sector, between the Black Sea, Baltic Sea and Caspian Sea regions. A joint communiqué was signed on creation of a new European energy corridor.

In order to improve integrated border management at the national and regional level, a project on regional border management in South Caucasus (2008-2009) was launched in the framework of the ENPI Assistance Programme. During the kick-off Ministerial Meeting held in Brussels in October 2007 participating countries agreed to implement measures on a bilateral basis (Azerbaijan-Georgia, Georgia-Armenia).

Georgia is co-founder (together with Armenia Azerbaijan and the European Commission) as well as host country of the Caucasus Regional Environmental Centre (REC), see further the section on environment. The REC Caucasus, with headquarters in Tbilisi, promotes capacity

building and cooperation between various stakeholders, including between neighbouring countries. Georgia has signed the new Charter for the REC.

Cooperation for the settlement of Georgia's internal conflicts

Although the EU is not a formal party in existing peace mechanisms for the resolution of conflicts in South Ossetia and Abkhazia, a number of conflict-related objectives were included in the ENP Action Plan in order to underpin the EU intention to contribute to the settlement of Georgia's internal conflicts. One of the most urgent priorities throughout 2007 was to re-establish a minimal level of confidence among the parties in order to prevent a new outbreak of hostilities and create favourable conditions for a restart of peace negotiations.

To this effect, a joint EU Special Representative- European Commission expert mission to Georgia, Abkhazia and South Ossetia took place in January 2007. As the result of this mission a package of confidence building measures was identified, aimed at improving the trust between Tbilisi and the two *de facto* separatist regimes in Abkhazia and South Ossetia. The package of measures received broad endorsement by EU Political and Security Committee in March 2007 and was subsequently discussed and agreed with Georgia and other main stakeholders. The implementation of this package, which includes inter alia embedding police advisors to the UNOMIG and OSCE missions as well as the appointment of an EU advisor to the Ministry of conflict resolution, started in autumn 2007.

The OSCE-led rehabilitation programme in South Ossetia, of which the European Commission is the major contributor, was on one of the few effective confidence building measures benefiting both ethnic communities in South Ossetia. The European Commission has also continued its support for the ongoing rehabilitation programme in Abkhazia during 2007.

Progress on the political track of the conflict resolution process was however limited due to a negative international context. The deterioration of relations between the Russian Federation and Georgia and a multiplication of military and diplomatic incidents have heightened tensions between Georgia and the separatist regimes.

With the aim of ending the deadlock in peace negotiations, Georgia launched in 2007 some unilateral initiatives, including the establishment of a Temporary Administration for South Ossetia (which is effectively in control of Georgian villages in South Ossetia), the establishment of the *de jure* Abkhazia local administration to the upper Kodori Gorge (the only part of Abkhazia controlled by Tbilisi), and the creation of a state commission for defining the nature of the autonomy of the two separatist districts after re-unification with Georgia. These unilateral measures did however further fuel mistrust between the parties and have not yet produced substantial results for advancing the peace process.

3. COOPERATION ON JUSTICE, FREEDOM AND SECURITY

The establishment of an EU-Georgia Sub-Committee on Justice, Freedom and Security issues is imminent.

The new Southern Caucasus Integrated **Border Management** programme (SCIBM), see under regional cooperation, consists of one common training component, two bilateral cooperation Georgia-Armenia and Georgia-Azerbaijan components, and three national components, enhancing strategic border management capacities across the region with the

goal of introducing coherent integrated border management systems. Elaboration of training activities in preparation for the SCIBM is underway (*see also section on regional cooperation*). The border management strategy of Georgia was approved after the reporting period, in February 2008, covering all the elements of the European Four-Tier Border Security System. On the advice of the European Union Special Representative (EUSR), Georgia elaborated new laws and regulations for the establishment of an integrated border management predicated on inter-agency cooperation. The border guard department of the Ministry of the Interior was transformed into a Border Police and as of November 2006, its personnel serve only on a contractual basis.

Cooperation progressed with the border protection agencies of EU Member States but remains to be further developed with agencies in Armenia and Azerbaijan. Progress on delimitation and demarcation of borders with neighbours other than Turkey was limited. Further work is required on developing comprehensive education and training strategies for this sector as well as on improvements to institutional capacity to effectively manage border crossing checkpoints.

Currently Georgia does not have a written **migration** policy document. Unwritten policy is of an extremely liberal nature and there is no single government body coordinating migration management. Legal provisions regulating the issue of entry into Georgia do not comply with European framework with a number of significant legislative gaps regarding entry (for example an ordinary visa suits all purposes of entry except for study purposes; irregularities lead only to fines irrespective of length of overstay in Georgia). This is coupled with unregulated labour migration to and from Georgia, leaving room for concern. Georgia ratified the Protocol against the Smuggling of Migrants by Land, Sea and Air supplementing the United Nations Convention against Trans-national Organised Crime already before the reporting period, in 2006, but has still to fully implement this instrument.

Georgia has **readmission** agreements in place with three EU Member States, and is negotiating with most other EU Member States. The European Commission has funded several AENEAS projects in Georgia, including document security, reintegration of returning migrants and informed migration.

Information exchange on citizens' and foreigners' personal data, visa applications and residence permits between the Civil Registry Agency, Georgian consulates and Ministry of Foreign Affairs, Georgian Border Police and other relevant agencies is irregular, leaving room for incomplete information on foreigners residing in the country and nationals residing outside Georgia. The law on the legal status of foreigners provided for an electronic database to be introduced by July 2007 for the management of migration flows, but such a database has not yet been created. Further improvements are also required to secure the automatic processing of personal data of individuals in line with the relevant Council of Europe convention, which entered into force in Georgia in April 2006, for example, by elaborating a law on data protection. The European Commission assists the Ministry of Justice and Civil Registry Agency in developing relevant provisions for data protection. Assistance was also provided for a thorough assessment on the required technical and legal measures to establish a system for issuance of biometric passports, foreseen for 2009.

With respect to the commitment undertaken by Georgia upon its accession to the Council of Europe in 1999, the parliament adopted in July 2007 a law setting up a legal framework permitting repatriation and reintegration of Meskhetians. Implementation is to start in 2008. An Action Plan for this purpose has not yet been elaborated.

The protection of **internally displaced persons** (IDPs) resulting from the conflicts in Abkhazia and South Ossetia in the early '90s progressed with the adoption in February 2007 of a strategy for improving their civil rights and living conditions. Despite extensive preparatory work undertaken in cooperation with UNHCR, the adoption of the strategy's implementation action plan is still pending. One of the most urgent priorities remains the census and registration of IDPs.

Georgia also adjusted its **refugee** protection system. In April 2007, amendments to the law on refugees were adopted. A new law on refugees is being drafted with the assistance of UNHCR. There are currently approximately 1 100 refugees from Chechnya in the Pankisi Valley. In 2007 the government started to grant temporary residence permits to refugees and issued related documentation, which eases the refugees' engagement in income generation activities and more generally improves the prospects for their integration. In addition to a daily allowance provided by the Georgian State Ministry for Refugees and Accommodation the refugees received food aid from WFP until the end of 2007 and further assistance from UNHCR, including sanitary items, basic medical care and primary education. As of 2008 the WFP food assistance is replaced by a cash allowance system provided by UNHCR, which together with increased income generation projects shall increase self-reliance and economic integration of the refugees. During the last two years more than 1 000 persons displaced from Chechnya and formerly listed as refugees, were identified to be Georgian citizens and documented as such.

Georgia is still not party to the 1954 **Statelessness** convention. Current legislation still foresees cases where Georgian citizens could lose their citizenship and could create risk situations for returning Meskhetians.

There are currently 1 100 refugees from Chechnya in the Pankissi Valley, assisted through UNHCR and receiving food, basic medical care and primary education. The government of Georgia already granted citizenship to 1 000 former refugees and has now adopted a new temporary regime which should allow those who are not eligible to citizenship to receive the same allowance as Georgian IDPs.

The national plan on the fight against **trafficking** in persons 2007-2008 established programmes for the support and reintegration of victims of trafficking including specific measures for the rehabilitation and reintegration of victims of trafficking. A national strategy to this effect was adopted in July 2007 and a second national shelter was opened in September 2007 with a commensurate increase in public funding. The national authorities also established a cooperating network with international organisations and NGO's to train different professionals to address particular target group needs.

With regard to the fight against **drugs**, a concept paper for a national drugs strategy was adopted in February 2007 focusing on supply and demand reduction as well as on education of professionals, but it has not yet been implemented. The drugs policy council began revising national legislation to establish lists of controlled substances in line with international standards and definitions. Weaknesses in terms of financing, rehabilitation and treatment remain issues of concern alongside the incarceration of drug users and unavailability of treatment in prisons. Interaction with the NGO sector is irregular and needs to be supported through public financing. In addition, Georgia is fully engaged in the SCAD programme (Southern Caucasus Anti-Drug) Phase 5 at regional level.

With regard to **money laundering**, in July 2007 amendments to the criminal code were adopted to harmonise national legislation with the European and FATF requirements including a definition of the crime of money laundering. A draft tri-partite memorandum of understanding on cooperation between the financial monitoring service, the Ministry of Internal Affairs and the Office of the Prosecutor General is awaiting signature by all parties. Further effective sanctions against money laundering need to be defined and applied alongside further efforts to improve inter-agency cooperation and coordination.

With regard to international and regional **judicial cooperation**, Georgia ratified the 1980 Hague Convention on Child Abduction in 1997 but further attention and resources are required to ensure full and effective implementation. Further improvements are also required to secure the automatic processing of personal data of individuals in line with the relevant Council of Europe convention, ratified by Georgia in April 2006. The 2005 UN Convention on the Seizure and Confiscation of the Proceeds of Crime and the Convention on the Financing of Terrorism remain as yet un-ratified.

4. ECONOMIC AND SOCIAL REFORM

Macroeconomic framework and functioning market economy

Economic **growth** continued to be strong in 2007, at about 12 %, despite external shocks stemming from Russia's economic embargo and higher energy prices. **Inflation** increased in the second half of 2007, reaching an annual rate of 11 %. Both fiscal and monetary tightening is essential to bring inflation back to single digits in 2008.

Foreign capital inflows and financial sector expansion have been driving the recent economic developments. Whereas previously **foreign direct investment** was linked to either privatisation deals or oil and gas pipeline construction, there are now signs of more broadly based foreign direct investment. The banking sector continued to attract foreign capital in 2007, supporting rapid credit growth. Further strengthening of financial sector supervision is called for as the sector continues to be one of the fastest developing segments of the economy.

Growth in exports was resumed last year when exports were successfully redirected to other markets after the closure of the Russian market in 2006. **The trade and current account deficits** have increased, however, owing to strong demand for imports. Presently, the current account deficit of about 16 % of GDP is financed by capital inflows, but an increase in the exports of goods and services is desirable for a more sustainable balance of payments in the longer run.

The fiscal revenues performed strongly as a result of robust nominal GDP growth and strengthened tax administration. Georgia has developed a medium-term expenditure framework which facilitates a policy-based allocation of public expenditures. The public protests in November 2007 prompted the government to revise spending priorities for 2008, allocating more resources to pensions, salaries and social programmes. Defence spending is projected to decline to about 19 % of total expenditures. While public debt and fiscal deficits are under control, further efforts are focused now on strengthening public service delivery and public institutions.

Employment and social policy

Georgia has opted for total liberalisation of **employment** and labour relations in which the market is the single regulator. The labour market is marked by the predominance of self-employed among the working population, reaching approximately two-thirds of the work force. There is a predominance of long-term unemployment. Lack of effective employment and labour market policies and disrupted social safety nets have exacerbated the labour market distortions. A state programme for professional preparation at work was adopted in 2006 to better address the mismatch between the job offer and workers' skills. As regards administrative capacity, the Ministry of Labour and Social Security is responsible for employment issues since 2005. The effectiveness of employment services is rather low, due to the lack of resources and outdated management reforms.

As regards **labour law and rights at work**, no progress can be reported as regards unrestricted strike rights. The 2006 labour code, which was prepared without prior consultation with trade unions, is not in line with the International Labour Organisation (ILO) standards. In particular, it falls short in addressing the obligations of the ILO Conventions on freedom of association, and on the right to organise and collective bargaining. Furthermore, the labour code contradicts both EU standards and the European Social Charter that the country ratified in July 2005, on a number of fundamental issues such as the duration of overtime work and termination of employment. The Code is to be revised accordingly if Georgia wants to benefit from the GSP+ scheme in 2009.

No progress can be reported as regards **social dialogue**.

According to the 2007 UNDP Development Report, Georgia is ranked 96th out of 177 countries. On the **social situation**, no progress can be reported as regards **poverty** reduction and social welfare. High poverty levels still represent a serious challenge with one third of the population living below the poverty line.

As regards **social inclusion** and protection, since early 2006, the government has cancelled all unemployment benefits and replaced them by the measures of a unified social support programme for poor families.

While the Constitution provides for equality between **women** and men, women's participation in political life remains low with 9.5 % women represented in the Parliament (*see also section 2*).

Limited progress was achieved on implementing the commitments on **agriculture** in the ENP Action Plan. A working group in charge of the development of an agricultural strategy was established in June 2007, and a tender for the preparation of a medium-term strategy in agriculture was launched in November 2007, with the support of the World Bank. A first draft is expected by May 2008. A working group to ensure the effective implementation of agricultural relevant commitments in the ENP Action Plan was set up in September 2007 by Ministerial order of the Ministry of Agriculture.

The Georgian Economic Development and Poverty Reduction Strategy requires a national strategy for **sustainable development** to be prepared. A National Commission for Sustainable Development was established in 1996 but only modest progress can be recorded.

5. TRADE-RELATED ISSUES, MARKET AND REGULATORY REFORM

The EU--Georgia **bilateral trade** has been growing steadily over the last five years and the EU has progressively become Georgia's main trading partner (29.2 % share in Georgia's overall external trade in 2006). In 2007, total turnover of the EU-Georgia bilateral trade amounted at € 1,563 billion, exports were of € 1,081 billion and EU imports of € 482 million. However, Georgian exports to the EU remain very limited and should be further diversified. Under the EU GSP Scheme Georgia qualifies for the enhanced preferences for good governance and sustainable development, the so-called GSP+. In order to continue benefiting from the system after January 2009, Georgia will have to ratify the UN Convention on Anti-corruption and the Cartagena Protocol and effectively implement all the 27 internationally agreed conventions listed in the GSP Regulation.

The European Commission is carrying out a feasibility study exploring the possibility of establishing a free trade agreement between the EU and Georgia.

Georgia made limited progress in the implementation of the objectives in the area of regulatory approximation to the trade and investment related EU legislation contained in the PCA and in the ENP Action Plan which is crucial for Georgia to achieve a better practical access to the EU market. Negotiations of a bilateral agreement on the protection of geographical indications for agricultural products, including wine and spirits started in 2007 and are ongoing.

Some progress was achieved in the area of **customs**. The new customs code entered into force January 2007. It aims at aligning the customs legislation and procedures with relevant EU and international standards such as the revised Kyoto Convention. It reduces the number of customs regimes and contains general provisions on free zones and free warehouses. The structure, terms and principles of the code are broadly compatible with the European Community Customs Code and the revised Kyoto Convention on the Simplification and Harmonisation of Customs Procedures. However, the lack of clear implementing provisions to the code hampers its implementation and reduces the transparency of the customs rules for economic operators. Attention should be paid to the implementation of valuation rules as well as of post clearance controls.

A State Revenue Service was set up in April 2007, by merging the tax administration with the customs administrations and the financial police, in order improve coordination of these agencies. The impact of reorganization on the operational capacity of customs should be monitored.

The State Revenue Service has continued upgrading its customs declaration processing system (DPS) to move from ASYCUDA++ DPS to ASYCUDA World DPS. A Risk Management System based on selectivity was set up and is being implemented as from 1 January 2008. The implementation of a transit module started at national level in October 2007 with interoperability in 27 Customs Offices with the ASYCUDA++ DPS and in one with ASYCUDA World DPS. A temporary inter-agency commission on the facilitation of Georgian state border reform is to coordinate the elaboration of the Georgian border management strategy for 2008-2012. The strategy also includes the definition of standard operating procedures (SOPs) for customs officers and the promotion of inter-agency cooperation at the border.

On **free movement of goods and technical regulations**, Georgia progressed through the implementation of the reform of technical regulation system according to which voluntary standards, conformity assessment procedures and mandatory technical regulations were introduced. Several amendments were adopted to the laws on certification of goods and services, on integrity of measurements and on standardisation. These changes served as legislative basis for the introduction of voluntary standards and recognition of third countries' technical regulations. Further, an institutional reform was implemented through the establishment of two independent agencies: the National Agency of Standards, Technical Regulations and Metrology and a Unified National Centre for Accreditation set up on the basis of the former standardisation body, the Sakstandard. The database of the International Standards Organisation has become available for the National Agency of Standards, Technical Regulations and Metrology. However, there is still much work to be done in providing the manufacture and research organisations with relevant information on quality issues.

Regarding **sanitary and phytosanitary** issues, Georgia, which had adopted a law on food safety and quality in 2005, established in 2006 a food safety, veterinary and plant protection service. However, in 2007 it decided to delay until the end of 2009 key elements of the reform, such as full food safety controls against the background of the limited capacity of the service and the serious difficulties for establishments to comply with the rules. Georgia adhered to the International Plant Protection Convention. It wishes to export fishery products to the EU and started to work on this with the European Commission. After an outbreak of African swine fever, Georgia established an institutional structure and adopted a plan of activities to combat the disease. Georgia participated in workshops under the European Commission's "Better training for safer food" programme.

Georgia has continued its efforts towards improving its **business climate**, in particular as regards the fight against corruption and the stability of the legislative framework. Reforms in the areas of tax and customs, inspection, permits, certification, accreditation and standardisation have strengthened the business environment. According to international surveys, Georgia is doing well with regards to the ease of doing business. Challenges remain with the implementation of the new legislation. Furthermore, much remains to be done in terms of transparency, law enforcement, protection of property rights, governmental interference, application of the legislation and judicial reform to achieve a sound business climate.

Limited progress can be noted in the field of **establishment and company law**. While the number of procedures necessary for starting a business as well as the time for accomplishing them has been reduced pursuant to the changes of the law on entrepreneurs in March 2007, provisions regarding access to information on companies and protection of shareholder rights are weak.

Concerning **services**, Georgia has made some progress in the field of financial services. The banking regulatory and supervisory body, the National Bank, set out its supervision policy in the "Georgian banking system development strategy for 2006-2009". According to this strategy, main attention will be focused in the medium-term on the adequacy of the risks identification and management system in commercial banks; on the mechanisms of internal control and audit and on the implementation of international standards of financial reporting, as well as on the improvement of the corporate governance. Moreover, Georgia has signed several agreements with supervisory authorities of different countries to expand the exchange of information on banks' activities. Despite the efforts made to improve supervision of

insurance companies and securities firms, it needs further strengthening, including through an increase in the number of supervision staff.

Good progress was achieved in the area of **taxation**. The amendments to tax code and to the law on entrepreneurship helped in reducing the time necessary for tax registration by starting the concept of a “one-stop shop” at the taxation inspectorate. Tax collection has been growing steadily in the past year to reach 21.8 % of GDP in 2006 and is expected to be even higher for 2007. Relations with taxpayers were significantly improved and a communication strategy was prepared. The tax inspectorates were merged with the customs administrations and the financial police to create the State Revenue Service in April 2007. Territorial units of the State Revenue Service were also reformed. In terms of further challenges, improvements are needed as far as of a clear division of tasks and responsibilities. Moreover the human resources management still remains weak. The tax exemptions from profit taxes for companies established in free zones introduced by the new legislation on free economic zones (FEZ) are not in line with EU and international principles.

With regard to **competition policy**, no significant progress is to be reported. The competition law is limited in its scope as it does not regulate restrictive agreements, concerted practices, the abuse of a dominant position and mergers. Furthermore, special attention is needed to increase the institutional power, administrative capacity and the independence of the Free Trade and Competition Agency which is still a structural unit of the Ministry of Economic Development with only an advisory role and there are not any legal mechanisms assuring the enforcement of the agency’s decisions.

In the area of **Intellectual Property Rights (IPR)**, Georgia has taken a number of legislative steps to further align its legislation with PCA obligations and TRIPS requirements, in particular by acceding in 2005 to the Budapest Treaty on the International Recognition of the Deposit of micro-organisms for the purposes of Patent Procedure. A number of amendments have been adopted to the laws on copyright and trademarks as well as on border measures related to IPR. Georgia has qualified for accession to the UPOV convention for the protection of new varieties of plants and is awaiting final confirmation. Implementation of IPR legislation and its deterrent enforcement remain an area of serious concern and the circulation of counterfeits is widespread on the Georgian markets. There is also a lack of coordination among the different enforcement agencies. Georgia still needs to intensify its efforts on one hand, on effective implementation and enforcement of the IPR legislation but also on raising awareness among the different right-holders and on training enforcement officials (customs, judges, etc.) on the other hand.

Reform of the **public procurement** system is ongoing with the support of the World Bank, with the aim of bringing legislation closer into line with EU standards. The State Procurement Agency is the leading institution. Georgia is an observer to the WTO agreement on Government Procurement (GPA).

A new law on **statistics** is yet to be adopted. The main purpose of the law will be to strengthen the independence of the State Department for Statistics (SDS). A revised version is currently under consideration by the President’s Office. The managerial and administrative capacity of the SDS remains a serious concern as the number of SDS staff has decreased from 540 to 189 persons in 2007, which puts at stake the sustainability of the national statistical system.

The draft law on **auditing and accounting** is pending Parliament approval. It clarifies the accounting and financial reporting requirements for Georgian companies that will be obliged to apply international financial reporting standards. While the draft law introduces a completely new regulatory framework for accounting and audit professions, it is not in line with EU standards as regards statutory audit and control mechanisms.

Concerning public finances, progress has been made with the reforms in the treasury system. A draft law on public external audit is in the parliament.

On **enterprise policy**, the second stage of the President's state employment programme initiated in 2006 was commenced in June 2007. The "Employment programme 2007 development of small and medium size businesses" envisages lending support to small and medium size businesses engaged in the tourism sector and the creation of new jobs. The main objectives of the programme are supporting and strengthening small and especially family-run businesses in the tourism sector and increasing access to credit resources for SMEs. A Business Information Center was established under the Georgian National Investment Agency. Its main activities relate, among others, to awareness raising campaigns for economic operators and promotion of contacts network between private and public sectors.

6. TRANSPORT, ENERGY, ENVIRONMENT, THE INFORMATION SOCIETY, RESEARCH AND DEVELOPMENT

The regulation of the sector used to fall under the responsibility of the Ministry of Economic Development and was entrusted to the "Georgian National Commission for Transport Regulation". In April 2007 following the adoption of the law on management and regulation of the **transport** sector (March 2007) this commission was reorganized into the sub-departmental body of the Ministry of Economy - Unified Transport Administration, which is responsible for technical regulation of the road, maritime and civil aviation transport sectors. This Unified Transport Administration develops and endorses the technical regulations for safety and security of transport operators, oversees the implementation of technical regulations and issues the licenses for transport operators. In the road sector, road safety remains an issue of concern. In the rail sector the effective restructuring and commercialisation of the incumbent railway operator is ongoing. "Georgian Railway" Ltd was granted the right to independently manage its cargo policy. Simplified tariff rates were introduced in 2007 with a view to attract additional cargo flows.

In the aviation sector, after the closing down of the Civil Aviation Authorities in June 2006, its functions had been transferred to the newly created "Georgian National Commission for Transport Regulation" and subsequently to the above mentioned Unified Transport Administration. There is a need to strengthen regulatory and in particular safety oversight in order to improve the safety performance of Georgian carriers. Georgia actively pursues a policy of liberalization of air traffic in order to promote competition. Georgia has proposed to change the law on licensing aviation activities, with a view to open investment in Georgian carriers to foreigners. The Batumi International Airport was modernized and the new Tbilisi International Airport was officially opened in February 2007.

In the maritime sector, the efficiency of sea ports and maritime operations still leaves considerable room for improvement. In 2007, international companies were invited to express interest as regards a concession of Poti Sea Port and the development of a "Free industrial zone". Georgia is seeking to develop existing maritime ferry connections, as well as establish

new connections between the Black Sea ports of Georgia and other countries. Consistent failure by the authorities to address the lack of port state control and flag state implementation has resulted in the Georgian fleet being classified on the black list of the Paris Memorandum of Understanding on port state control. Maritime safety remains an issue of great concern.

Georgia, a net **energy** importer, continues to aim at strengthening energy security. The Parliament adopted an energy strategy document “Main directions of state policy in the power sector”. Its main objective is to satisfy electricity demand inter alia by relying increasingly on the country’s hydropower potential. Other elements of the strategy include the gradual opening up of the electricity market and the promotion of energy efficiency and the use of renewable energy sources.

Georgia is positioning itself as a key transit country for the transport of Caspian energy resources to (EU) markets. The full operation of the Baku-Tbilisi-Ceyhan (Turkey) oil pipeline and the first gas flows through the Baku-Tbilisi-Erzurum (Turkey) gas pipeline are significant in this context. Georgia agreed with Poland, Lithuania, Azerbaijan and the Ukraine to work together on the extension of the Odessa-Brody oil pipeline to Gdansk in Poland. This might open possibilities to increase significantly Caspian oil supplies. Gas imports from Azerbaijan allowed Georgia, which was fully dependent on Russian supplies, some diversification. The country further studied options for underground gas storage. Georgia cooperated actively in the European Commission’s feasibility study regarding the Trans-Caspian/Black Sea energy corridor. Georgia developed plans to build, with Kazakh investors, an oil refinery at the Batumi port. These developments are important also for the EU’s energy security, in particular in relation to other projects such as the “Nabucco” gas pipeline (from Turkey to Austria).

The country continued participation in the “Baku initiative” for EU-Black Sea/Caspian energy cooperation. Under this initiative ministers agreed a roadmap aiming at market convergence, security of supply, sustainable energy development and regional cooperation.

Georgia abolished import/export licenses in the energy sector. It amended the regulations on the wholesale electricity market, thereby giving priority to small scale power plants. Georgia amended the electricity and gas laws to promote the use of renewable energy sources including small hydro. It introduced new rules for electricity accounting. Georgia privatised hydropower stations and distribution companies. It continued to rehabilitate and to construct power plants (including hydro-plants) and networks. It agreed with Turkey and Azerbaijan to strengthen electricity interconnections. In this context, Georgia and Turkey launched a feasibility study for the electricity link among them. The construction of a Georgia-Armenia interconnection progressed. The country has been granted observer status to the Energy Community, which aims to extend the internal energy market. The National Energy Regulatory Commission increased gas prices, but price distortions remain in the energy sector. A background to the increases was the sharp increase of Russian gas import prices. Georgia installed electricity meters in a host of cities, which helped to increase bill collection rates. Considerable efforts are needed to improve energy efficiency and enhance the use of renewable energy sources.

Key **environment** issues concern threats related to climate change, air quality, water quality, waste management, land use, coastal and marine pollution, chemicals and nature protection. Georgia made progress on climate change. A second national communication, a greenhouse gas inventory and adaptation measures are under preparation. A pilot project is implemented in the Oni district. One Clean Development Mechanism (CDM) project has been prepared,

and registered at the UN level. Georgia participates in the Danube - Black Sea Task Force (DABLAS). Two of the 50 priority DABLAS investments concern Georgia². Georgia also participates in activities undertaken under the EU Water Initiative, within which a national policy dialogue is considered.

A second national programme of environmental protection to cover a period of 5 years is under preparation. A policy document on forestry is also being prepared. A water governance reform is planned. Work is ongoing to implement existing strategies and plans, but continued attention is required. Overall, framework legislation and sectoral legislation is in place in many areas, but require further development, in particular on environmental impact assessment as well as on implementing legislation. Latest legislation includes amendments to the framework law on environment protection and to the law on ambient air, as well as a new environment impact permit law. New legislation on water is under preparation.

While administrative structures on environment are partly in place, a major challenge is to strengthen administrative implementation capacity at all levels of the country, including coordination between authorities. Monitoring as well as enforcement require special attention. Georgia has prepared some reports on the state-of-the environment, but not made them public. Furthermore, these reports will in future be prepared only every three years. Access to environment information as well as involvement of the public in environment decision-making is limited. Public projects are exempted from environmental impact assessment procedures.

Georgia has ratified relevant international and regional conventions and protocols, except the Strategic Environmental Assessment Protocol of the UNECE Convention on Environmental Impact Assessment in a Trans-boundary Context. Georgia has not signed the UNECE Convention on the Protection and Use of Trans-boundary Watercourses and International Lakes and the Convention on Trans-boundary Effects of Industrial Accidents. Georgia participates in the International Commission on the Protection of the Black Sea against Pollution. The European Commission and Georgia have enhanced co-operation and information exchange, including on climate change, water, sustainable development and protection of mountains, sustainable integrated land use of Eurasian Steppes, obsolete pesticides, classification and labelling of chemicals, as well as on Black Sea environmental collaboration. Georgia is co-founder (together with Armenia, Azerbaijan and the European Commission), as well as host country of the Caucasus Regional Environmental Centre (REC). The REC Caucasus, with headquarters in Tbilisi, promotes capacity building and co-operation between various stakeholders, including between neighbouring countries. Georgia has signed the new Charter for the REC.

The Ministry for Economical Development has not yet formulated –a coherent strategy for the development of **Information Society** which has resulted in major gaps, such as in e-commerce. As for electronic communications the independent regulator, the Georgian National Communications Commission (GNCC) is in the process of developing a modern regulatory framework. Since June 2007, there is a pricing conflict between this commission, the Ministry and the fixed e line operator UTC because of the high internet access charges, which are responsible for the low penetration rate (about 4%) of internet use. At the same time, UTC has launched internet broadband services. Broadband internet will also be

² Kobuleti, final stage of approval; Borjomi-Bakhuriani, pre-feasibility stage

promoted by three licences for wireless WIMAX services. Furthermore, three licences have been granted for third generation (3G) mobile services.

Regarding the **audiovisual sector**, there are, alongside the public sector, a large number of independent and public TV and radio stations. However, Georgian audiovisual legislation still needs to converge with European standards on media regulation. Georgia still has to ratify the Council of Europe Convention on Transfrontier Television. Moreover, the current legislation and practice of the national broadcasting commission does not allow an adequate protection of minors and consumers. Films and programmes not suitable for children are broadcasted outside adequate times.

In Georgia **research and innovation** activities remain modest, but there is a clear resolve to upgrade Georgia's capacity in technological research and innovation. The Georgian Ministry of Education and Science is in the process of formulating a new national research and innovation strategy in close collaboration with the Georgian National Science Foundation in order to modernise national research. Furthermore a number of recommendations are being developed with a view to update the Georgian legislative framework relevant for research activities. Co-operation with European research institutions has been stepped up in order to foster a better integration into the European research area and into the Community R&D framework programme.

7. PEOPLE-TO-PEOPLE CONTACTS, EDUCATION AND HEALTH

Reform of **vocational training and education** progressed well with the adoption of a package of new legislation in May 2007, based on reform principles announced in 2005. Key measures included governance and financing reform, licensing of educational institutions and quality assurance. Under the Bologna Process, accreditation of higher education institutions proceeded through the newly established national body (NCEA) as well as the modernisation of curricula. The development of a national strategy and action plan for life-long learning is currently under way, including the elaboration of a national qualifications framework in line with European standards. Tempus was instrumental in supporting universities in the implementation of higher education reforms in line with the Bologna principles; in particular in the development of a credit transfer system, the assessment of learning outcomes and the development of modern curricula and teaching methods. Student mobility to the EU increased through participation in the Erasmus Mundus and Erasmus Mundus External Cooperation Window programmes, which also promoted academic cooperation. Further measures are required to expand and enhance quality education and training provision, realise equity in vocational education and training in relation to minorities, the economically vulnerable and women. Attention must also be given to the provision of life long learning and validation of non-formal learning.

In the area of **youth**, Georgia registered an increase in participation rates in the relevant actions of the Youth in Action Programme as compared to 2006. Youth exchanges and other youth activities were also hosted by local organisations under the programme. Georgian young people and youth workers were involved, for instance, in a large-scale project on conflict management combining trainings and youth exchanges, which involves other partners from the Southern Caucasus countries as well as from EU Member States.

In the area of **culture**, Georgia remains committed to the ratification of the 2005 UNESCO Convention on the Protection and Promotion of the Diversity of Cultural Expressions.

In 2007, **health** reform progressed. Georgia adopted a set of programmes to this effect on various areas such as the promotion of reform, financing, medical assistance to people living in poverty; in-patient assistance, the provision of specific medicines, better accessibility and availability of health services, and a hospital plan. Georgia also adopted a public health law. Georgia will continue to focus on more equitable access, including for the poor, to a basic health care package, a balanced implementation of the privatisation of health service provision and the financial sustainability of the sector. The country participated in the EU Network of competent authorities in health information and knowledge. It also took part in the TAIEX supported seminar “Health in all policies” jointly organised by the European Commission, the WHO and the European Health Observatory. Communicable diseases including tuberculosis remain a challenge in Georgia.

8. FINANCIAL COOPERATION – 2007 KEY FACTS AND FIGURES

With the entry into force of the European Neighbourhood and Partnership Instrument (ENPI) the strategic, policy-driven character of EC assistance was strengthened and the EC financial allocations generally increased. The introduction of cooperation instruments such as twinning and TAIEX strengthens the EC's ability to provide expert advice and to support technical cooperation in regulatory areas.

Since the adoption of the ENP Action Plan with Georgia, EC assistance was increasingly geared towards supporting the achievement of the policy objectives as outlined in the Action Plan. € 120.4 million was allocated for Georgia under the National Indicative Programme for 2007-2010. The programme is financing the implementation of 4 priorities: democratic development, rule of law and governance (including also public finance and administrative capacity building); economic development and Action Plan implementation (promoting trade and improving the investment climate, support for the Action Plan implementation and regulatory reforms, education and people-to-people contacts); poverty reduction and social reforms (reforms in health and social protection sectors, rural and regional development); and support for peaceful settlement of Georgia's internal conflicts.

The 2007 ENPI Annual Action Programme for Georgia has an allocation of € 24 million. In 2007 the emphasis is on public finance reform support programme, twinning facility in support of the ENP Action Plan implementation and economic rehabilitation and confidence building for Abkhazia and South Ossetia.

Georgia also benefits from co-operation activities financed under the ENPI multi-country and regional programmes and is eligible under the ENPI Cross Border Cooperation component.