

## **Georgian Capital Repatriation Project**

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Practice of financial amnesty has been world-widely approved, and many countries are using it with different frequency and efficiency. Both developed and developing countries attempt to attract capital with this method.

Traditionally, there is a big interest in capital, which had been obtained on the territory of one country and later it fled out of this country due to the political instability, weak legislation or any other reasons. Many countries successfully manage to attract the “fled” capital and make it work for the welfare of the country. However, there is a successful attempt of the countries, where this capital has fled out from, to repatriate it and return to its own environment.

So, the concept of financial amnesty basically implies repatriation of the fled capital and its treatment for the welfare of the country’s economy. Financial amnesty is an important way to fill the budget of the country, to invest in the priority sectors, and attract additional financial resources. Each country should determine the terms of amnesty, the extent of its liberal views, the alternative ways of investment of the inflow capital, taxation issues, etc. in compliance with the current economic and political objectives.

Financial amnesty, which occurs only once, will not bring any negative impact to the country – it should be considered as an attempt of the country to attract extra capital and facilitate the growth of the enterprise in the country.

There are a lot of examples of financial amnesty around the world. Great success in this field was achieved by Belgium (2003), Ireland (1988), South Africa (2003), Italy (2001), Poland (2003), Kazakhstan (2001), Switzerland (1968), India (1997), Argentine (1995), Columbia (1987), Portugal (1988), etc.

For us, as for the post-soviet country, the successful experience of Kazakhstan is most important. Kazakhstan managed to return USD 480 Million within 45 days (15 May – 13 July, 2001) due to the financial amnesty. Despite the fact that there are many examples of financial amnesty all around the world the amnesty of the “shade” capital in Kazakhstan is considered as the unprecedented and risky venture. It was unprecedented because Kazakhstan did not duplicate any previously existed model of any other country and it managed to settle the global problem in practice under the conditions of its own, unique, reality, and risky because concept of amnesty for negatively concerned by the world-wide society, and it took place simultaneously with the anti money laundering campaign. Capital, received as a result of corrupt unlawful practices, war crimes, the crimes against humanity and violation of constitutional order or national security, is not eligible for amnesty.

Financial amnesty was successful in Tajikistan, also, where USD 187 Million was legalized. Capital repatriation is an attempt of the countries with transitional economy as well as of the developed countries. Also successful financial amnesty was in Belgium. Belgium had unique approach to the issue of financial amnesty. They decided to attract the large capital only, which would facilitate country to develop faster. The small capital owners are subject to the higher rate taxation whereas the owners of the large capital have to pay lower rate taxes. The country managed to mobilize €850 Million. According to the experts, €1 Billion fled out of the country, so the repatriation came up to 85%. Due to the amnesty announced in Ireland USD 750 Million was returned, which was 15 times more than it was forecasted (USD 50 Million).

On the basis of financial amnesty in Italy €56 Billion was returned, of which €55 Billion was transferred from Switzerland. Due to the financial amnesty in Switzerland USD 6.5 Billion was repatriated.

Russia has already prepared the Law on Amnesty. According to the expert assessment the capacity of Russian capital abroad ranges between USD100-500 Billion, and at least USD 25 Billion is supposed to be returned.

So, as a result of globalization of financial markets, any unpleasant public actions are followed by the local financial capital flight from the country.

There were a lot of reasons of capital flight from Georgia within past 15 years:

- Unsustainable political environment
- Degraded economic system
- Antagonistic (negative) approach to the business of the administrative-bureaucratic system
- Irrational tax strategy
- Corruption in system
- High level of criminal activity.

As the Ministry of Economy of Georgia declared, the Government has a plan of economic reforms in the country. It's known that "National program of poverty reduction and economic growth", which was drawn by the former government with cooperation with the International Financial Institutions, will be used in this document.

According to the above mentioned document, pace of the Gross Domestic Product (GDP) growth will be placed within the annual 5-6% framework. It means that by 2015 we shall achieve the capacity of GDP which we had in 1991. And according to the industrial product (with pace of its revival which was in 1996-2002), we shall achieve the level, which we had in 1991, in 2037 only<sup>1</sup>. So, it's obvious how important it is to seek for the alternative investment resources to facilitate economic activity in the country.

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<sup>1</sup> V. Advadze, "24 Hours", #55, 6 March, 2004.

As world-wide practice shows, attempt of enforced capital repatriation is rather low-efficient. The success of such project is depended on what kind of favorable conditions for business activity are in the country, which is going to announce the financial amnesty. What does “favorable conditions” imply? This is:

- First of all, security of those juridical and physical persons, who are going to repatriate capital
- Overall anonymity of capital repatriation procedures
- Simplification of Tax Administration and reduction of the tax rates
- Liberalization of environment for entrepreneurial activities
- Minimize the state interference in economy.

The concept of amnesty is extremely obvious – on the basis of experience, approved by the international financial system, simple and at the same time effective mechanisms, which ensure the repatriation to Georgia of the capital fled out of the country as well as the capital generated outside of the country, should be drawn up.

Need of overall financial amnesty in Georgia comes out from the following statements:

- Dynamic political strategy of the new government requires realization of adequate economic policies
- The first round of financial amnesty, about tax amnesty, is already announced in the country, and requires consequent steps from point of view of overall financial amnesty.
- Georgian economy suffers from the lack of financial resources. Capacity of the direct foreign investments is insignificant, which makes it more necessary to seek for the alternative resources
- Announcement of overall financial amnesty will be a message to the whole world that the country takes new direction of liberal economic strategy, which necessarily will increase investments
- Successful project of amnesty together with the necessary liberalization of taxation system will ensure competitive and productive economy in Georgia
- By drawing moderate and liberal amnesty project existing shortage of financial trust of population towards the state, which was inherited from the former government, will gradually diminish
- Indirect effect received as a result of financial amnesty is more important, than the direct effect, as it will be followed by increased trust of international investors and improved climate for investments

Existence of state policy adequate to the capital repatriation in Georgia will insure increased level of trust from the side of financial bodies of western countries that, in its way, will positively affect credit rating of the country.

Result of positive influence of financial amnesty will affect the following financial segments:

- Large amount of illegal money, generally calculated in US Dollars banknotes, which feeds the economy of the country, will obtain the legal status
- There is a possibility of repatriation of large amounts of money, invested in western banks under condition of low profitability or as the securities, which were not returned after the import activities occurred within last 15 years
- The capital of endogenous genesis, which fled out of the country due to the criminal and discriminating environment, existed in the country during the last 10 years of the 20<sup>th</sup> century, reserves repatriation until establishment of free and equal business environment.
- Inflow of business and capital, generated by successful activity of Georgian citizen in CIS countries, to Georgia, that can be insured by the following facts:
  - Development of positive political events and liberal, economically effective environment in Georgia
  - Discomfort on the basis of ethnic belonging, which usually accompanies life and business activity in CIS countries (so called “Georgian capital of CIS” can be considered as the most prospective resource, because, as it’s known, business activity of Georgian citizens in CIS is most successful in comparison with other western countries)

To identify the concept of “Repatriation of Georgian Capital” project it is necessary to assess the approximate capacity of capital fled out of the country. It should be mentioned at the beginning that it’s almost impossible to calculate precisely the capacity of capital fled out, because no organized accountings were made in this direction. Accordingly, we shall use the least and indirect methods of assessment.

According to the calculations of budget office, the capital flow of the Georgian market is USD 600 Million<sup>2</sup>. As R. Gotsiridze put it, this capital serves the shadow economy: there is USD 210 Million in the legal sector, while amount, which is 12 times more, serves the illegal business.<sup>3</sup>

According to the data of Chamber of Control, production with total cost of USD 400-500 Million fled out of Georgia due to the incorrect financial credit policy in 1992-1993. In conditions of hyperinflation to cover a loan, disbursed in “Coupons”, 1% of borrowed

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<sup>2</sup> According to the year 1999

<sup>3</sup> Source: “Micro Macro Economy”, #2, 1999, interview with R. Gotsiridze “About the reason of GEL Devaluation”

amount, converted into USD, was sufficient, while the rest 99%, received as a profit, was obtaining illegal status.<sup>4</sup>

It's impossible to determine precise amount of capital fled out in 1992-1995, as capital flow administration and capital inflow calculation were missing in that period. Relatively exact figures can be found for the following years. According to the payment balance of Georgia calculated by the State Department of Statistics of Georgia in 1996-1997, capital illegally fled out of the country in 1996 averaged USD 27.8 Million, and in 1997 – USD 120.6 Million, which means 4.3 times more in comparison with the previous year. These facts illustrate that the process of capital outflow from Georgia which had begun during the crisis years, didn't stop upon end of the crisis in Georgia, and, moreover, it tended to grow.<sup>5</sup>

USD 600 Million	According to the calculations of the budget office by the data of 1999, unregistered USD 600 Million is in circulation. The Head of the Parliament Budget Office of Georgia, Mr. Roman Gotsiridze assumes that this capital serves the shade economy, i.e. main part of the capital, presented by stable currency, is in illegal circulation. Let's see it in figures: USD 210 Million is in legal sector, while huge amount, approximately 12 times more, serves the illegal business.	(Source: "Micro Macro Economy", February, 1999, page 16, interview with Mr. Roman Gotsiridze "About the reasons of Lari Devaluation")
USD 400-500 Million	According to the data of Chamber of Control due to the incorrect financial credit policy in 1992-1993, production with total cost of USD 400-500 Million fled out of Georgia. In conditions of hyperinflation to cover a loan, disbursed in "Coupons", 1% of borrowed amount, converted into USD, was sufficient, while the rest 99% was left out of state monetary network. The goods, purchased in Georgia for low prices in "Coupons" were sold abroad for real prices in stable currency. "Many physical persons became rich due to the profit received," Mr. Revaz Shavshishvili, the first chairman of Chamber of Control, said in his interview to the newspaper "Kronika" in >>>	(Source: "Kronika", #8 (120), 23-29 February, 2004
USD 148.4 Million	According to the payment balance of Georgia calculated by the State Department of Statistics of Georgia in 1996-1997, capital, illegally fled out of the country in 1996, averaged USD 27.8 Million, and in 1997 – USD 120.6 Million, which means 4.3	(Source: "Micro Macro Economy", February, 1999, page 16, Mr.

<sup>4</sup> Source: "Kronika" #8 (120), 23-29 February, 2004

<sup>5</sup> Source: "Micro Macro Economy", February 1999, N. Turashvili's article "Iceberg of state Finances"

	times more in comparison with the previous year. These facts illustrate that the process of capital outflow from Georgia which had begun during the crisis years, didn't stop upon end of the crisis in Georgia, and, moreover, it tended to grow.	<i>Nariman Turashvili's Article "Iceberg of state finances"</i>
Total: USD 1 148-1 248 Million, or <i>approximately USD 1 200 Million</i>		

Schemes of capital outflow are so various and complicated that it's almost impossible to calculate the precise amount of capital fled out with a specified approach. In conjunction with the different approaches in Georgia it can be considered advisable to use "comparative" method (use of historic analogues). Particularly, the ratio between the capital flight and GDP in experienced countries can be used as a model for Georgia.

In our case, with this purpose relevant data of Russian Federation, Kazakhstan, and Tajikistan are used. Capital fled out of Russia is assessed as USD 100-500 Million, in Kazakhstan it is estimated as USD 0.5-20 Million. The amount of GDP was taken from data of statistical calculation of the comparing countries and Central secret services agency<sup>6</sup> of the USA. On example of Georgia the individual ratio between capital flight and GDP in above mentioned countries, as well as their simple average volumes, are used. With such approach capital fled out of Georgia is estimated as USD 1.106 Billion.

On the basis of capital repatriation project business environment can be significantly enhanced. We have used a method of Model Calculations to demonstrate what kind of positive results can be provided in economic system by estimated increased financial injections. Predictable calculations for 2004-2005 were made by the model of economic policy and structural growth in 3 options.

The first option of calculation is based on the inert tendency of development. It is implied that the government does not pursue the active economic policy and the economic development of Georgia will have the same tendency, which it had during the past 8-10 years.

The second option anticipates possible repatriation of USD 50 Million in 2004, due to the financial amnesty, and its investment in economic system. It means that approximately 90% of repatriated capital will be invested in economy, and the rest 10% will be used for non-investment purposes, such as money-flow services, taxes, etc.

The third option is based on the concept of possible repatriation of USD 500 Million and the same distribution of this capital in investments and services as in the second option.

While making calculations according to these two options, it's implied that no other specific measures are pursued in regulation of economy during the prognosis period, and the effect received is completely provided by the activation of additionally received capital. The model makes it possible to measure indirect effect, which is demonstrated in results of calculations.

<sup>6</sup> <http://www.cia.gov/cia/publications/factbook/>

## The prognosis of Georgian Economy in 2004-2005

(% in comparison with the previous year)

	Option	2003	Prognosis	
			2004	2005
Gross Domestic Product	1	8.6	7.1	8.5
	2		8.4	15.3
	3		17.1	36.3
Industry Product	1	14.0	8.4	10.0
	2		11.7	19.2
	3		42.6	62.0
Agricultural Product	1	7.0	5.7	7.3
	2		6.1	13.2
	3		8.9	26.3
Investments	1	16.3	6.3	11.4
	2		11.5	20.5
	3		56.8	76.3
Household Consumptions	1	8.7	6.1	8.1
	2		7.6	13.8
	3		8.5	22.9
Export	1	17.4	7.7	10.0
	2		7.8	15.3
	3		9.9	25.6
Import	1	18.5	7.3	9.2
	2		7.5	13.9
	3		10.4	20.9
Revenues of the Central Budget	1	4.7	2.8	8.4
	2		4.0	15.2
	3		14.6	35.9

Model calculations show that 8.4% growth of GDP is anticipated in 2004 according to the second option, and 17.1% - according to the third option (in comparison with 7.1% according to the first option). As it was expected, the figures in 2005 are much more significant in comparison with the neutral option (8.5%): 15.3% is anticipated according to the second option, and 36.3% - according to the third one.

It is expected that investments according to the third option will essentially change Georgian economy and enhance its structure. By this option the portion of industry in GDP, which by the first option is much less than the portion of agriculture, will be equal to it, and in 2005 will be even more. Construction activity will be essentially increased. Its production in 2004-2005 will be 73% more, and will stimulate growth of its portion in GDP. Such grade of growth will positively impact the industry and social infrastructure, providing them with conditions of rapid growth.

The parameters of value added growth, demonstrated in expanding of tax basis, are of special interest. The significant growth of salaries (39.3%), VAT (57%), profit and other types of profit (49%) is anticipated in 2004-2005. In conditions of current fiscal policy and tax mobilization, such growth will increase income of the budget 1.5 times.

### **Summary – Recommendations**

According to the mentioned above, new financial investments are vital for economic development of Georgia. From this point of view, a model of “Georgian Capital Repatriation” project implementation should be drawn. The basic principles and objectives of capital repatriation are given below:

1. At the first stage, the tax amnesty should be implemented in the country.
2. At the second stage, overall financial amnesty should be announced, which implies returning to Georgia of the capital fled out of the country and as well as the capital generated abroad.
3. Liberalization of the Tax Code.

*The first stage* of the Tax Amnesty has already been commenced: The law “About the declaration of tax liabilities” has been drafted. The project is timely and effective. We have the following recommendations towards it:

- By this project the entrepreneur, who was pursuing the legal accountancy and, respectively, has declared liabilities to the state budget, is in discriminated position;
- There is a curious approach to the definite group of entrepreneurs, who due to their entrepreneurial activity were obeying the Law and during the years were paying all taxes, imposed by the state. Entrepreneurial vision and declaration of all tax liabilities, which was based on high civil culture, spurred such entrepreneurs to transfer almost all their incomes to the state budget, and, correspondingly, be satisfied with a symbolic income.



On the basis of the law draft, fair entrepreneurial practice becomes doubtful from the point of view that such entrepreneur will face the losing reality due to his law-abidance during the years. Respectively, the specified incentive regulations should be provided in the draft to eliminate discriminating environment.

*On the second stage* the overall financial amnesty should be announced. The purpose of financial amnesty is inflow of additional financial resources to the Georgian economy and pursuing the single measure of legalization of the capital, obtained due to the legal or shade entrepreneurial activity within the country or out of it, which after receiving profit got illegal status. A special law about overall financial amnesty should be drafted for fulfilling the above mentioned project. The Law will not involve capital, received through corrupt unlawful practices, war crimes, the crimes against humanity, violation of constitutional order or national security, violence against property, loyalty in the state services, public health, and morality.

The Law about overall financial amnesty will be technically implemented according to the following scheme: financial resources mobilized within the country or outside of it will be placed on the special accounts via deposits in national or foreign currency or transfers from the personal accounts in foreign banks. This capital can not be used within the period of legalization. The list of foreign currency is determined by the National Bank of Georgia.

The period of overall financial amnesty is 90 (ninety) days during a year. Commencement date of the period is determined by order of the President of Republic of Georgia.

The amounts will be deposited (transferred) on the special accounts, opened in national banks of Georgia. After deposit (transfer) the person is provided with a document, certifying amount and date of deposit.

*Terms for legalization:*

Repatriated monetary assets are subject to taxation by 10% and will be placed on deposits without interest for the period of 7 days (this period is called legalization period) or will be subject to taxation by 10% without legalization period. The person can use his capital the next day after finishing the legalization period. Repatriated non monetary assets are subject to taxation by 12%. Information about the special accounts and amounts on them is confidential.

The special accounts do not serve as a basis for any procedural measures, neither criminal liability nor administrative charges.

Money transfer or deposit is also acceptable in commercial banks, but the deposit insurance issue will come up automatically. There is no deposit insurance system in Georgia, that's why accounts in national banks are priority in this dimension.

*On the third stage* it's necessary to improve taxation basis through the tax rate decrease. If the Tax Code is not enhanced, the first and second stages will lose their power. The Tax Code changes present the first signs that the liberalization of economic policy is starting and that there are good conditions for specific actions, such as declaration of tax liabilities and overall financial amnesty project. It is announced that the new Tax Code will enter into force in 2005. This period is enough to produce new improper entrepreneurial tendencies, and make a new business-enterprise activity to move to shade. In order to eliminate this vacuum before the new law will be adopted, urgent steps should be taken to receive thought-out taxation initiatives.

The above mentioned three stages will give us an opportunity to form an economic strategy, which can be called "Repatriation of the Georgian capital" project. This action will facilitate the formation of Georgian competitive economy. On the basis of above mentioned projects, the following economic effects are anticipated:

- The "black" cash, circulating in the country, will obtain the legal status
- The capital, fled out of the country due to the various uncertainties, will flee back into Georgian economy
- New capital, generated abroad and embodied with modern investment and technologies, will flee into economy of the country (so called "Georgian capital", generated in Russia within past 15 years).