

CHAPTER II. IMMEDIATE IMPACT OF THE CONFLICT AND THE INITIAL RESPONSE

OVERALL IMPACT ON THE ECONOMY

9. Over the last five years, Georgia has implemented far reaching strategic reforms centered on anti-corruption measures and has established strong mechanisms of accountability and transparency in government. The reforms aim at developing a competitive private sector as the main engine of growth, with the state playing a supportive role by providing basic public goods and services – as seen in improvements in education and health care delivery and the introduction of a well targeted social safety net to protect the extreme poor. Driven by rapidly rising foreign direct investment (FDI) flows, economic growth averaged 10½ percent per year over the last three years and reached 12½ percent in 2007.

10. The recent growth has largely been jobless in net terms, as high quality private sector jobs created have just about compensated for job cuts resulting from public sector reforms. The pre-conflict unemployment rate of 13 per cent concealed much under-employment. The government estimated that over the next four-five years up to net 250,000 jobs would have been created on the basis of rising foreign direct investment, (pre-conflict FDI forecast: \$4-8 billion over the same period), sufficient to lower unemployment to single digits.

11. The crisis of August 2008 has resulted in shocks to economic growth and stability in Georgia. These shocks have led to a weakening of investor, lender and consumer confidence, a contraction of liquidity in the banking system, stress on public finances, damage to physical infrastructure and other infrastructure bottlenecks, and increased numbers of internally displaced persons.

Table 1: Impact of the Conflict

	2008	
	Pre-conflict	Post-conflict
Growth (percent)	9.0	3.5
Inflation (percent)	10.0	8.0
Fiscal balance (percent of GDP)	-4.0	-6.0
FDI (\$billion)	2.1	1.2
External current account (percent of GDP)	-16.6	-20.8
Budget support needed (\$ million)	--	480

Source: JNA staff calculations.

12. Now, two months into the crisis, output continues to be weak and the near-term outlook is of a rise in unemployment, with consequent negative effects on poverty reduction. The construction, real estate, retail and tourism sectors have been particularly badly hit and the long term confidence effects on the country's potential as a transit centre for trans-continental energy and trade is also a matter for serious concern.

13. A key point of stress arising from the crisis is to Georgia's public finances, as the economic downturn results in shortfalls in revenue collection. To avert a sharper and more protracted downturn, it is critical to adopt a counter-cyclical fiscal stance with reductions in public expenditures amounting to much less than the projected fall in budgetary revenues. This will require significant budgetary support from donors.

14. In the immediate aftermath of the crisis, the economy experienced an increase in the demand for dollars and withdrawal of deposits from the banking system. Deposits have recovered since but are below pre-crisis levels. The immediate risks of a liquidity crunch were rapidly addressed by the National Bank of Georgia (NBG) and the Financial Services Authority (FSA) through easing monetary conditions and selected regulatory forbearance.

15. The economy is expected to begin recovering in the second quarter of 2009 after experiencing a contraction in the second half of 2008 and the first quarter of 2009 – provided budget support in the required amounts is received. As a result, growth is projected at 3.5 percent in 2008 (Table 1) and 4 percent in 2009, which represents a downturn compared to the pre-crisis projections of 8-9 percent growth for 2008-09. Growth is expected to subsequently accelerate to 6 percent in 2010-2011. As a result of the economic downturn, GNI per capita by 2011 is projected to be \$660 below pre-crisis projections.

16. Revenue shortfalls compared to pre-crisis projections are \$385 million for 2008 and \$640 million for 2009. Additional shortfalls are expected in privatization receipts. Reductions in total expenditures of about \$120 million in 2008 and \$570 million in 2009 are planned; these figures include rises in certain categories of spending (such as shelter and support for displaced populations). This fiscal stance will require donor budgetary support of \$480 million in 2008.

17. Preliminary estimates indicate that unemployment may increase from 13.3 percent in 2007 to 15.1 percent by 2010, and poverty levels increase from the current 23.6 percent to 25.9 percent. Under these circumstances, protecting public social expenditures would be important to ensure that the social safety net remains intact and addresses the needs arising from higher unemployment and poverty levels and the increased numbers of IDPs.

18. In order to ameliorate the employment shock, the authorities are asking various donor countries to provide temporary work permits for about 100,000 Georgian workers for a period of several years.

Sector Impacts

19. The impact of the conflict on Georgians living in the conflict-affected areas has been considerable. They have seen their lives suddenly uprooted and for many of them the future is uncertain. Damages have been amplified by the massive displacement of people (Tables 2 and 3). The longer-term impacts, if not addressed promptly, may be sizeable. Those already poor might fall deeper into poverty, and many of the newly vulnerable may become poor.

20. Physical damage to the infrastructure sectors as well as to the environment is tragic but not large as measured by post-conflict conditions elsewhere in the world and is being rapidly addressed largely by the government's own efforts. In infrastructure, critical sectors

such as energy and roads would remain vulnerable to exogenous shocks which could lead investors to search for opportunities elsewhere in the region. A sharp reduction in investment, compared to pre-conflict levels, is being experienced. These effects could combine to stunt the long-term development potential of the country.

SOCIAL SECTORS

21. The affected population is largely rural and poor. As with the rest of the population, the poor will be supported through the targeted social assistance program – it is important that equity considerations require identical treatment of the poor. Certain needs particular to the conflict-affected will be addressed as follows:

- the newly long term displaced (up to about 30,000 people): in need of temporary shelter (until permanent housing is provided); food and non-food support; access to health and education; permanent housing; source of livelihood, start-up assistance;
- the temporarily displaced (about 34,000 people; expected to return to their homes by next spring): in need of temporary shelter; food and non-food support; psycho-social assistance; access to health and education as well as support to repair damage to their houses, assets and to restore livelihoods once they have returned;

Table 2: Groups of IDPs³

Internally Displaced Persons	In collective centers	With host families	Returnees	Spontaneously settled	Total
1992 IDPs	94,169	55,005		73,460	222,634
2008 IDPs	41,992	17,211	68,269		127,472
Total	136,161	72,216	68,269	73,460	350,103

Table 3: IDPs by Geographical Distribution

Regions of origin	South Ossetia	Area adjacent to South Ossetia		Abkhazia	Area adjacent to Abkhazia	Total
2008 IDPs	22,085	68,394	30,802	1,218	5,000	127,499
1992 IDPs	12,493			210,141		222,634
Total	34,578		99,196	211,359	5,000	350,133

Source: JNA staff calculations.

- the returnees (about 73,000 people): population that had experienced temporary displacement but has returned back: In need of assistance to restore their livelihoods and repair damage to their property;

³ As of end-September 2008.

- the population residing in conflict affected areas (estimated at 31,000). Conflict induced economic deterioration might push more people into poverty and/or already poor people might be pushed deeper into it;
- the IDPs from 1992 (approximately 220,000 people – 55,000 households): New displacements have highlighted the situation of the persons displaced for over 15 years, particularly those still living in collective centers or with host families and those who are particularly vulnerable to poverty.
- the population elsewhere in Georgia might be affected by conflict induced economic deterioration, leading to jobs (the swing in employment, as noted, is equivalent to almost a fifth of the labor force) and income loss, might be pushed into poverty and already poor people might be pushed deeper into it.

22. **Return, relocation and resettlement.** For the most part, IDPs have access to water, sanitation facilities and secure shelter, although conditions in the collective centers vary from adequate to sub-standard. Preliminary data indicate that 90 per cent of the houses in the accessible villages north of Gori were either undamaged or suffered only minor damage, with more damage occurring inside homes due to looting. On September 11, 2008 the government issued a decree outlining its preliminary strategy to respond to the needs of the newly displaced. The search for an adequate response has highlighted the predicament of the IDPs displaced since 1992 of whom almost 150,000 still live in 1,600 collective centers or with host families. Emergency (winterization) and longer-term (durable housing) measures have been identified for this group as well as efforts to secure the protection and fulfillment of the rights of the displaced people.

23. **Social protection.** The conflict led to a rise in the number requiring social assistance, thereby adding to the administrative burden. It is estimated that an additional c. 100,000 people who have been affected by the conflict, directly or indirectly, are now vulnerable and thus in need of social protection assistance. A possible economic deceleration combined with increasing food prices would lead to a deepening of poverty and food insecurity among the vulnerable. The costs of the targeted social assistance program will rise.

24. **Education.** The most important impact in the sector is the interruption of education of newly displaced children and of those children who attended schools that are now housing IDPs. About 99 schools have suffered damage to varying degrees. Of these, six schools were burned down, and one school and the State University in Gori were heavily damaged. Schools and kindergartens have been used to house many of the internally displaced—by mid-September approximately 18,000 IDPs were still occupying such facilities. The school year started as planned in most schools, with double shifts introduced in some schools to offset the loss in capacity. The resumption of pre-schooling, however, is severely affected by the lack of facilities, especially in Tbilisi.

25. **Health.** The conflict had a severe impact on the capacity of health care providers to ensure the delivery of services. . In terms of human suffering, the officially registered number of citizens killed during the conflict is 391, with the injured at 2,234. Health

infrastructure in the conflict area has suffered considerably. In the buffer zone, 13 primary health care facilities were damaged to varying degrees. Equipment was looted from many of these, and many health workers were displaced. The emergency center in Gori was totally destroyed.

26. **Employment and livelihoods.** The deceleration of the economy will inevitably lead to an increase in poverty and unemployment. As noted, the government is requesting increased work permit quotas for Georgians from donor countries. If quotas for about 100,000 workers were to be granted, economic and social pressures would abate greatly. There has also been a disruption to non-agricultural and trading enterprises throughout the country but particularly in and around the conflict areas.

27. **Food security and agricultural livelihoods.** The conflict separated people from their land which for most had been the main source of income and food. Having been able to nourish themselves independently, all of a sudden the displaced not only could not attend to their crops but also had to rely on food aid. The cutoff of irrigation supplies from South Ossetia before the recent conflict, and the massive displacement caused by the crisis provoked the disruption of agricultural activities, particularly the harvest of field and fruit crops. Losses to agricultural production in the Gori plain are large, borne largely by the area's 40,000 smallholder families. Without resumption of irrigation, not only will this year's fruit crops be lost but the trees themselves may eventually die.

Infrastructure Sectors

28. **Transport.** *Roads* suffered only minor damage and repairs have already been carried out. Some road construction machinery and equipment was looted. The conflict has, however, highlighted the vulnerability of the road network, especially of the main road network, as well as the need to upgrade alternative routes that have fallen into disrepair. This would also link local communities to the main network thus improving access to services and markets and bringing more economic benefits to the country.

29. *Georgian Railway (GR)* suffered conflict-related damage to one major bridge, damaged the signaling, fiber optic communications cable and electrification attached to the bridge, and damaged other infrastructure in several locations (including damage to tracks and electrification, and station buildings). GR restored service quickly through the construction of a temporary detour of the main bridge. Other infrastructure has also been repaired and is fully operational. *Poti Port* suffered minor physical damage but suffered revenue and reputational losses, leading to sharp rises in insurance cover costs.

30. *Aviation* suffered the destruction of the primary and secondary radar in Tbilisi. There is now no primary radar coverage of the Georgian air space. Though other radars are being used at the moment, they can handle fewer flights, leading to a loss of revenue. The Tbilisi airport runway is in need of urgent repair.

31. **Energy.** The direct impact to energy infrastructure is modest and includes torn-off and broken power lines, damaged gas pipelines, a resulting temporary interruption in gas power and gas supply, and a temporary suspension of oil shipments. Damages have largely

been repaired and service to customers restored, although power transformers and switchgear have not been replaced yet, thus relying on backup systems. The conflict has brought to the fore the vulnerability of the all-important Enguri hydropower plant as it straddles the administrative boundary with Abkhazia. Repairs to the natural gas network in the Gori region have been undertaken as temporary measures and should be followed by more comprehensive rehabilitation as soon as possible to maintain safety and reliability of operations. Customers' payment discipline has been markedly lower since the conflict, however, particularly in regions that suffered directly.

32. **Urban and municipal sector.** Damage to municipal infrastructure in Gori, Senaki, Poti and Zugdidi was minimal, limited mainly to cracking on c. 100 kms of local roads caused by heavy military vehicles and damages to over 70 kms of water pipes, two wastewater treatment plants and public and private buildings. Only few repairs have been undertaken so far. The conflict put additional strain on the already dilapidated infrastructure in these towns. It is critical that needs associated with the new settlements are addressed.

33. **Environment.** Environmental damage is localized, but possibly significant future damage can be expected if various mitigating actions are not put in place quickly. Major damage includes the following. *Protection and production forests.* Forest fires broke out almost simultaneously at several sites in Georgia around August 14. Fires were largely extinguished by the beginning of September. *Natural habitats and protected areas.* Damage has been limited to two national parks and one nature reserve.

IMPACT ON THE GEORGIAN REGIONS OF ABKHAZIA AND SOUTH OSSETIA

34. The impact of the conflict on Abkhazia appears to have been moderate. A 2007 review of socioeconomic needs found widespread poverty and very high unemployment, partly related to the effects of the 1992 conflict. Most of the population lives in rural areas and most farms measure between 0.3 and 0.6 hectares. Assistance, largely from the UN, focuses on returnees and the area of the conflict for development (micro and small enterprises), food security and agriculture production, health, education, social protection, child, IDP and returnees' protection and housing.

35. A UN humanitarian assessment mission to South Ossetia, in mid-September found extensive destruction of property in Tskhinvali and in some nearby villages. Public claims of up to 80 per cent destruction of the housing stock in Tskhinvali appear exaggerated, but neither is the destruction light. No quantified estimates could be made. The UN mission found that the most severe needs for emergency relief had been covered in the first 5-6 weeks following the conflict, but certain important gaps remain. The protection of civilians emerged as the most urgent humanitarian concern, especially in conditions for return and durable solutions for the most vulnerable displaced persons. The mission also noted an insufficient rule of law, widespread violations of property rights. There is also an urgent recommendation concerning reestablishment of mass vaccination campaigns for polio and measles.

IMMEDIATE HUMANITARIAN RESPONSE

36. From the onset of the crisis, the government and the UN system triggered the humanitarian response, together with NGO partners, through the establishment of sectoral groups and immediate delivery of assistance to the affected population. This response has focused on provision of essential support to newly displaced populations across the country and the setting up of a camp hosting 2,500 IDPs in Gori. Food and non-food items (NFI), health care and psycho-social support were put in place and vital repairs to water and sanitation in collective centers enabled the continued accommodation of IDPs.

37. Soon after the cessation of hostilities, IDPs began to return to their places of origin and the humanitarian response began to focus both on support to those able to return and continued attention to those who remained displaced. The government led efforts to rehabilitate houses and apartments of the returnees with support from other partners in the overall return process, and reorganized the collective centers and postponed the start of the school year to 1 October, 2008 to allow the accommodation of IDPs to be better managed.

38. On 18 August, 2008, the UN launched a 'Flash Appeal' to raise funds for the Humanitarian Response in Georgia. The Appeal aimed to raise a total of US\$60 million for 40 NGO projects, 24 UN projects and 2 IOM projects to respond to the needs provoked by the crisis in the period to March 2009 in the sectors of food aid, health and nutrition, logistics and communication, coordination and support, protection, shelter and NFIs and water, sanitation and hygiene.

39. Particular achievements of the humanitarian response were: the delivery of food assistance to IDPs; the operation of mobile clinic teams in conflict-affected areas; the creation of child friendly spaces for play and recreation in 50 collective centers; the opening of psycho-social support desks in 20 IDP centers in Tbilisi; water and sanitation interventions in Tbilisi collective centers, including establishment of rapid response teams for emergency infrastructural rehabilitation in collective centers; distribution of personal hygiene articles and household water kits to IDPs in Gori, Tbilisi, and West Georgia; support with provision of safe water for Gori; and coordination across all agencies.

40. The response from the government has overall been speedy and adequate. The government has endorsed a policy of "full support to local integration of IDPs from South Ossetia and Abkhazia" and has quickly adopted measures to implement it, in particular providing durable housing solutions.

41. The government has added to its 2007 IDP strategy, in order to encompass the response to the new displacements. The supporting action plan contains measures for the (i) creation of conditions for the dignified and safe return of IDPs, including creation of conditions for return and provision of assistance to presumed returnees; (ii) support to decent living conditions for the displaced population and their participation in society, including improvement of the living and socio-economic conditions of IDPs. The action plan has two parts, the first including measures to be undertaken by the state budget and the second presenting complementary measures to be funded and implemented by the international and non-governmental organizations within the framework of the State

Strategy. The continuing humanitarian response is guided by and complementary to the government plan.

42. Access remains the main issue affecting humanitarian operations. The current lack of humanitarian access into either South Ossetia or western parts of the country, the nature of the access requirements put in place by foreign forces for entry into the 'adjacent areas' (including prior notification of missions, locations to be visited, cargoes, etc) and the state of lawlessness in those areas continue to prevent full implementation of humanitarian operations. The potential impact explosive remnants of war (ERW) in areas of return is as yet unknown. There is undoubtedly a need for mine risk education (MRE) and clearance activities in the 'adjacent areas'.

JOINT NEEDS ASSESSMENT AND FLASH APPEAL

43. To ensure consistency amongst the humanitarian and the transitional and development oriented actions, promoting the necessary continuum from humanitarian response to development, the JNA and the Flash Appeal have been coordinated. To this aim, the revision of the Flash Appeal and the JNA has been conducted in parallel.

44. However, these two instruments have different scopes and foci. Whereas the Flash Appeal focus on the immediate humanitarian needs of those affected directly by the conflict, the JNA looks at the needs of those directly and indirectly affected by the conflict, in addition to the macro-economic impact and infrastructure damages and losses. As such, the JNA sets the basis for mainstreaming of early recovery efforts within all sectors, determines the recovery requirements and priorities from early to full recovery and provides links to the longer term development objectives.

45. The initial phase of the JNA has been tailored to ensure consistency with the Flash Appeal. Thus, the revised Appeal will run seven and a half months instead of the usual six, to end March 2009, therefore coinciding with the initial six months period of the JNA.