

POLICY BRIEF

The Economic Impact of COVID-19 in Rural Georgia

COVID-19 is causing major disruption to the economy worldwide and consequently in Georgia. This paper looks at how Georgia's economy will be affected, the likely impact on its rural areas and potential policy responses. It argues that the crisis impacts demand, supply and exchange rates, and that short-term impacts should be distinguished from longer term impacts. It shows that a consensus is emerging that the economic impact of this crisis will not be short-lived, but that the economy may have to deal with severe effects until deep into 2021. It reasons that agriculture will not be affected strongly, while services will be greatly affected. Finally, it provides some policy options to mitigate the effect.

What happens to the economy?

Economists distinguish three main levels of economic impact:

1. A **short shock and quick recovery** under which the economy returns to its pre-virus state and no output is lost (so-called "V-shaped recession").
2. A **longer and more severe recession** followed by eventual recovery that does however not compensate for the output lost (so-called "U-shaped recession").
3. A **major shock and damaging long term impacts** leading to recession and then growth slower than without the shock (so-called "L-shaped recession"). Many enterprises will have gone out of business and people will have lost their jobs.

The emerging consensus is that recession cannot be avoided, with several factors combining to do economic damage:

1. **Demand:** people stay at home because of illness, social distancing and quarantine and therefore spend less. The services sector is particularly badly hit as governments warn people to stay away or force closures.
2. **Supply:** businesses reduce production because of lower demand or because staff are off sick or in quarantine. Enterprise finances are hit as revenues fall, but fixed costs stay unchanged. Some businesses increase supply as demand for products linked to the crisis increases – hand sanitiser, face masks and some pharmaceuticals.
3. **Uncertainty:** decisions to invest are deferred because of loss of consumer confidence, negative expectations and unpredictability of the length of the crisis.
4. **Exchange rates:** deterioration of the epidemic, lower remittances and reduced trade in goods and services, falling investor and consumer confidence leads to capital flight and changes in the exchange rates, with effects on trade.
5. **Finance:** people lose their jobs or move onto sick pay at levels well below their usual salary. Businesses become insolvent or make much lower profits. Those with mortgages and rents are unsure if they can continue to pay, combined with a general problem of paying bills as incomes fall. Where debt is in foreign currencies, as is widespread in Georgia, changes to the exchange rate also affect households' and business' ability to meet payments.
6. **Labour force:** illness and death affect productivity and take people out of the workforce.

In addition to these short-term effects, a crisis like this may have **structural effects** on labour market and the economy that emerge in the long run.

7. **Changes in the way businesses work:** the crisis opens possibilities for innovative or better adapted sectors and **business models** to prove their value: for example, **working from home, e-work, e-education, online-shopping and food delivery** could increase, partially replacing current models. Some businesses may also decide that more diversified methods and mechanisation are a better insurance against future outbreaks of disease and thus substitute capital for labour.
8. **Supply chain changes:** even before the COVID-19 crisis, parts of the global supply chains were being brought back to the home country or at least to the region ("repatriation"). As businesses realise the cost of depending on external suppliers, they might now be even more inclined to use local suppliers at least for those parts that are essential for production.

What type of recession can be expected?

There is a general agreement that a global recession is looming.¹ Some also warn of a long recession with a lasting structural impact. *The Economist*, a magazine, predicts that a quarter of all firms outside China would become insolvent if the COVID-19 slump extended to six months.² This could then cause a banking crisis.

As a small, open economy, Georgia will not be able to rely on domestic consumption to keep the economy afloat. TBC, a bank, predicts that Georgia faces a net loss of USD 450m in tourism, goods exports, remittances, foreign direct investment and imports in case of a short recession. For a prolonged global recession, it predicts a recovery starting only in the last quarter of 2020 and a sharp depreciation of the Georgian Lari (but a recovery thereafter).³

Previous pandemics provide examples of the **spread of the economic costs**: about one-third occur because of quarantine, closures and loss of life, while the rest occur because of more lasting changes in consumer confidence, business behaviour and the impact on financial markets.⁴ The most conservative estimates of the total extra fiscal stimulus announced to date put it at 2% of global GDP,⁵ and over 20% in monetary stimulus.⁶ The European Investment Bank estimates that it will take a decade to regain pre-virus GDP and debt levels. This provides a rough benchmark of the cost of COVID-19.

What might happen in Georgia's rural areas?

Georgia's urban population will probably show the highest rate of infection because people living, working and socialising closer together mean that transmission will be greater. But travel between urban and rural areas means that there will be transmission into the rural population. This might happen because of tourism, where approximately 30% of Georgia's domestic tourism is for visiting friends and family. Note also that the epidemic epicentres in both Austria and Germany are small towns (Ischgl with 1,600 and Gangelt with 11,600 inhabitants), caused by tourism (Ischgl) and a single social event (Gangelt).

Poorer rural health services and an older population mean that the severity of the illness, hospital admissions and death rates will probably be higher in the countryside.⁷ Getting medicines may also be harder in rural areas.

Loss of income will hit the rural population especially hard: about 60% have a household income below GEL 500; 40% do not have enough savings to make investments. In average, 25% of the income may be affected, with strong variations between households: over 50% of private sector employees earn at least 80% of their income from the job. Pre-crisis, some 11% of rural non-farm businesses already considered their situation as bad and the same percentage expected that it will get worse.⁸

¹ E.g., the leading Robert Koch Institute of Germany warns that the extraordinary situation may last for up to 2 years, with all the economic consequences. The Imperial College London predicts for the UK either half a million deaths by the end of the summer if nothing is done, or strict measures of social distancing until Q1/2021 to cope within the limits of the health system (<https://www.imperial.ac.uk/news/196234/covid19-imperial-researchers-model-likely-impact/>).

² <https://www.economist.com/finance-and-economics/2020/03/12/corporate-bonds-and-loans-are-at-the-centre-of-a-new-financial-scare>

³ <https://www.tbcresearch.ge/en/Research/Download?ResearchId=283&Type=PDF>

⁴ <https://blogs.imf.org/2020/03/04/potential-impact-of-the-coronavirus-epidemic-what-we-know-and-what-we-can-do/>

⁵ <https://www.economist.com/briefing/2020/03/19/governments-are-spending-big-to-keep-the-world-economy-from-getting-dangerously-sick?frsc=dg%7Ce>

⁶ <https://www.economist.com/leaders/2020/03/19/how-to-prevent-a-covid-19-slump-and-protect-the-recovery?frsc=dg%7Ce>

⁷ Note that the 150 respirators available in Georgia mean that there is only one available for every 25,000 citizens, or in average one per municipality (Note: apparently, Georgia obtained 500 additional respirators from private sources, improving the ratio to one respirator for every 6,000 people).

⁸ Results of two large true random surveys conducted by UNDP/IRDG (Improving Rural Development in Georgia) at the end of 2018 in 8 ENPARD target municipalities: Keda, Khulo, Borjomi, Akhalkalaki, Kazbegi, Tetrtskaro, Lagodekhi and Dedoplistskaro.

Agriculture and agroindustry

Agriculture looks less likely to be affected than other sectors since demand for food will probably not change much.⁹ Demand for domestic production might even increase if imports are disrupted. The many under- and unemployed people in the countryside may compensate for potential losses from the rural labour force due to sickness and death. Another factor is that most farmers traditionally cultivate their own land only using family labour. Impacts could also be felt if illness or lockdowns prevent products getting to market, although short supply chains mean this is probably not a major risk. Export-driven industries such as wine may however be affected.¹⁰

Difficulties in the **agroindustry** supply chain (e.g. delays and temporary shortages) may affect this sector more than others, because of perishability and seasonality. Labour shortages and loss of skills may temporarily affect production. Many smaller companies (the usual case in rural Georgia) might encounter a credit crunch, leading to insolvencies and closures.

Services

Georgia's service industry generates 60% of GDP and employs 44% of total employment.¹¹ Most new firms in 2018 were in wholesaling and retailing, and car and motorbike repair. **Georgia's rural economy is dominated by services** and, for example, in 8 of the municipalities which receive EU-funded support to rural development, most firms in the non-farm economy work in trade (49%), transport (18%) and hotels and restaurants (7%).¹²

This matters because of expectations that **services** will be hardest hit. Services involve the most human contact and so will be the worst affected by social distancing and compulsory closures. The services sector is diverse, and some parts will be harder hit than others. Tourism, restaurants and entertainment, the creative industries, and non-food retail outlets will be badly affected.

Tourism and hospitality are hit first and hardest as borders are closed and governments urge or force their citizens to stay at home rather than going out for entertainment. Hotels in Georgia surveyed by TBC had 50-60% fewer reservations in March and April and restaurants have seen a sharp decline of total revenue.¹³ This is in line with Western experience, where restaurant bookings are down by 82% (UK), 90% (Germany), and 94% (Canada)¹⁴. **In Georgia, 2020 tourism revenues are already down by 25% year-on-year and might reach 50% in case of a prolonged recession.**¹⁵

Related services, many of which are informal, will be hit (for example taxis, guides, travel agencies, moneychangers, cleaners and outsourced services such as laundry). Income will be lost; jobs will be shed; and those businesses with loans might have to be wound up. The impact could be large: rural hotels and restaurants employ, on average, around 5 people, nearly two thirds of them women. Most of these jobs are full-time (82%) and with the intention of permanency (73%). There will be obvious knock-on effects on demand, with this felt even by those business which are not directly affected.

Trade in and production of durable consumer goods and clothing, footwear and textile will be affected because purchases will be deferred. These effects are however likely to be temporary and rebound once the crisis ends. **Construction** will suffer as people prefer to hold cash to prepare for the worst.¹⁶ Trade in groceries and other essential goods will not be affected, although shopping patterns may change with people doing larger and less frequent buying.

⁹ Note however that Australian experience indicates that in times of crisis, the consumption of high-end quality agricultural products suffers (<https://nff.org.au/media-release/farm-sector-braces-for-coronavirus-impact/>).

¹⁰ <https://www.tbcresearch.ge/en/Research/Download?ResearchId=283&Type=PDF>

¹¹ World Bank data: 2018 on GDP, 2019 on employment

¹² See previously mentioned IRDG survey.

¹³ <https://www.tbcresearch.ge/en/Research/Download?ResearchId=283&Type=PDF>

¹⁴ <https://www.bbc.com/news/business-51706225>

¹⁵ <https://www.tbcresearch.ge/en/Research/Download?ResearchId=283&Type=PDF>

¹⁶ <https://www.tbcresearch.ge/en/Research/Download?ResearchId=283&Type=PDF>

Manufacturing is of little importance in rural areas. It only gains importance in Georgia's secondary cities (Batumi, Rustavi, Kutaisi, Poti and Marneuli).

Public service jobs are also unlikely to be affected much. This is a major source of rural income from variously local government, teaching, and the health service. If schools close, it is unlikely that teachers will be made redundant. Government and the health services will continue working.

Remittances, which are also an important source of rural income, may well fall if the people who send them lose their jobs, either in Georgia or abroad.

Potential policy responses: protecting the rural economy

Though there are historic precedents, the integrated and globalized economy of today only partially allows comparison with previous measures. The situation is also unusual in that, with interest rates at historical lows, government have little opportunity to cut rates further to stimulate the economy. That said, with the refinancing rate at 9%, Georgia may have a little more fiscal space than others.

There is consensus that timely, decisive and coordinated actions by health authorities, central banks, fiscal, regulatory and supervisory authorities are needed to contain the virus and offset the economic impact of the pandemic.¹⁷ One of the lessons of the global financial crisis and later the Euro-Crisis was that convincing markets and households that policymakers are serious about countering the slump is essential.¹⁸ The International Monetary Fund emphasises that monetary and fiscal tools must both be used: central banks must support confidence and liquidity, while governments must support affected businesses and households, including the informal sector.¹⁹

This brief focuses on fiscal measures and assumes a short crisis. If the crisis lasts longer, **the proposed measures would result in an unsustainable use of resources which will be needed for the recovery efforts.**

If the COVID-19 infection case trajectories of other countries are any guide for Georgia, daily increases of between 20% and 33% can be expected at least for the weeks after Georgia has 100 confirmed cases.²⁰ For the UK, which might be about 20 to 30 days ahead of Georgia in terms of number of cases, it is estimated that 20% of workers will be simultaneously absent in the coming weeks, causing a concurrent shock to both supply and demand.²¹ Some countries draw the conclusion that stimulating demand is the priority. This could though lead to inflation if firms cannot produce enough because people are sick or quarantined. And as trade and other services are closed, people may not be able to spend the money.²²

The informal sector

An important difference in the applicability of approaches used in Europe as compared to Georgia is the informality of the economy. Depending how "informality" is calculated, between 10% and 53% of the Georgian economy is informal,²³ disproportionately affecting women.²⁴ In the 8 IRDG target municipalities, about 50% of the businesses are unregistered.²⁵ As support is normally only given to registered firms, they may not immediately get help.

¹⁷ <https://www.imf.org/en/Publications/Policy-Papers/Issues/2020/03/16/Policy-Steps-to-Address-the-Corona-Crisis-49262>

¹⁸ <https://www.economist.com/briefing/2020/03/19/governments-are-spending-big-to-keep-the-world-economy-from-getting-dangerously-sick?frsc=dg%7Ce>

¹⁹ <https://www.imf.org/en/Publications/Policy-Papers/Issues/2020/03/16/Policy-Steps-to-Address-the-Corona-Crisis-49262>

²⁰ <https://www.ft.com/coronavirus-latest>. Note that Japan, Hong Kong, Singapore and South Korea are notable exceptions.

²¹ <https://www.economist.com/britain/2020/03/12/anti-covid-19-measures-mask-a-shift-in-britains-budget-strategy>

²² <https://www.theguardian.com/business/2020/mar/17/how-best-to-fight-the-economic-impact-of-the-coronavirus-pandemic>

²³ <https://forbes.ge/news/3597/Georgia-One-of-the-Largest-Shadow-Economies>

²⁴ <https://georgia.unwomen.org/en/digital-library/publications/2018/12/womens-economic-inactivity-and-engagement-in-the-informal-sector-in-georgia>

²⁵ See previously mentioned IRDG survey.

The ways that rural entrepreneurs deal with risk, usually a hindrance to growth, offer useful protection against poverty. Some 60% of rural entrepreneurs have a second job or business.²⁶ For example, most rural guesthouses are not registered and run as a side-line. This second job, acting as a safety net, is likely to be valuable now.

The difficulty will be in **identifying the needy cases**. Because there are no reliable data on who has worked in the informal sector and how are they affected, the only approach may be a blanket support to any household seen to be in financial difficulties. These financial difficulties are aggravated by the steep devaluation of the Georgian Lari, leading to a drastic increase in vulnerable people. The best policy response is providing **income support**, possibly by increasing or introducing regular cash transfers through the social security system. As the Lari is predicted to devalue further, such system might be indexed.

Most of the rural population faces recurrent costs of utilities, medical expenses and credit cost. As almost all the rural population and businesses live and work in their own dwellings, rental costs are negligible.²⁷ Given the special situation, at least all COVID-19 related expenses, including funerals, should be covered by the government, thus reducing related worries. For utility bills, it is better to increase social transfers, thus also providing stimuli for saving, than to reimburse them or, still less appropriate, to pay the provider to reduce the tariffs.

Note the high share of old people in rural areas. Although anecdotal evidence indicates that most of those are cared for by relatives, it must reasonably be assumed that there will still be a substantial share whose relatives are too far away. Moreover, as young and old should not mingle and therefore possibly not stay together, old people whose families are living further away cannot be cared for by them and require separate support.

The formal sector

Households with formal employment and registered businesses hit by supply disruptions or a drop-in demand can be supported by wage subsidies, tax relief, cash transfers and loans, helping people to meet their needs and businesses to stay afloat.²⁸

Underemployment and job losses will be unavoidable. For businesses affected by heavily reduced demand, as accommodation, transport and trade in border areas, **wage subsidies** in form of short-time work allowance (so-called Kurzarbeitergeld) may be introduced. This tried-and-tested approach has been used by Germany in the aftermath of the 2008/9 financial crisis and has been copied by various other governments, including the British. It compensates for the forgone wages of employees whose working hours had to be reduced, through the same channels that are already used for unemployment insurance.²⁹ The registered self-employed may receive similar benefits, based on their previous income. Established channels of the Ministry of Health, Labour and Social Affairs in co-operation with the Ministry of Economy and Sustainable Development may be used for this. As low tax country, the impact of **tax relief or deferment** will be limited, but still an important, effective and relatively cheap policy instrument. These tools are used by almost all Western countries.

According to the World Bank, more than 25 countries are already using **cash transfers** for economic mitigation.³⁰ These are usually targeted at very small firms and the self-employed in sectors particularly affected by the virus. Qualifying criteria include a documented drop in sales and a retrospective

²⁶ See previously mentioned IRDG survey

²⁷ Result of a survey conducted by UNDP/IRDG in 8 target municipalities in Georgia. 96% of the rural population lives in premises they own (IRDG survey).

²⁸ <https://blogs.imf.org/2020/03/09/limiting-the-economic-fallout-of-the-coronavirus-with-large-targeted-policies/>

²⁹ <https://www.theguardian.com/business/2020/mar/17/how-best-to-fight-the-economic-impact-of-the-coronavirus-pandemic>

³⁰ <https://www.economist.com/briefing/2020/03/19/governments-are-spending-big-to-keep-the-world-economy-from-getting-dangerously-sick?frsc=dg%7Ce>

deadline at which a firm needed to be financially healthy. Any subsequent deterioration is deemed to be because of the virus.³¹

Note that in all cases it is important to support only those firms and self-employed whose business is **healthy and viable** and can be expected to recuperate after the crises. But a much starker political choice must be made: businesses can only be supported in the short, perhaps medium term. If the crisis continues, then this support become unsustainable.³² In that case, and if businesses are not basically healthy and viable, support must switch to social measures.

Loans as policy instrument

Loan instruments may take two forms: supporting households and businesses cope with existing loan repayments and providing fresh loans.

The upcoming financial squeeze will hit many businesses hard: 36% of businesses in eight UNDP/IRDG target municipalities surveyed were servicing a loan; 40% were late in repayment. While trade, hotels and restaurants have been taking up loans more often than other non-farm sectors, they were less often late in repayment. Transport companies are the worst performers in terms of loan repayment. As only healthy businesses should be supported, it is likely that many transport related businesses will become insolvent. Those healthy businesses should be supported through **deferral of loan repayment or even partial grants**. Note however that many loan defaults will put stress on the banks' or micro-finance organizations' balance sheets, requiring later bail outs.

Mindful of the need to contain public expenditure, governments are relying heavily on **contingent liabilities through loan guarantee funds**. This means that banks can lend with greater confidence and there is only public expenditure if borrowers' default. Since Georgian banks have to date been generally less interested in lending outside the towns, a proportionately higher guarantee coverage might be needed. As the loans will usually be for working capital or consumption, thus without collateral, it might even be necessary to include a grant element. Borrowers could be offered bonuses for repaying loans early.³³ Note that such guarantee schemes will require significant but temporary staff increases in the banks to process all the loan applications.

In practice, the most appropriate measures for Georgia's rural areas seem to be loan guarantees, if the crisis can be limited to the short or perhaps medium term. It may be the only way to keep solvent rural enterprises alive. This would suitably be combined with a grant scheme to rural enterprises.

Measures for a long crisis

The presented measures are probably effective for bridging a short crisis. But no government will have the financial means to sustain them in the longer term. In time, it is therefore important to help businesses downsize which may increase their chances of survival, or to help them closing orderly. The focus must then shift to mainly supporting people, which is more important.³⁴ As rural areas may receive less attention than urban areas, it shall be highlighted that areas that experience above average losses in a crisis will need, after the crisis is over, significantly longer for recovery. Particularly rural areas are then at risk to be left behind. Hence, support needs to be adequately granted.³⁵

³¹ <https://www.economist.com/briefing/2020/03/19/governments-are-spending-big-to-keep-the-world-economy-from-getting-dangerously-sick?frsc=dg%7Ce>

³² <https://www.cato.org/publications/commentary/painful-choices-will-have-be-made-longer-goes>. Note that the Imperial College estimates for the UK, that suppression policies need to be in place for 55% to 96% of the next 18 months.

³³ <https://www.economist.com/leaders/2020/03/19/how-to-prevent-a-covid-19-slump-and-protect-the-recovery?frsc=dg%7Ce>

³⁴ <https://www.cato.org/publications/commentary/painful-choices-will-have-be-made-longer-goes>

³⁵ <https://www.brookings.edu/research/three-steps-the-government-needs-to-take-in-a-coronavirus-recession/>