

**Georgia's Balance of payments by Main Trade Partner  
Countries in 2007**

(for the National Bank of Georgia)

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**Tbilisi, January 2010**

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The author is grateful to Mr. Vakhtang Pkhakadze and Mr. Archil Mestvirishvili from the National Bank of Georgia for their comments.

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## Introduction

The balance of payments is the most important statistical document in the external sector of an economy. It describes a country's economic links with the rest of the world. The balance of payments is a statistical statement that summarizes the economic transactions of an economy with the rest of the world for a specific time period. That includes all transactions between residents and non-residents for goods, services, and income; financial claims on and liabilities to the rest of the world; and those classified as transfers (one-sided transactions). As for the balance of payments of Georgia, it is summarized and published by the National Bank of Georgia.

One of the main reasons why the balance of payments is important is globalization. It is one of the most characteristic tendencies of the contemporary world economy. It is obvious that without integration into international organizations and country unions it is practically impossible to develop. Today there is no country that can be viewed as a country with closed economy. Georgia is no exception. Therefore, we find it interesting to analyze Georgia's balance of payments by regions and countries. There are three main facts that make this analysis considerable. The first is that Georgia has a small economy. The second is that Georgia's economy is very open and the third is that Georgia is a transition country. The main objective of this paper is to answer the following questions: which countries are Georgia's biggest partners in the international economic relations and what is Georgia's international position with those countries according to the accounts of the balance of payments.

In this paper Georgia's balance of payments is divided by the top eight countries and one region (according to the shares in Georgia's total trade), which are the main partners of Georgia in the international economic transactions. These countries and the region are: European Union, Russia Federation, Turkey, Azerbaijan, Armenia, Ukraine, The USA, Kazakhstan, and China. In addition, I considered the rest of the countries as one unit.

## **Short Review of Balance of payments**

Balance of payments is a statistical document that keeps records of all transactions for goods, services, transfers and financial assets and liabilities between residents and non-residents during specific period of time. It shows the balance between all real and money flows across country borders.

Usually, balance of payments is divided into two components:

- Current account – shows international flows of goods, services, and income and current transfers.
- Capital and financial account that displays international capital transfers and acquisition or disposal of nonproduced, nonfinancial assets under capital account and foreign direct investments, portfolio investments and other investments under financial account.

## **Balance of Payments of Georgia in 2007**

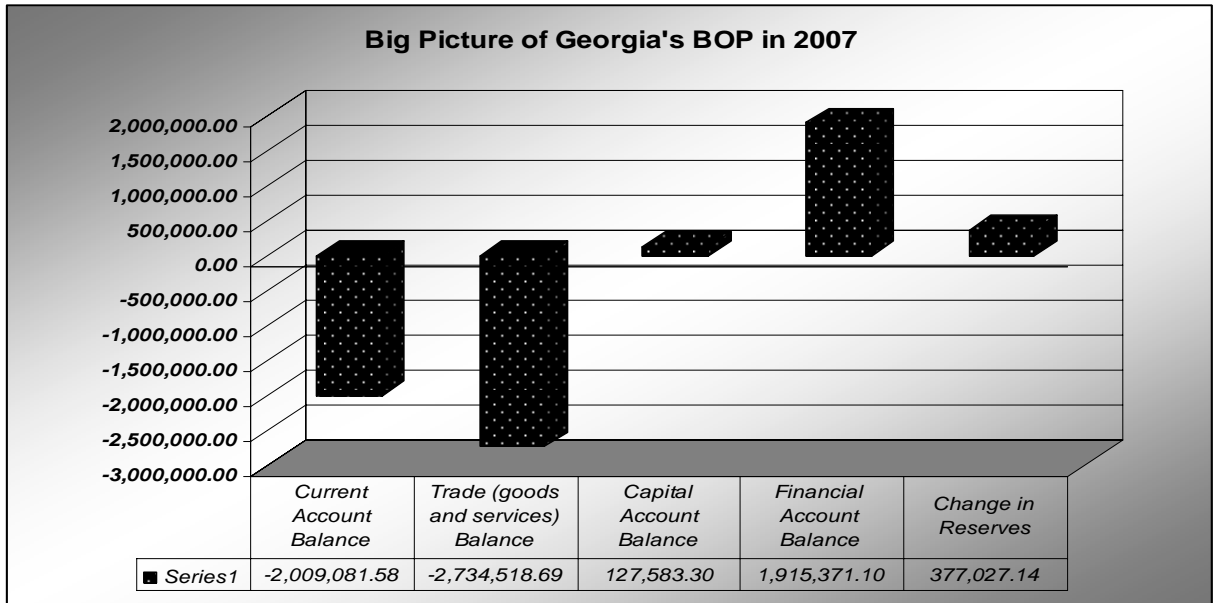
Georgia's balance of payments is characterized with the features of a typical transition country. These features are: the current account deficit and surplus of the capital and financial account. Figure 1.1 shows a picture of Georgia's balance of payments in 2007. We can see that during 2007 there is a large current account deficit, covered by the surplus of capital and financial account. It means that Georgia's international expenditures on real resources (goods, services, labor force, etc.) exceed international income and this difference is financed by the inflows of foreign capital.

In 2007 Georgia's current account balance was approximately -2 billion USD. It is about 11.8 percent of GDP. This amount of deficit is rather high for Georgia's economy. That is why it can cause economic problems, especially in the financial sector, as there are many experiences in the world where the high level of current account deficit led to the financial crises (for instance, Indonesia in 1997-1998).

At the same time, Georgia enjoyed positive balance on capital and financial account. They equaled respectively \$127 and \$1 915.4 million. This means that inflow of foreign capital into Georgia was higher than capital outflow and this positive net inflow exceeded the difference

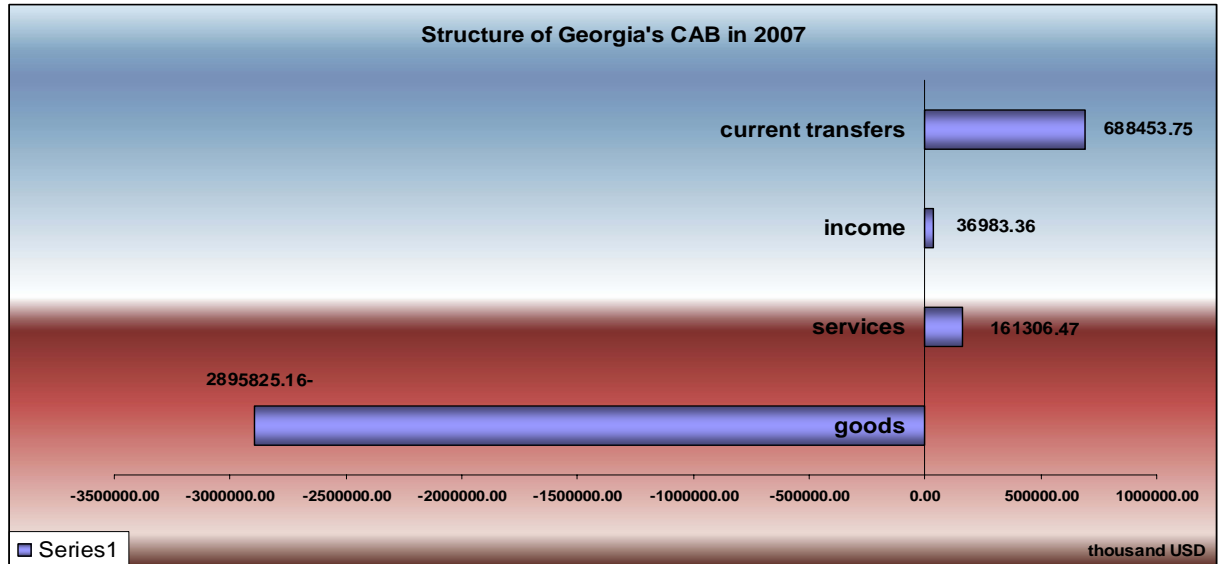
between Georgia's international expenditures and income. Therefore, there was positive change in reserve assets in 2007.

**Figure 1.1.**



The current account is very important indicator as it is of a special interest to economists and politicians. Besides, Georgia has a high level of current account deficit which is considerable for policymakers. It is interesting to consider the structure of it (see figure 1.2.). From the graph it can be clearly seen that the negative balance of goods is the main reason of the current account deficit. Georgia's imports of goods (international expenditures) are much higher than exports of goods (international income). Although other components of the current account are positive, they can not compensate the negative balance of goods.

**Figure 1.2.**



Despite the fact that the current account deficit is 11.8 percent of GDP it is essential to discuss whether this level is sustainable or not. Unfortunately, there is no agreement among economists how to determine the level of sustainable deficit. So, it is very difficult to say that this level is unsustainable as each country has its unique level which depends on many factors.

As for Georgia’s financial account, like other transition countries it is dominated by foreign investment, the share of which (except reserve assets) is approximately 64 percent.

### Current Account of Georgia by Countries

The current account is further subdivided into four broad categories: goods, services, income, and current transfers. The components covering goods, services, and income are designed to reflect the provision or acquisition of real resources by the reporting economy to/from the rest of the world. When dividing Georgia’s current account by main trade partner countries, I mostly used the data of the NBS which was available in the statistics and balance of payments divisions. These data are: Georgia’s BOP in 2007, grants and credits by countries, transfers from and to abroad, money transfers by countries, loans by countries, and transportation revenues by countries. The graphical presentation of Georgia’s current account by countries is given in Appendix 1, Graph 1. In fact, I divided it after I had broken down goods, services, income, and current transfers’ accounts. Georgia

had a positive balance of current account with the Russian Federation, the United States, and Armenia. Respectively, Georgia had negative current account balances with the rest of main trade partner countries.

The biggest part of Georgia's current account is goods account. Actually, there were a lot of data about the trade of goods by countries. I used the data from the department of BOP (NBG). I divided the goods account proportionally to this data. Georgia had negative balance on goods with all main trade partner countries, except Armenia. (See appendix 1, graph 2).

Unlike the production of goods, the production of a service is generally linked to an arrangement between particular consumers. Thus, international trade in services is closely linked to international production of services as the production process involves a resident and a nonresident. Georgia's service account is the most complex and therefore it was more difficult compared to other accounts to split. I used different types of data for this purpose. Actually, in some accounts I needed to make assumptions in order to divide them by Georgia's partner countries. Georgia had positive balance of service account with all main partner countries except the EU and Turkey. The graphical representation is given in appendix 1, graph 3).

Transportation covers services provided by all modes of transportation performed by residents of one economy for those of another. Modes of transportation consist of sea, air, and other – which include land, internal waterway, space, and pipeline. Transportation includes the movement of goods (freight), as well as rentals of carries with crew. Related supporting and auxiliary services (such as cargo handling, navigation fees, and maintenance and cleaning of carries) are also included in transportation. In the BOP standard components, transportation services are classified by type of carrier (sea transport, air transport, and other transport) and functional category of service (freight, passenger, and other).

As for Georgia's transportation account, it is the biggest part of the service account. In fact, there are two ways to break down it. I decided to divide it into freight, passenger service and other transportation services (sea, air, railway, pipeline and roadway). This means, that at first I segmented these accounts by countries, then sum them up and got transportation account by countries. Its graphical presentation is given in appendix 1, graph 4.

The freight item is closely related to the goods component of the balance of payments. Freight, as fees in the value of exported goods and in imports recorded f.o.b. at the frontier of the exporting country is recommended in the standards for external trade statistics, whereas exclusion of such fees is recommended in the BPM. Freight services provided to or acquired from abroad by the reporting economy will mostly, but not always, relate predominantly to that economy's exports and imports of goods. Considering this, I decided to split it proportionally to exports and imports. In addition, as the freight account is very specific I took into account distance between Georgia and a partner country and the type of transportation (see appendix 1, graph 6).

Passenger services are described in the BPM as services provided by carriers for the transport of passengers between countries and services provided, within a specific country, to residents by a carrier operated by a nonresident enterprise. It is very difficult to collect data on carrier services provided to nonresidents and performed within the economies in which the carriers reside. In order to divide the passenger service account I used the data about the passengers that/who crossed Georgia's borders during 2007. Georgia had a positive balance of passenger services with the following trade partner countries: Azerbaijan and Armenia (See appendix 1, graph 5).

The travel component of the current account balance covers all goods and services acquired for personal use by travelers during their visits in host countries. A traveler is defined in the BPM as an individual who stays for less than one year in a country where he or she is not a resident. To break down Georgia's travel account, I used the data on the citizens and noncitizens that crossed Georgia's borders during the given year. Besides I took into account two factors: the type of transportation and a country from where a tourist is. To evaluate the expenditure that one tourist spent I used the survey of the tourists in Georgia which was conducted in 2006. Georgia has positive balance of travel account with almost all selected countries. The exception is the European Union (see appendix 1, graph 8).

As for the remaining accounts of the service account, as there is little information about these accounts, I mainly relied on experts' valuation to divide the following accounts: construction, government, insurance, entertainment, communication, financial, computer, royalty and license, and other business services. It is shown in Appendix 1 that Georgia



mainly had service relations with developed countries (the EU and the USA). (see Appendix 1, Graph 9).

Construction services cover work on construction and installation projects performed by construction enterprises that are residents of economies other than those in which the work is taking place.

Insurance services cover the provision of various types of insurance to nonresidents by resident insurance enterprises and vice versa. This item covers many types of insurance, including insurance on freight insurance, marine insurance, fire insurance, reinsurance, life insurance, and commercially provided pension and annuity services.

Financial services cover a number of transactions in services related to the financial industry.

Government services include 1) transactions between the compiling country's government and other government (or international organizations); 2) transactions between the compiling country's government and nongovernment nonresident entities; 3) personal expenditures of diplomatic, military, and other personnel of official entities in the non-resident economy where the entities are located.

Income, in economic accounts such as the balance of payments, consists of earnings arising from the provision of the factors of production: land, labor and capital. Ownership of land, according to BOP concept, is always attributed to residents. The income component of the balance of payments is restricted to income earned from the other two factors of production: labor and capital. Income earned from the former is called compensation of employees, while income earned from the latter is called investment income.

In order to divide the income account by countries, I used the following data: transfers from/ to abroad, stocks of FDI, and loans by countries. Actually, I split the compensation of employees proportionally into transfers, and investment income account is broken down proportionally into stocks of FDI (direct investment) and stocks of loans (other investments). Georgia had positive income account with the USA and Russia Federation (See appendix 1, graph 10).

Compensation of employees includes wages, salaries, and other compensations (whether paid in cash or in kind) earned by nonresident individuals for work performed for resident of the economy in which the work is performed.

Interest rate and other income received by nonresident workers from financial investments made in host economies are classified as investment income. Georgia's compensation of employees account by countries are given in appendix 1, graph 11. Georgia had positive balance with all partners.

Investment income is defined in the BPM as the income accruing to an investor from the ownership of financial assets. The most common types of financial assets are bank deposits, loans, bonds, bills shares in the equity capital of an enterprise, and head office claims on branches. Investment income derived from these assets comprises mainly interest, dividends, remittance of branch profits, and direct investor shares of the retained earnings of direct invest enterprises. Georgia's investment income account is very different from compensation of employees account. In fact, Georgia had negative balances of this account with all selected countries, except USA.

In the standard components of the balance of payments, current transfers are divided into two sub-components: general government and other sectors. The current transfers of other sectors are further divided into workers' remittances and other transfers.

The general government sub-component consists of current transfers made between the government sector of the compiling country and nonresidents. This item includes current transfers between the government of the compiling country and foreign government and current transfers between the resident government sector and nonresident, nongovernment entities. The current transfers-general government item includes subsidies or grants to current budgets (except for subsidies or grants relating to additions to the capital stock of the recipient country); gifts of food, clothing, medicine, etc.; gifts of military equipment that has no civilian uses; technical assistance; indemnities imposed under peace treaties; insurance premiums minus service charges and insurance claims; and government contributions to the administrative budgets of international organizations. Worker's remittances consist of goods or financial instruments transferred by migrants living and working in new economies to residents of the economies in which the migrants formerly resided.

In order to divide these accounts by selected countries I used the data of transfers from/ to abroad and grants and credits by countries. I split the general government account proportionally into the data on grants, and I divided the workers' remittances account

proportionally to transfers from/to abroad. As for other transfers, I made an assumption in this account that this account has the same distribution as the transfers from/to abroad by countries and therefore, I used their shares to segment other transfers' account (see appendix 1, graphs 13, 14, 15, 16, 17).

### **Georgia's Capital Account by Countries in 2007**

The basic item of Georgia's capital account is capital transfers. It includes government sector and other sectors. The latter includes migrants' transfers and other sectors. I divided the government sector account proportionally the data on government grants by countries which was available in BOP department. In order to break down the remaining capital accounts I made an assumption that the other accounts had the same distribution as migrants' transfers by countries and split it proportionally to this data (see appendix 1, graphs 18, 19).

### **Georgia's Financial Account by Countries in 2007**

The financial account consists of the following items: foreign direct investments (FDI), portfolio investments, financial derivatives, other investments, and reserve assets. As the data on the FDI by countries was available in the NBS, I easily divided it by countries proportionally to these data. As for other accounts there are some assumptions made. It is assumed that portfolio investments, financial derivatives and other investment account except trade credits and loans had the same distribution as the FDI account by countries and are split proportionally to the FDI. The trade credit account is divided proportionally to the data on exports and imports by countries. As for loans' account, as the data on loans from abroad was available in the BOP department, they are segmented proportionally as

well. (See appendix 1, graphs 20, 21, 22, 23, 24, 25, 26, 27).

Appendix 2 represents Georgia's BOP for each principal economic partner countries. It could be done only after splitting the whole balance of payments by countries.

In appendix 3 five pictures are given representing wide pictures of Georgia's trade balance, current account balance, capital account balance, financial account balance, and overall balance with respect to all world countries (on the world map).

## **Summary**

In this paper Georgia's 2007 balance of payments is fully divided by the following countries and a region: the European Union, the United States, the Russian Federation, Ukraine, China, Armenia, Azerbaijan, Turkey, Kazakhstan and other countries.

The main characteristics of Georgia's balance of payments in 2007 are: 1. Georgia has a negative trade balance with almost all trade partner countries and such a situation is not desirable for our transition economy; 2. Current account balance is negative with most of trade partner countries. This fact also is not favorable for Georgia. 3. Capital account balances are positive with all countries and with the region. 4. Georgia has positive balances in financial account with all selected countries. This means that there is an inflow of financial assets which is very important during transition for the promotion of the economic development. 5. The overall balances show that the main sources (countries or a region) of financial and capital inflows which offset trade deficits are European Union, The United States, the Russian Federation, and Kazakhstan.

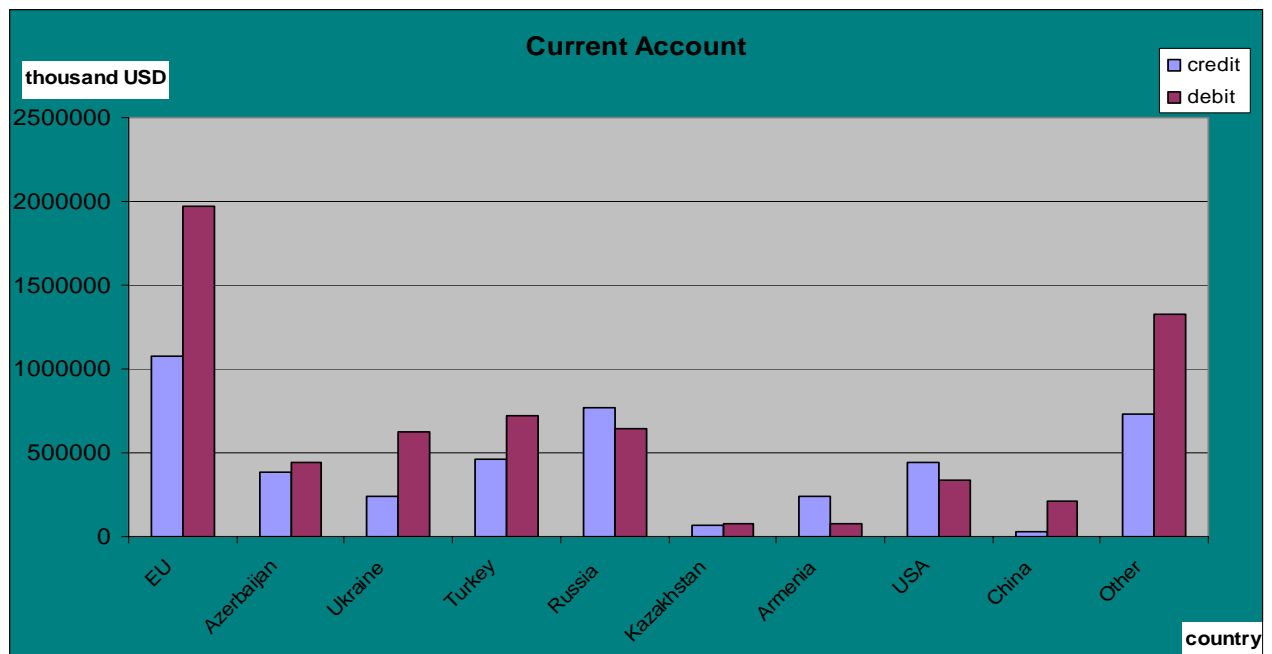
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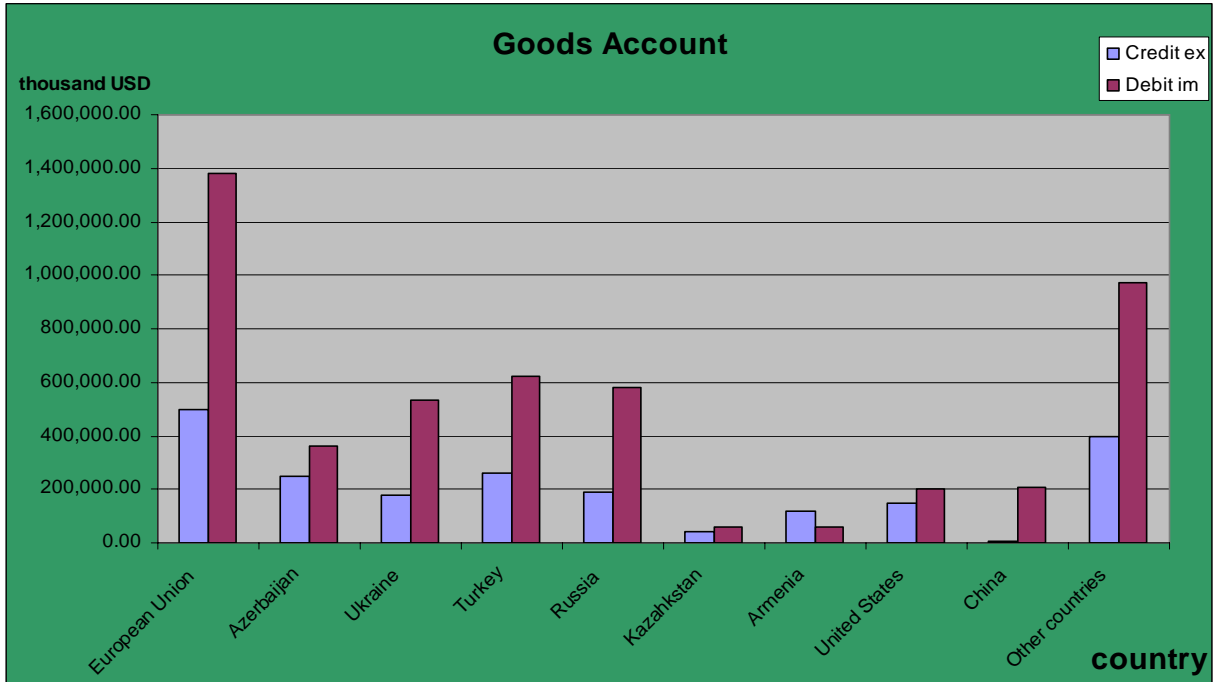
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## Appendix 1

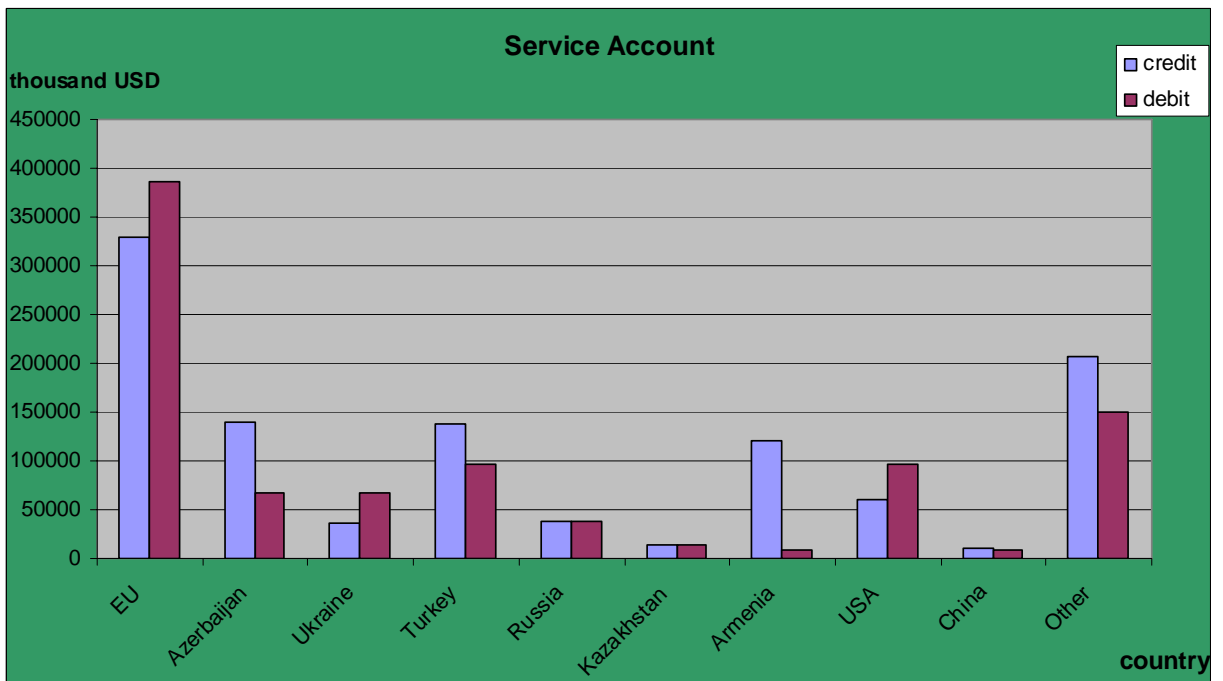
**Graph 1: Georgia's Current Account by Countries**



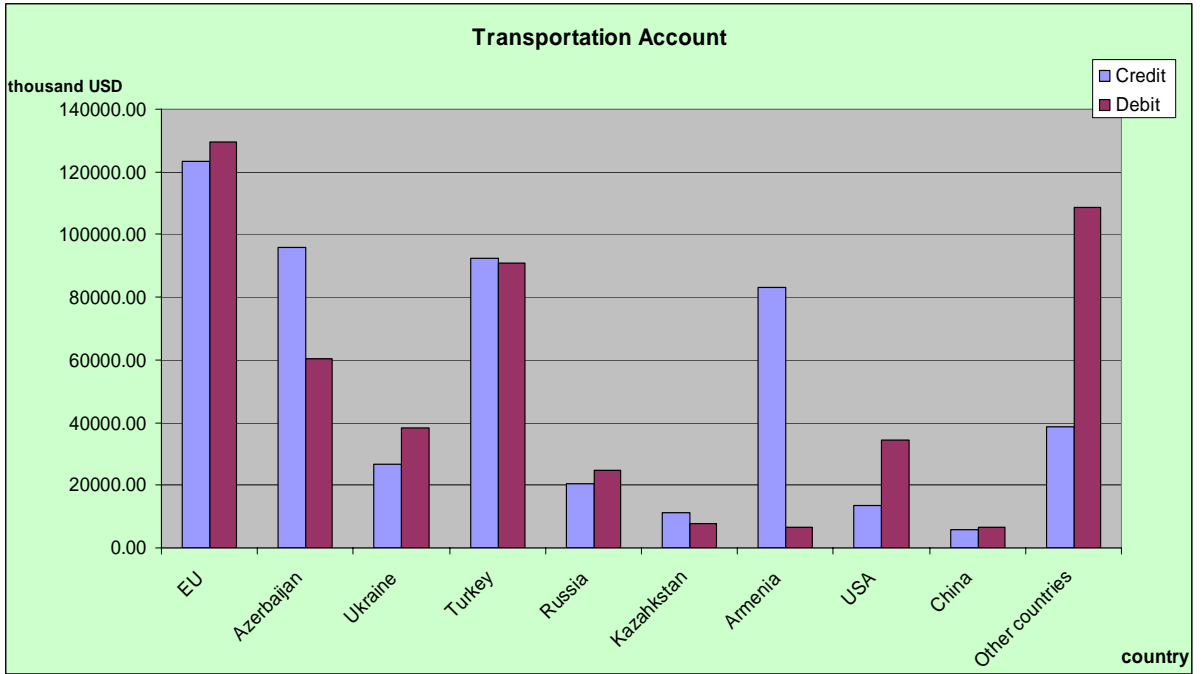
**Graph 2: Goods Account**



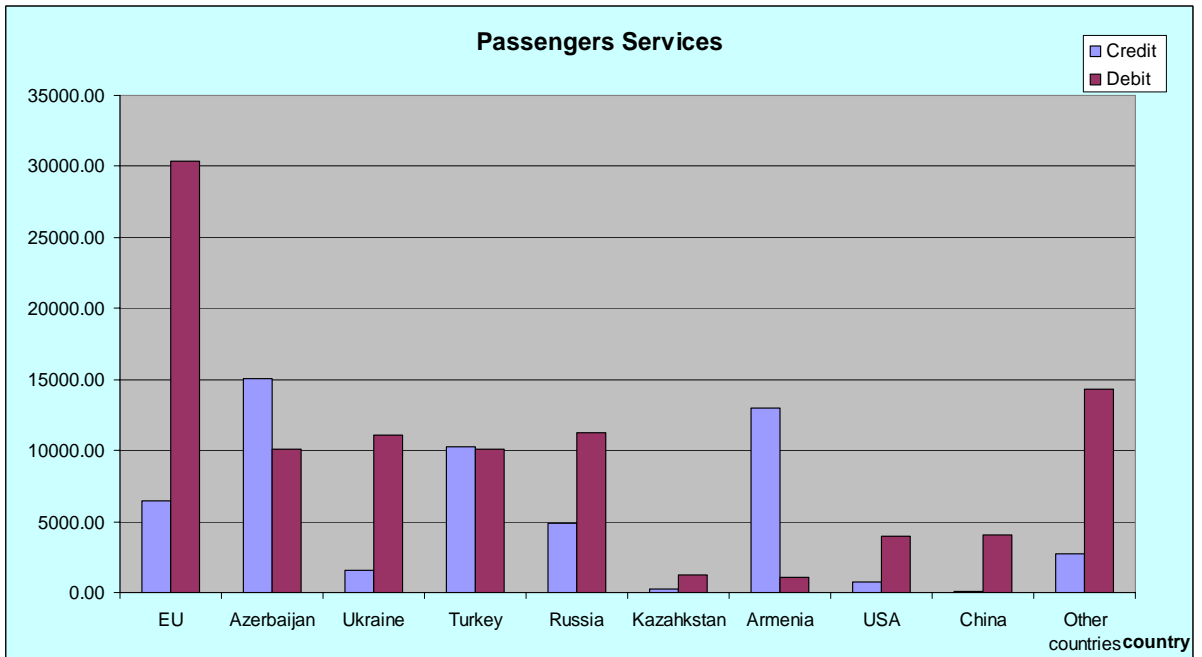
**Graph 3: Service Account**



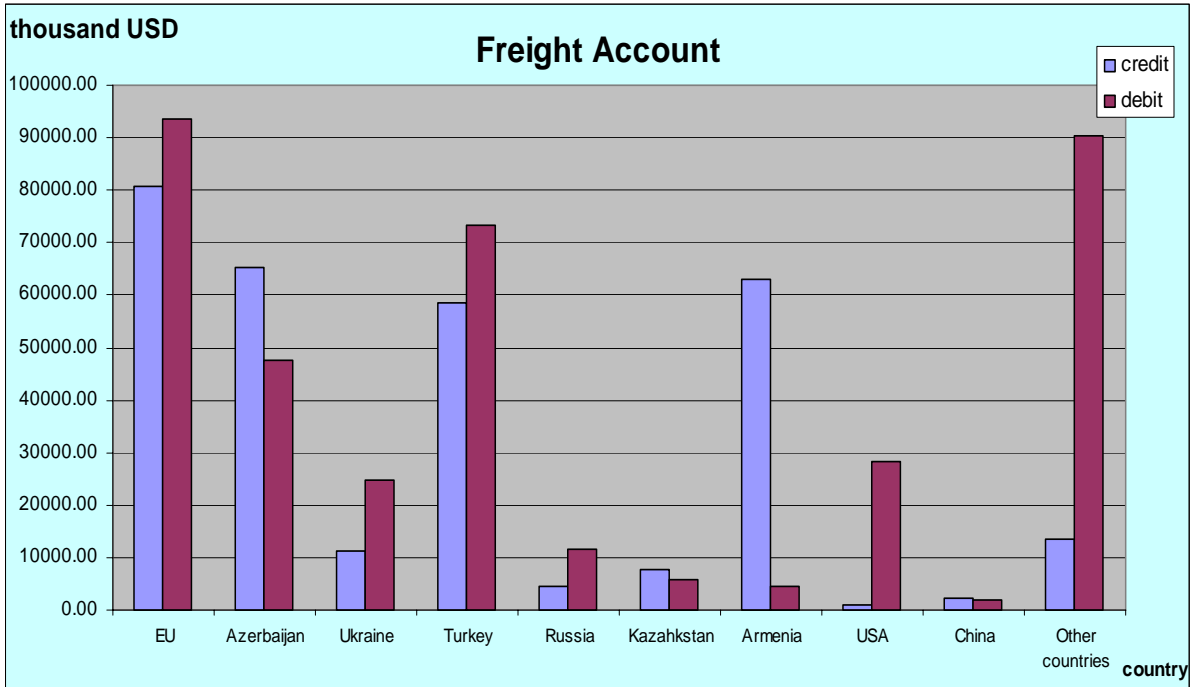
**Graph 4: Transportation Account**



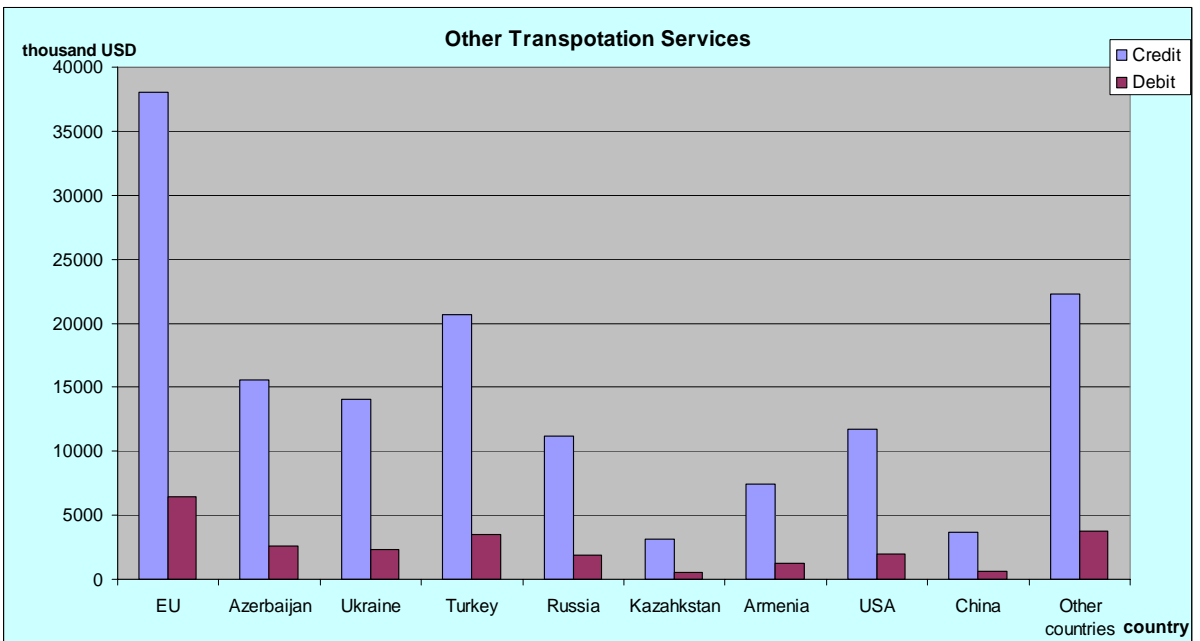
**Graph 5: Account of Passengers Services**



**Graph 6: Freight Account**

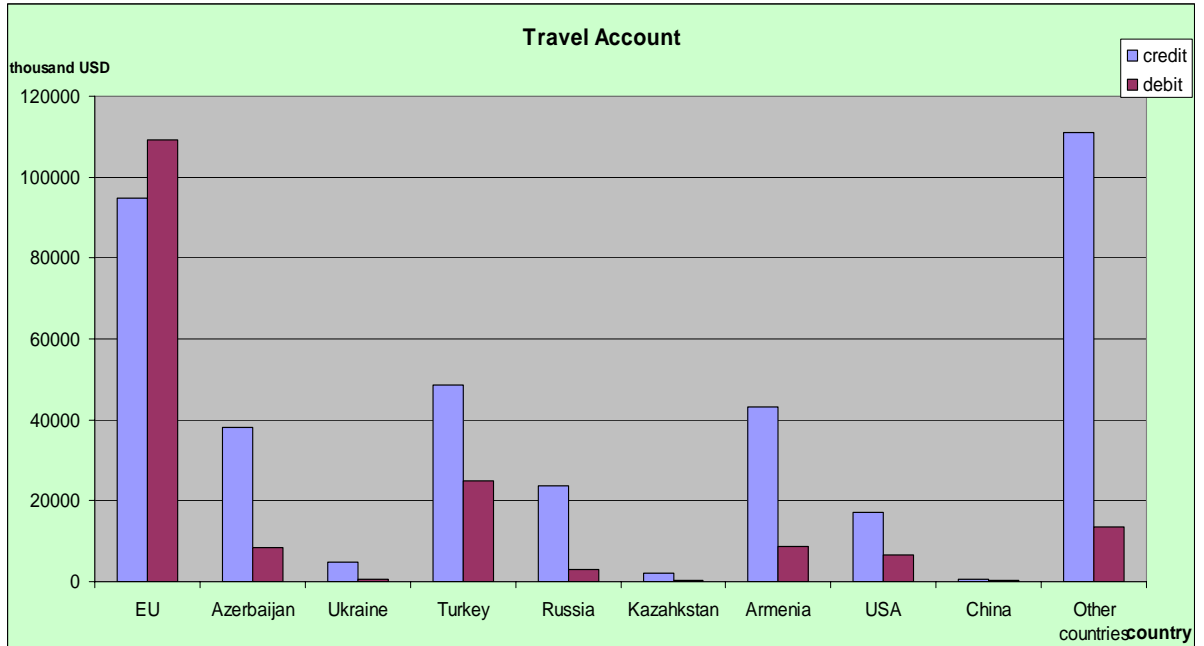


**Graph 7: Other Transportation Services (sea transport, air transport, railway transport and etc)**

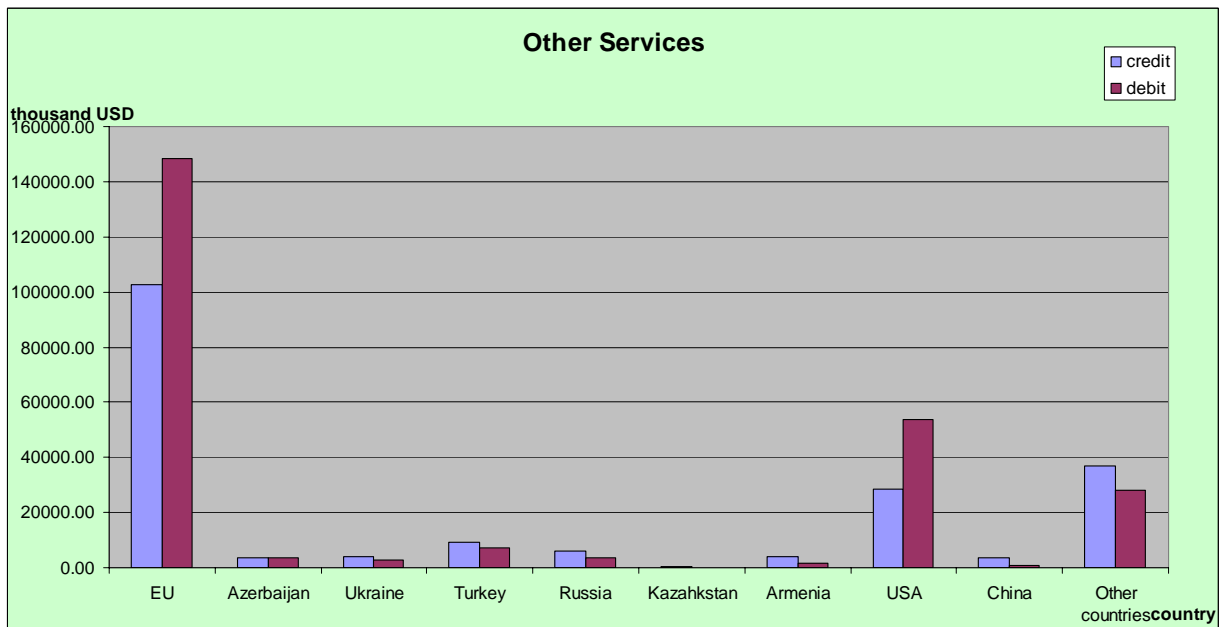


**Graph 8: Travel Account**

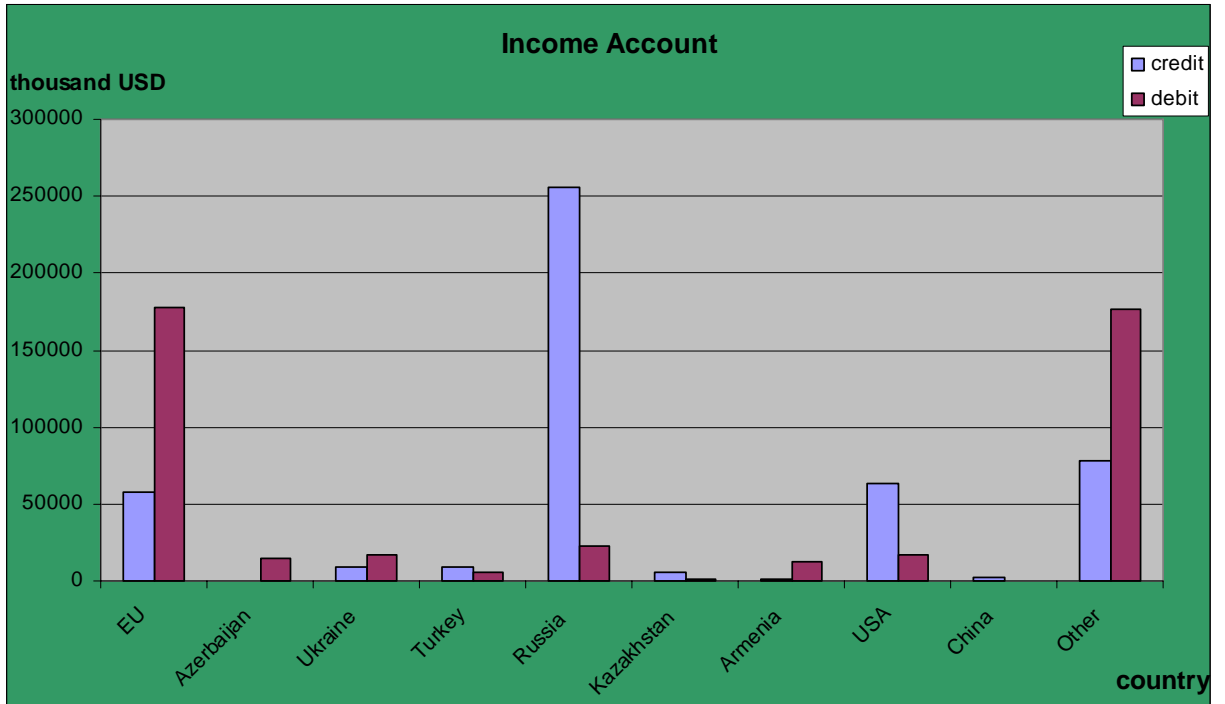




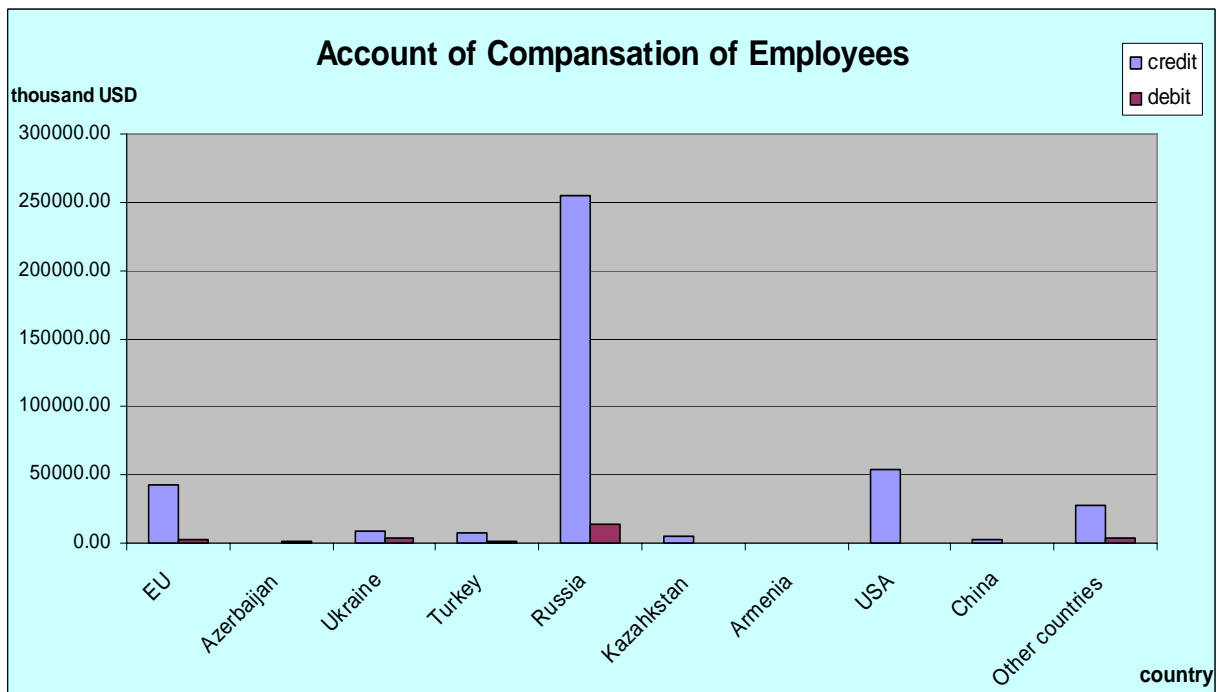
**Graph 9: Other Services (communication, construction, insurance, financial, computer, royalty and license, entertainment, government and other services)**



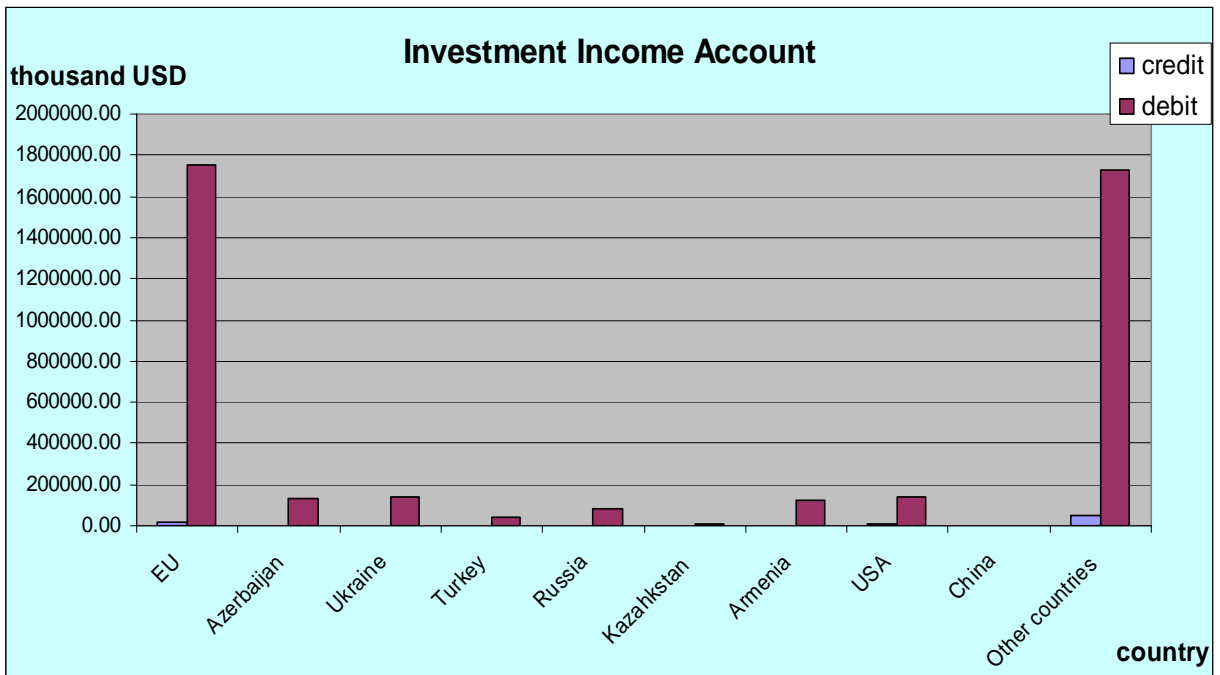
**Graph 10: Income Account**



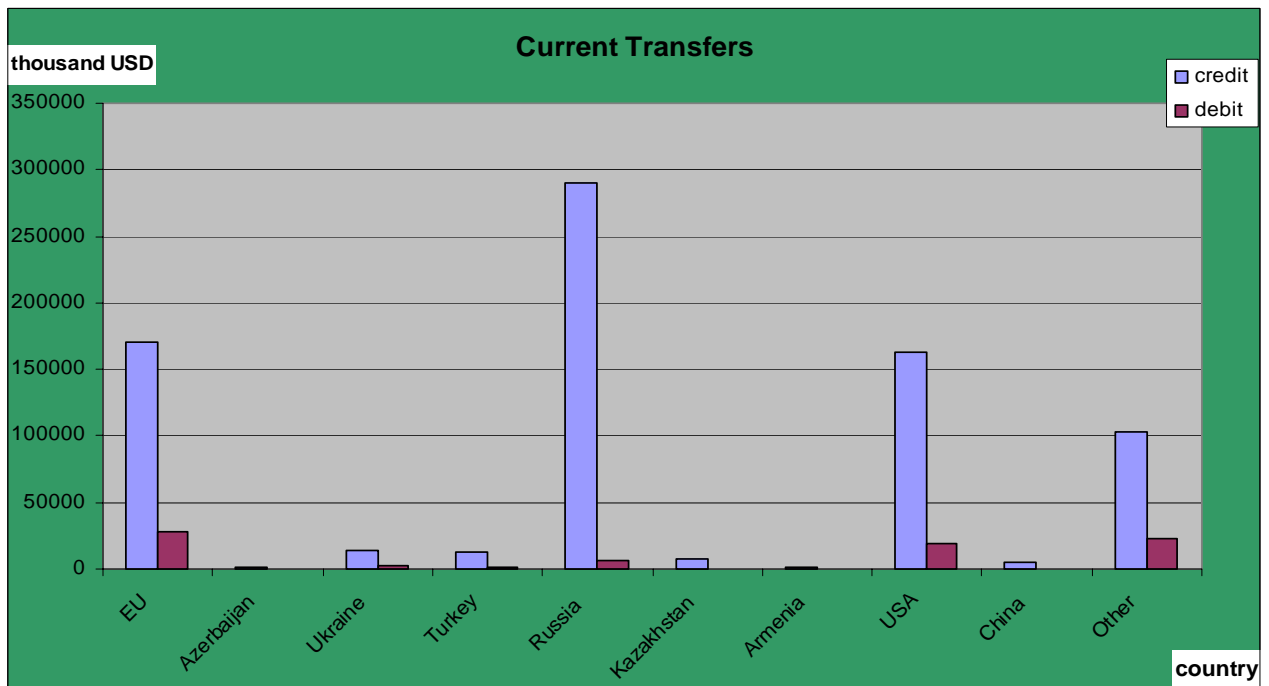
**Graph 11: Account of Compensation of Employees**



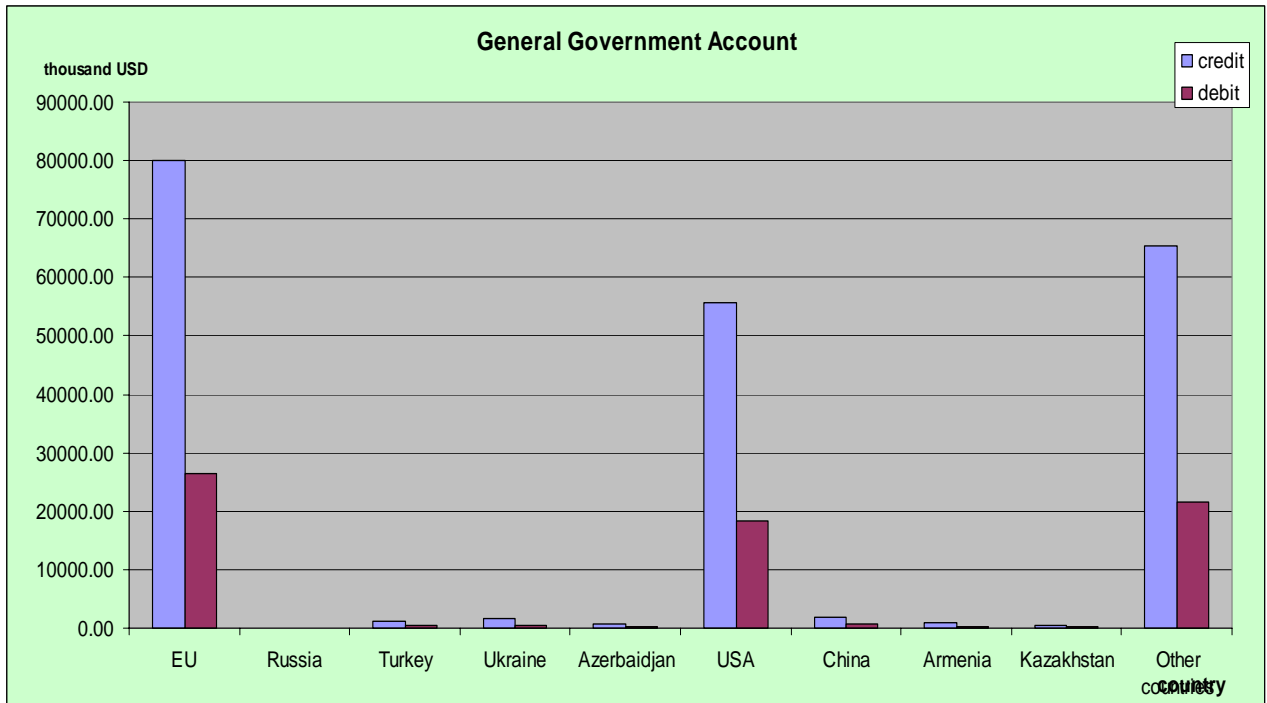
**Graph 12: Investment Income Account**



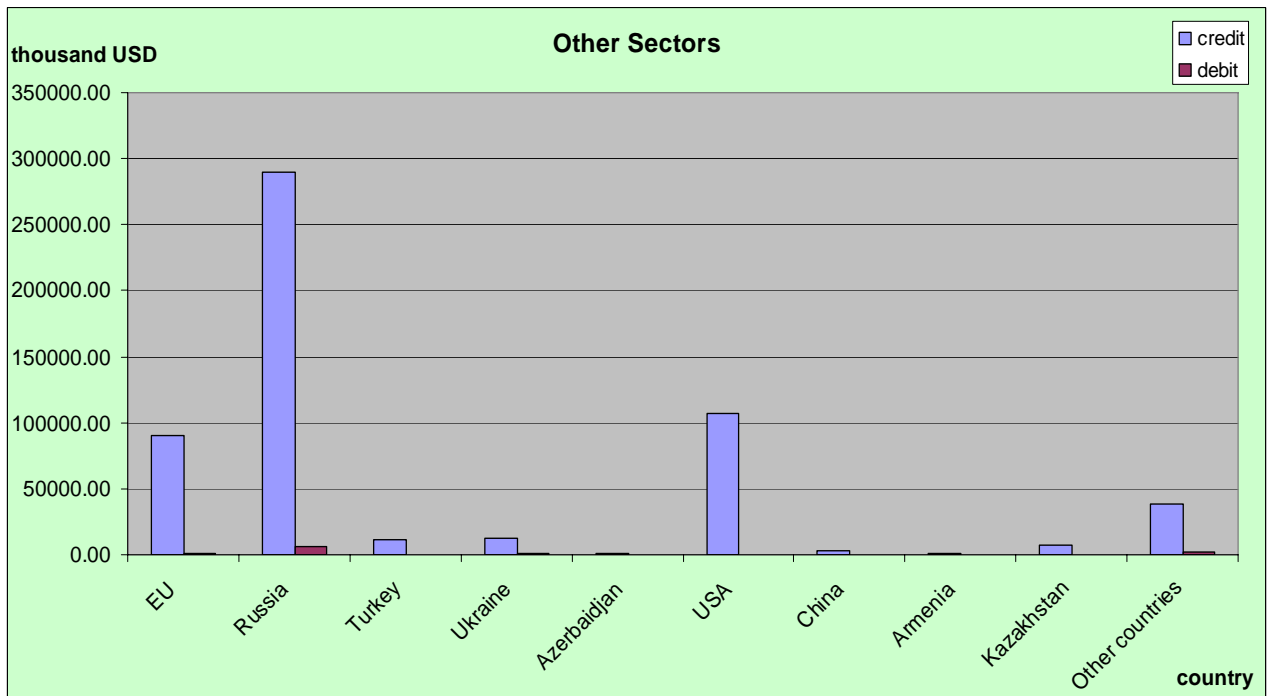
**Graph 13: Current Transfers**



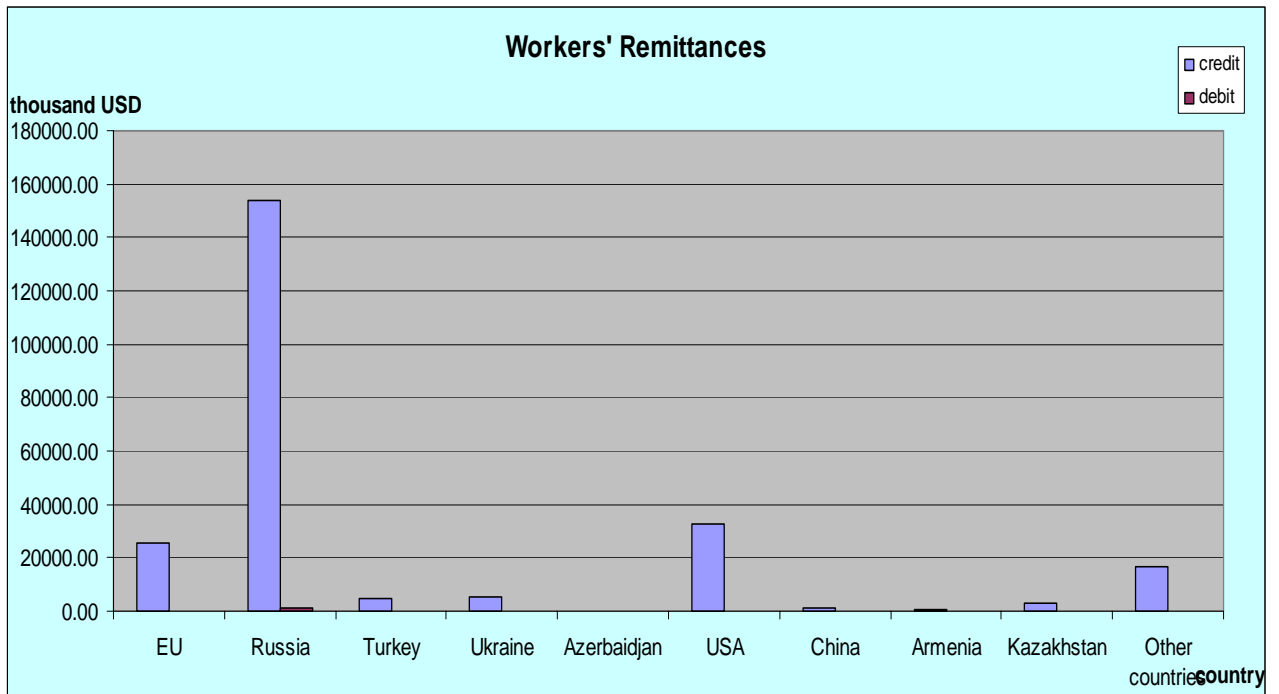
**Graph 14: Government Sector Account**



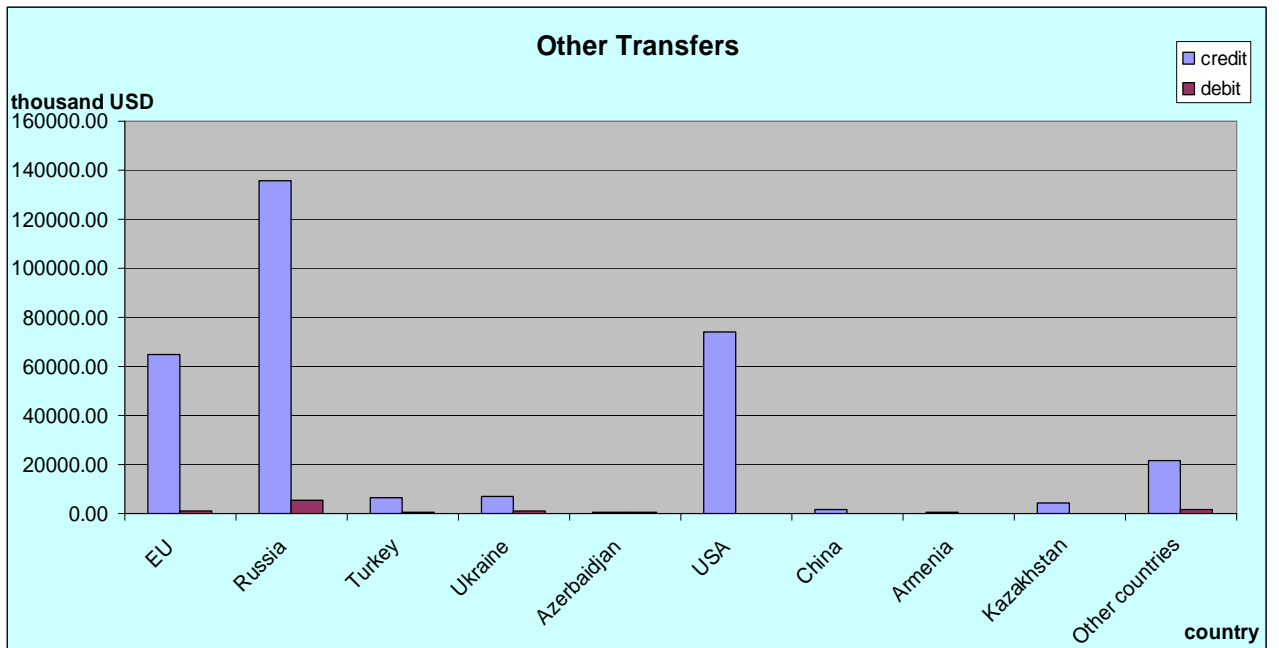
**Graph 15: Other Sectors' (workers' remittances and other transfers) Account**



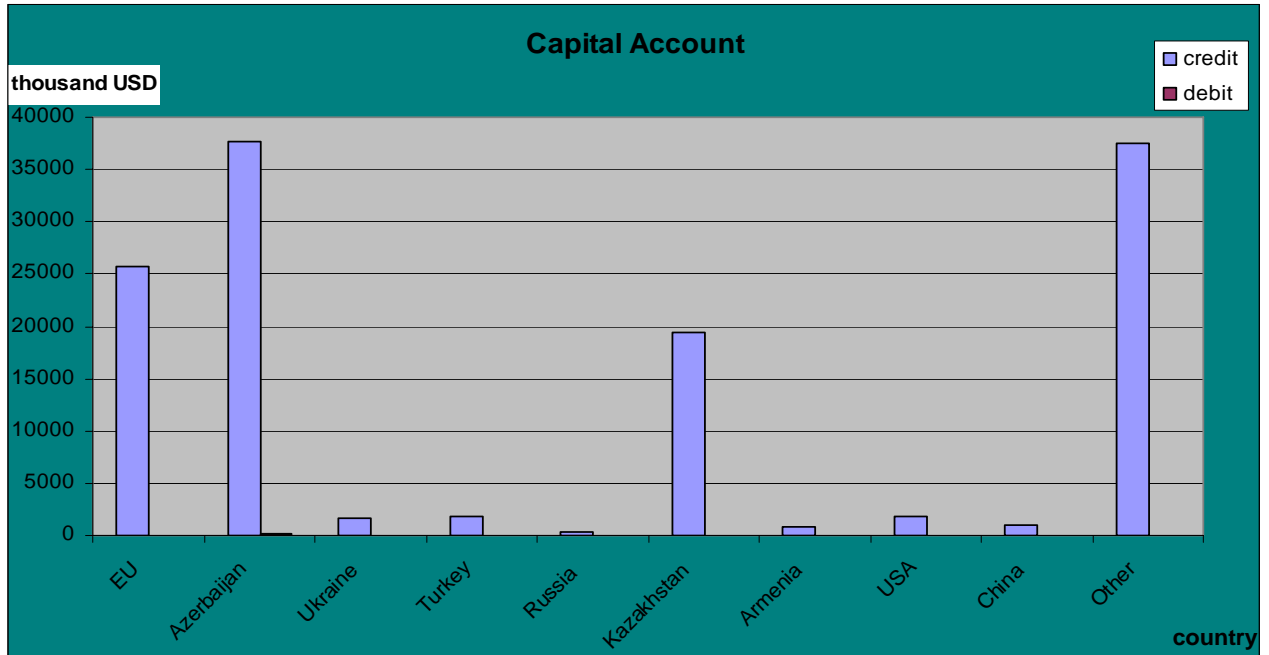
**Graph 16: Workers' Remittances**



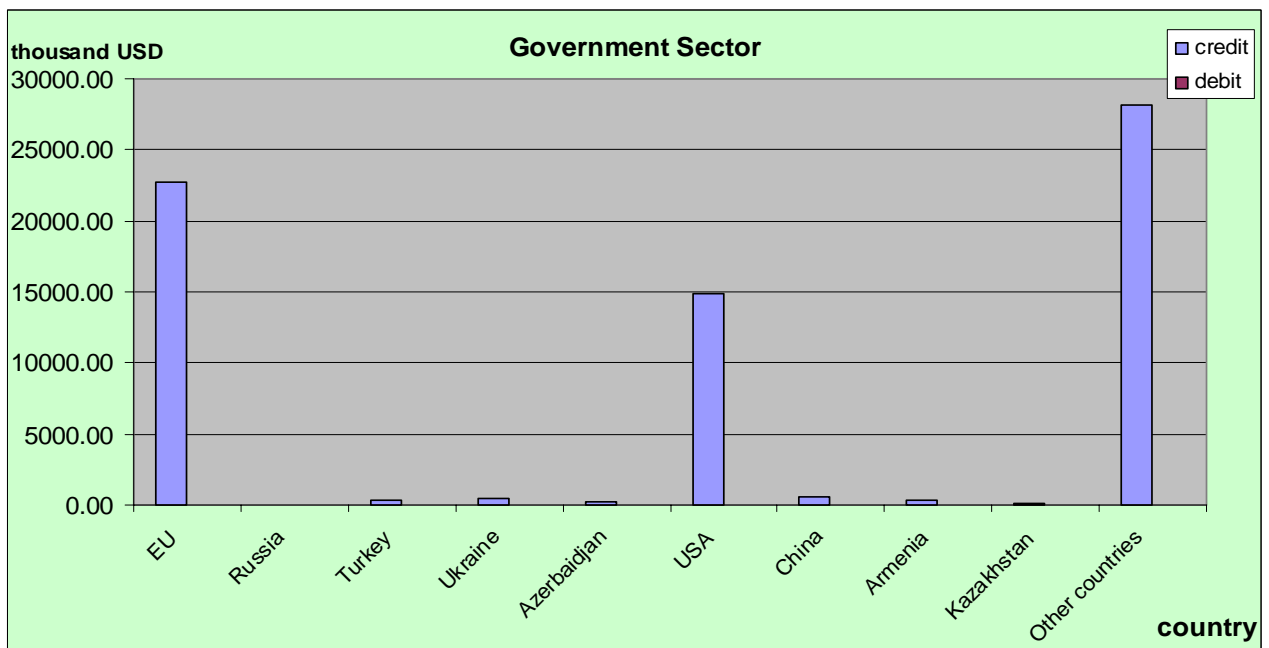
**Graph 17: Other Transfers**



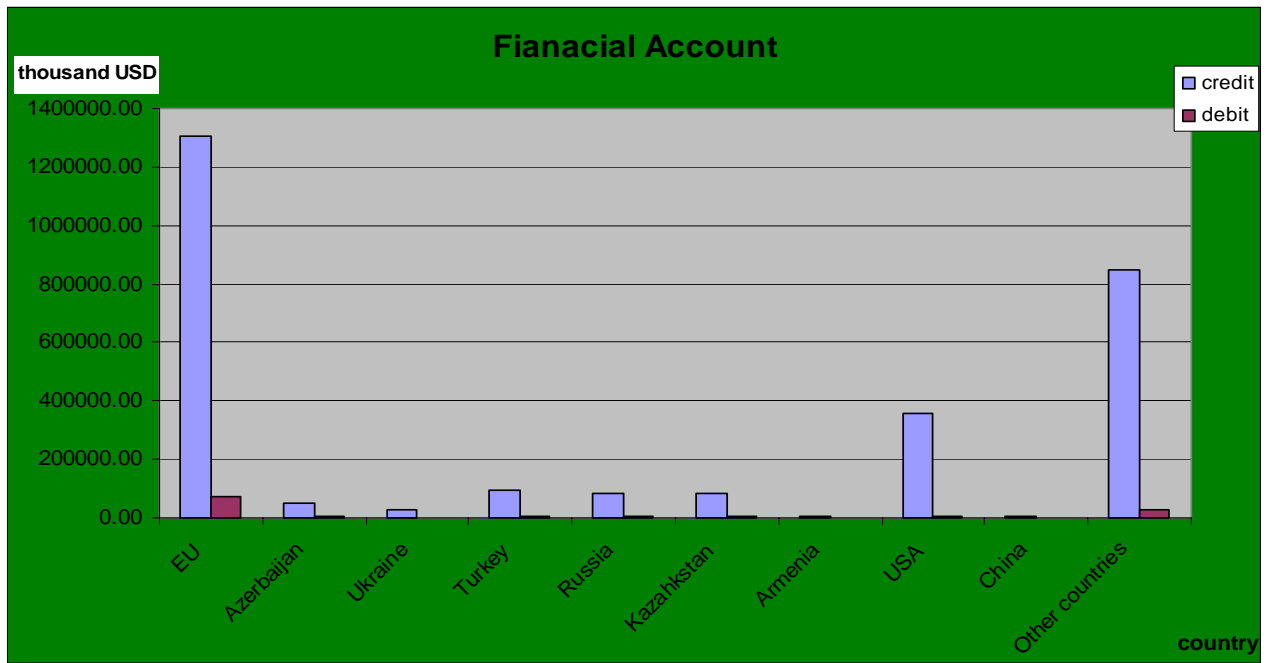
**Graph 18: Georgia's Capital Account by Countries**



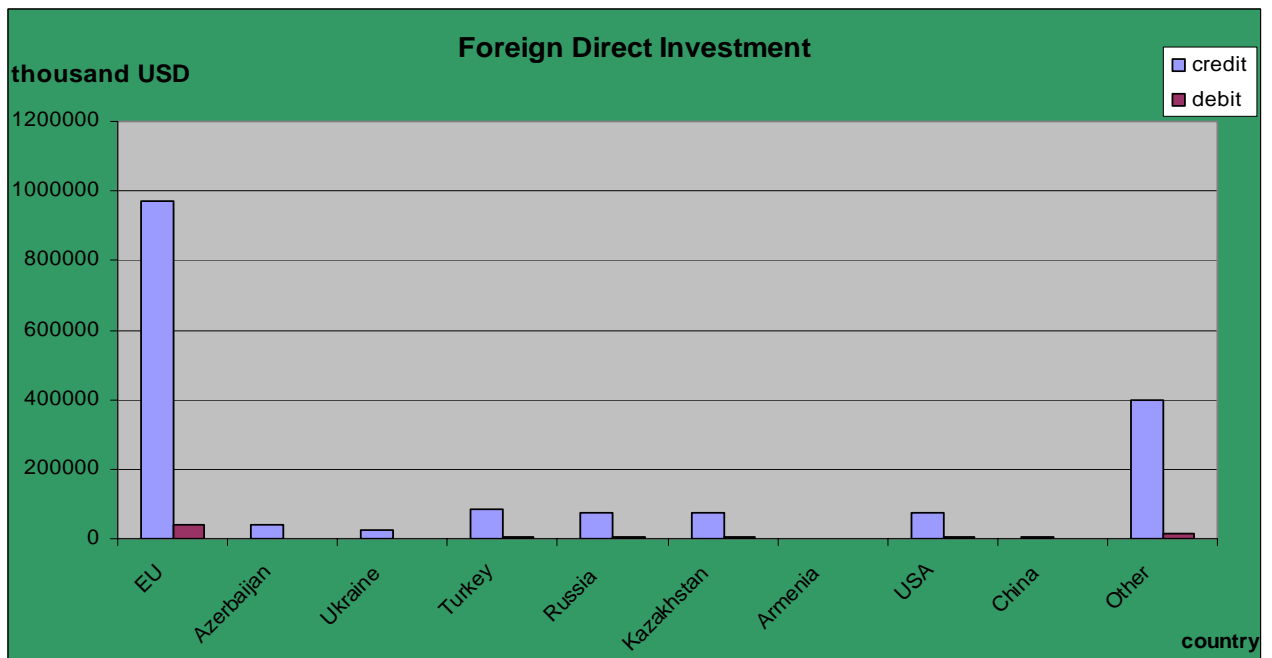
**Graph 19: General Government Sector**



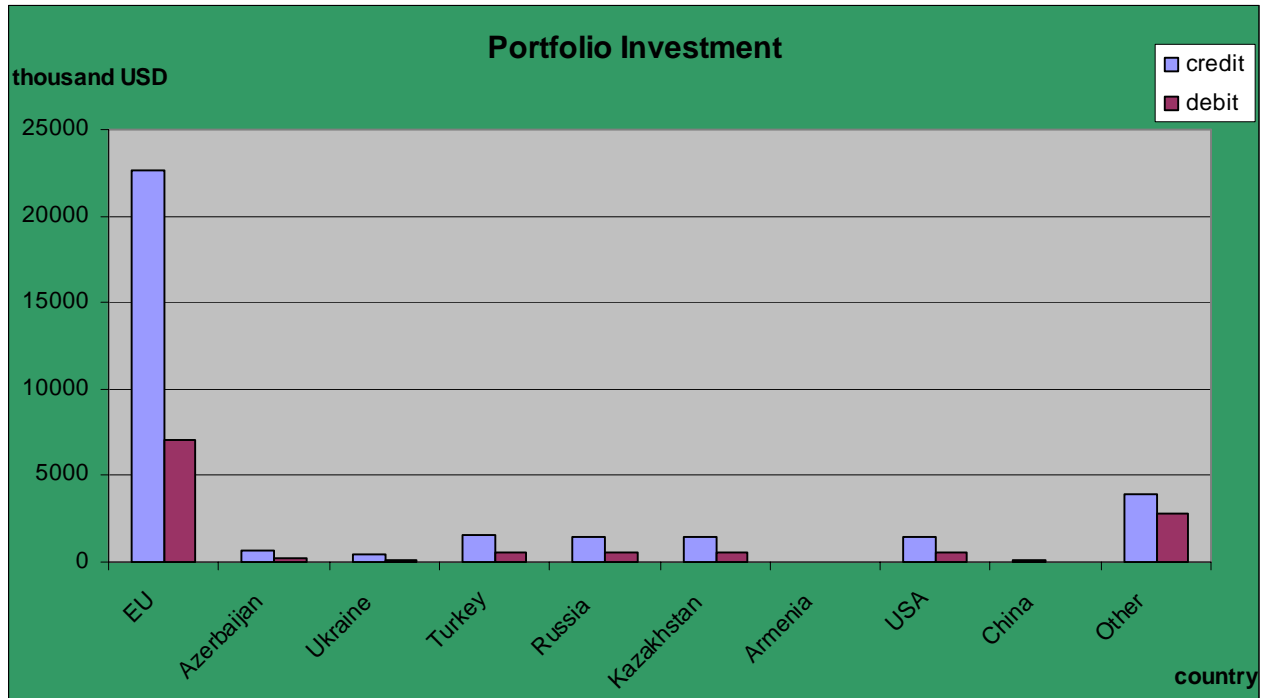
**Graph 20: Georgia's Financial Account by Countries**



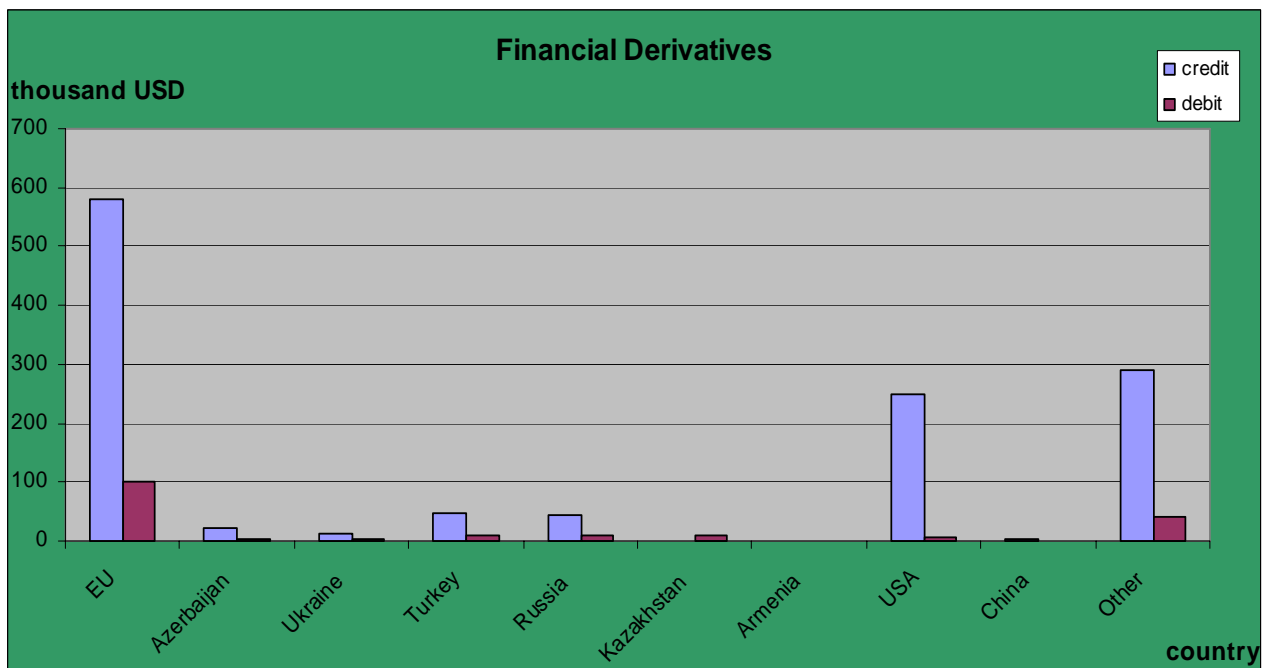
**Graph 21: FDI Account by Countries**



**Graph 22: Portfolio Investment Account by Countries**

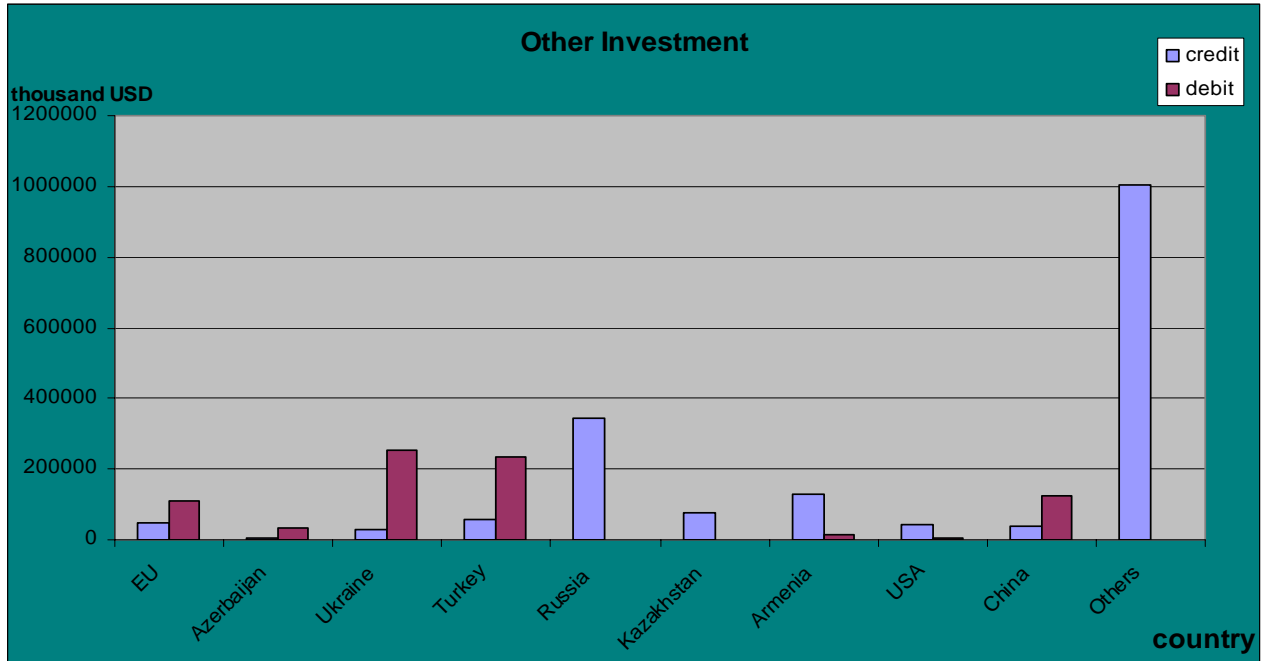


**Graph 23: Financial Derivatives Account**

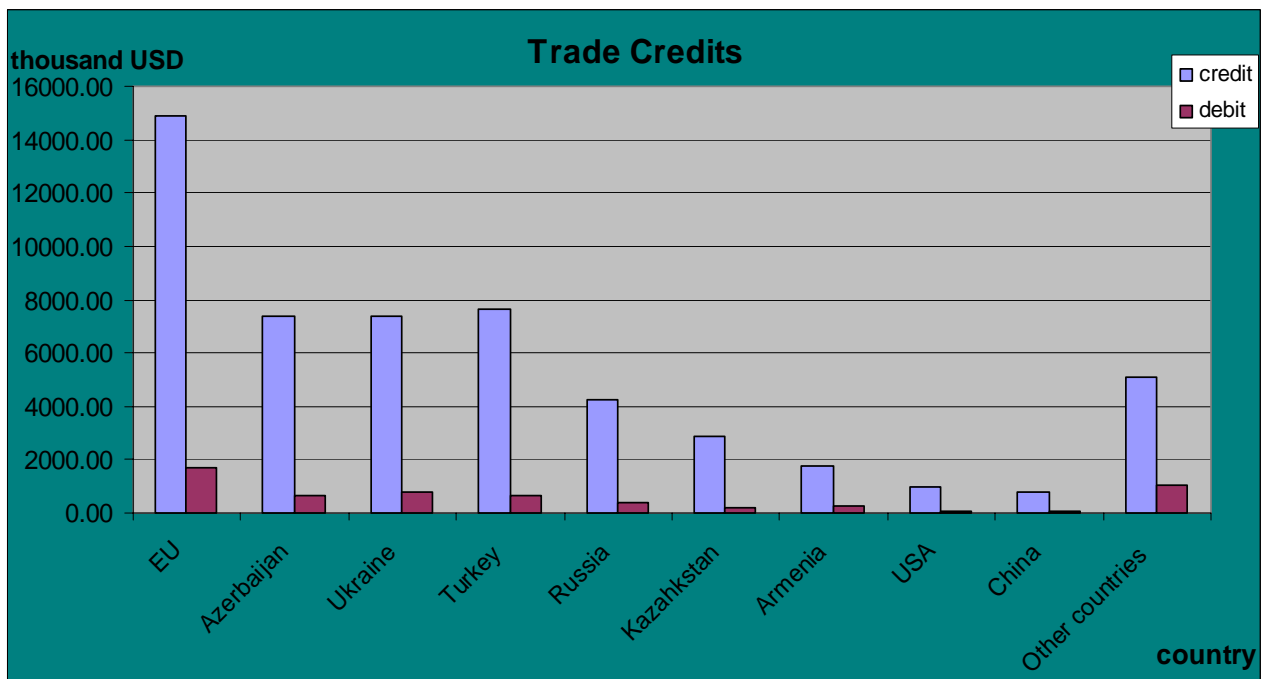


**Graph 24: Other Investments**

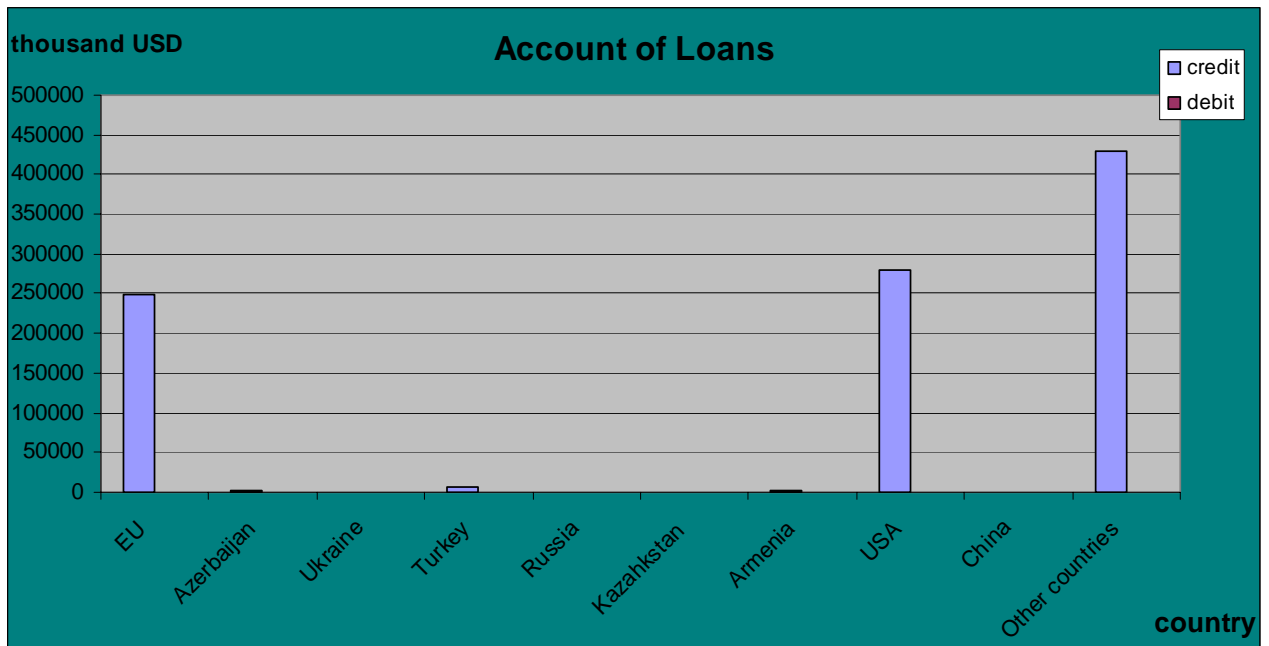




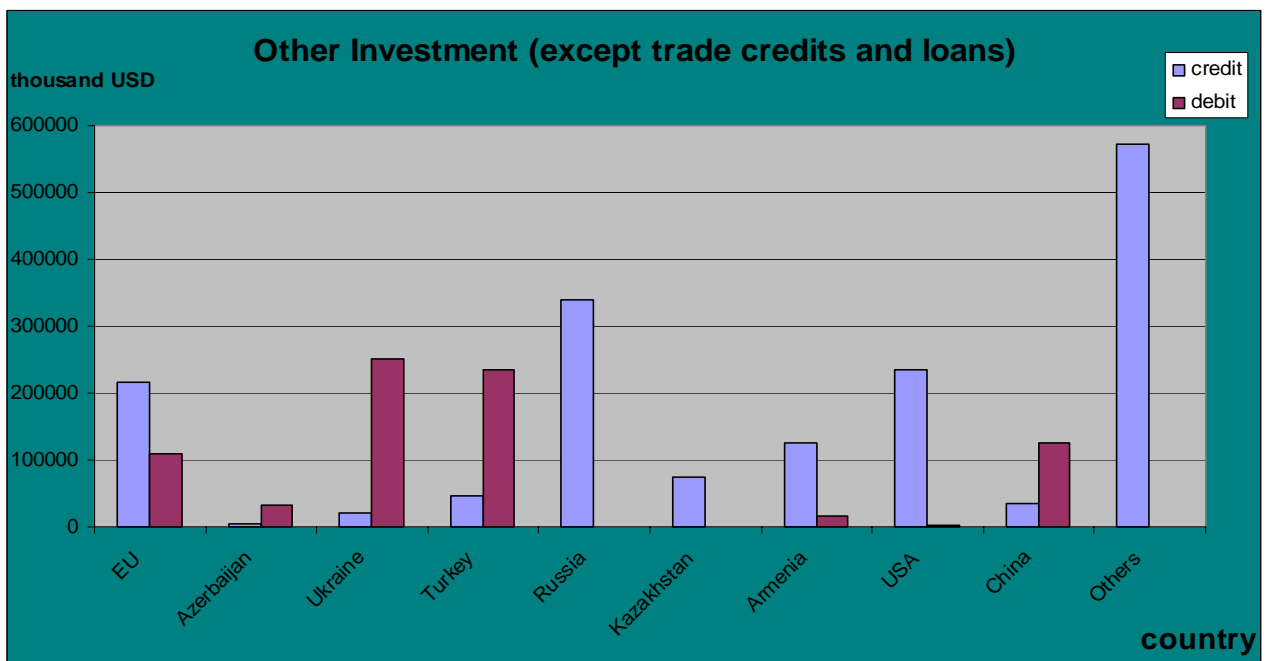
**Graph 25: Trade Credits by Countries**



**Graph 26: Loans' Account**



**Graph 27: The Rest Accounts of the Other Investments (cash and deposits and other assets)**





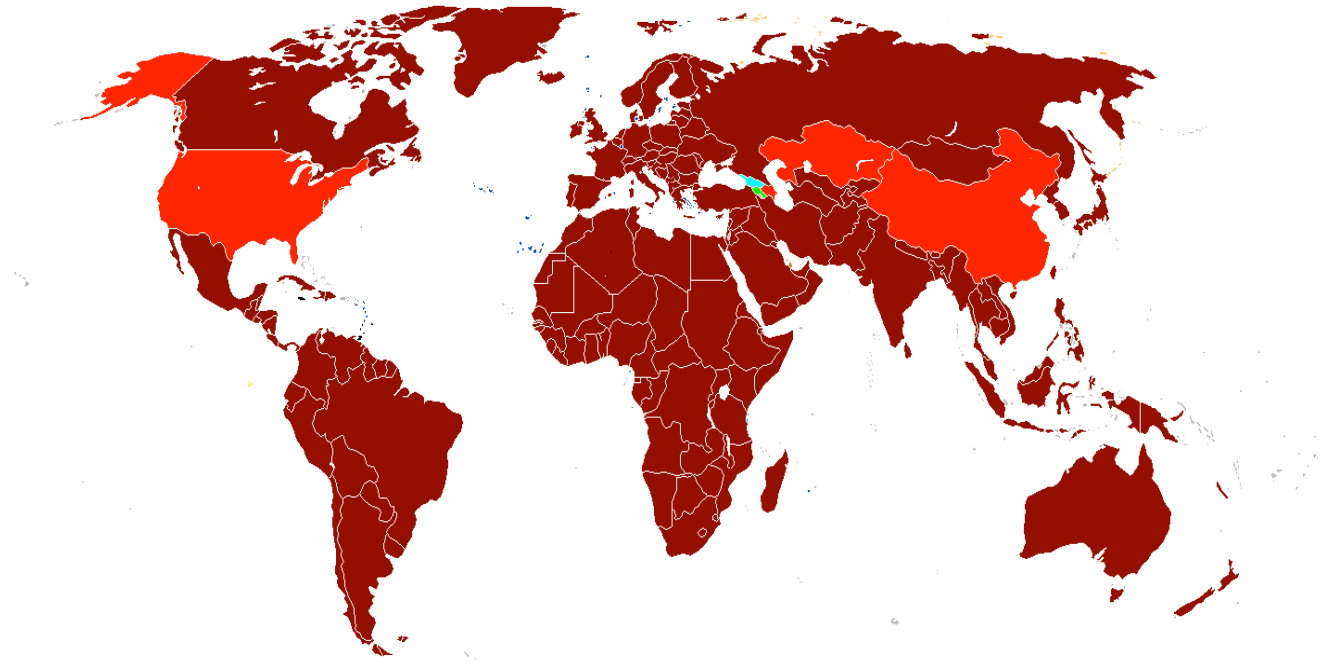
## Appendix2: Short Form of Georgia's BOP by countries in 2007

|                                 | <b>EU</b>       | <b>Azerbaijan</b> | <b>Ukraine</b>  | <b>Turkey</b>   | <b>Russia</b>   | <b>Kazakhstan</b> | <b>Armenia</b>  | <b>USA</b>      | <b>China</b>    | <b>Others</b>   |
|---------------------------------|-----------------|-------------------|-----------------|-----------------|-----------------|-------------------|-----------------|-----------------|-----------------|-----------------|
| <b>Current Account</b>          | <b>-890,860</b> | <b>-55,537</b>    | <b>-384,734</b> | <b>-268,007</b> | <b>124,134</b>  | <b>-11,403</b>    | <b>161,346</b>  | <b>103,032</b>  | <b>-184,445</b> | <b>-602,609</b> |
| <b>a. goods</b>                 | <b>-858,375</b> | <b>-114,783</b>   | <b>-357,585</b> | <b>-325,136</b> | <b>-392,824</b> | <b>-21,928</b>    | <b>60,327</b>   | <b>-52,330</b>  | <b>-192,737</b> | <b>-640,455</b> |
| credit                          | 519,530         | 247,169           | 177,321         | 297,771         | 188,014         | 39,292            | 119,884         | 151,561         | 8,973           | 338,770         |
| debit                           | -1,377,905      | -361,952          | -534,906        | -622,906        | -580838         | -61,219           | -59,558         | -203,891        | -201,709        | -979,225        |
| <b>b. services</b>              | <b>-55,701</b>  | <b>72,572</b>     | <b>-31,788</b>  | <b>42,403</b>   | <b>-445</b>     | <b>-919</b>       | <b>111,633</b>  | <b>-35,629</b>  | <b>2,480</b>    | <b>56,700</b>   |
| credit                          | 329,868         | 139,501           | 35,807          | 138,136         | 38,203          | 13,577            | 120,354         | 60,917          | 10,276          | 207,432         |
| debit                           | -385,570        | -66,929           | -67,596         | -95,733         | -38,647         | -14,495           | -8,721          | -96,546         | -7,796          | -150,732        |
| <b>c. income</b>                | <b>-120,036</b> | <b>-13,849</b>    | <b>-7,858</b>   | <b>3,072</b>    | <b>233,693</b>  | <b>3,863</b>      | <b>-12,044</b>  | <b>47,210</b>   | <b>1,792</b>    | <b>-98,859</b>  |
| debit                           | 57,589          | 490               | 9,295           | 8,526           | 256,159         | 5,316             | 714             | 63,696          | 2,029           | 77,788          |
| credit                          | -177,625        | -14,339           | -17,153         | -5,454          | -22,466         | -1,453            | -12,758         | -16,486         | -237            | -176,647        |
| <b>d. current transfers</b>     | <b>143,253</b>  | <b>523</b>        | <b>12,497</b>   | <b>11,654</b>   | <b>283,709</b>  | <b>7,580</b>      | <b>1,431</b>    | <b>143,782</b>  | <b>4,019</b>    | <b>80,005</b>   |
| credit                          | 170,740         | 1,159             | 14,449          | 12,503          | 289,810         | 7,844             | 1,726           | 162,412         | 4,653           | 103,161         |
| debit                           | -27,487         | -636              | -1,952          | -849            | -6,100          | -263              | -295            | -18,631         | -633            | -23,155         |
| <b>Cap. and Fin. Account</b>    | <b>883,488</b>  | <b>111,981</b>    | <b>306,268</b>  | <b>378,542</b>  | <b>-233,082</b> | <b>17,688</b>     | <b>-142,300</b> | <b>-88,197</b>  | <b>168,762</b>  | <b>639,803</b>  |
| <b>Capital Account</b>          | <b>25,643</b>   | <b>37,540</b>     | <b>1,590</b>    | <b>1,854</b>    | <b>244</b>      | <b>19,438</b>     | <b>903</b>      | <b>1,895</b>    | <b>942</b>      | <b>37,535</b>   |
| credit                          | 25,672          | 37,703            | 1,602           | 1,892           | 255             | 19,444            | 903             | 1,895           | 944             | 37,578          |
| debit                           | -29             | -162              | -12             | -38             | -12             | -6                | -1              | 0               | -3              | -43             |
| <b>Financial Account</b>        | <b>857,845</b>  | <b>74,441</b>     | <b>304,678</b>  | <b>376,688</b>  | <b>-233,326</b> | <b>-1,749</b>     | <b>-143,202</b> | <b>-90,092</b>  | <b>167,821</b>  | <b>602,268</b>  |
| <b>a. direct investment</b>     | <b>930,097</b>  | <b>36,455</b>     | <b>23,312</b>   | <b>81,849</b>   | <b>73,648</b>   | <b>71,129</b>     | <b>1,808</b>    | <b>71,285</b>   | <b>5,605</b>    | <b>379,737</b>  |
| to abroad                       | -41,897         | -1,530            | -901            | -3,471          | -3,290          | -3,972            | -45             | -3,121          | -294            | -16,797         |
| from abroad                     | 971,994         | 37,984            | 24,213          | 85,320          | 76,938          | 75,101            | 1,854           | 74,406          | 5,899           | 396,535         |
| <b>b. portfolio investment</b>  | <b>15,557</b>   | <b>430</b>        | <b>254</b>      | <b>977</b>      | <b>926</b>      | <b>921</b>        | <b>13</b>       | <b>878</b>      | <b>72</b>       | <b>1,082</b>    |
| assets                          | -7,045          | -257              | -152            | -584            | -553            | -550              | -8              | -525            | -43             | -2,810          |
| liabilities                     | 22,601          | 688               | 405             | 1,560           | 1,479           | 1,471             | 20              | 1,403           | 114             | 3,893           |
| <b>c. financial derivatives</b> | <b>479</b>      | <b>17</b>         | <b>11</b>       | <b>39</b>       | <b>37</b>       | <b>-8</b>         | <b>1</b>        | <b>240</b>      | <b>2</b>        | <b>249</b>      |
| assets                          | 581             | 21                | 13              | 47              | 45              | 0                 | 1               | 248             | 2               | 290             |
| liabilities                     | -102            | -4                | -2              | -8              | -8              | -8                | 0               | -8              | -1              | -41             |
| <b>d. other investments</b>     | <b>159,543</b>  | <b>37,539</b>     | <b>281,101</b>  | <b>293,824</b>  | <b>-307,936</b> | <b>-73,791</b>    | <b>-145,024</b> | <b>-46,687</b>  | <b>162,142</b>  | <b>234,588</b>  |
| assets                          | 111,693         | 33,480            | 252,494         | 234,682         | -326,067        | -75,689           | -128,756        | -44,118         | 125,686         | -385,747        |
| liabilities                     | 47,850          | 4,059             | 28,608          | 59,142          | 18,131          | 1,898             | -16,268         | -2,569          | 36,456          | 620,334         |
| <b>e. reserve assets</b>        | <b>-247,831</b> | <b>0</b>          | <b>0</b>        | <b>0</b>        | <b>0</b>        | <b>0</b>          | <b>0</b>        | <b>-115,808</b> | <b>0</b>        | <b>-13,388</b>  |
| <b>Net errors and omissions</b> | <b>7,371</b>    | <b>-56,445</b>    | <b>78,466</b>   | <b>-110,536</b> | <b>108,948</b>  | <b>-6,285</b>     | <b>-19,047</b>  | <b>-14,835</b>  | <b>15,683</b>   | <b>-37,194</b>  |

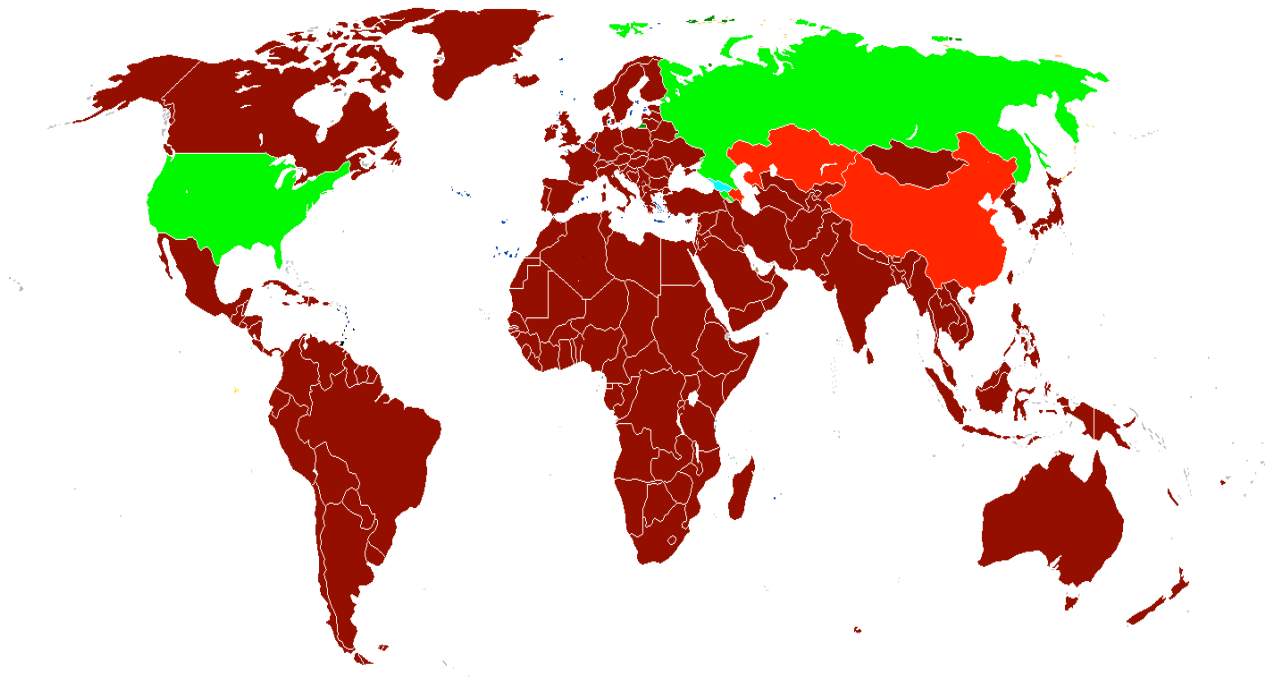
### Appendix 3

In the pictures below dark green color shows a net account of more than \$200 million and light represents that it is less than this amount. As for red colors, dark red means that a net account is less than \$200 million and light one reflects that it is more than this amount.

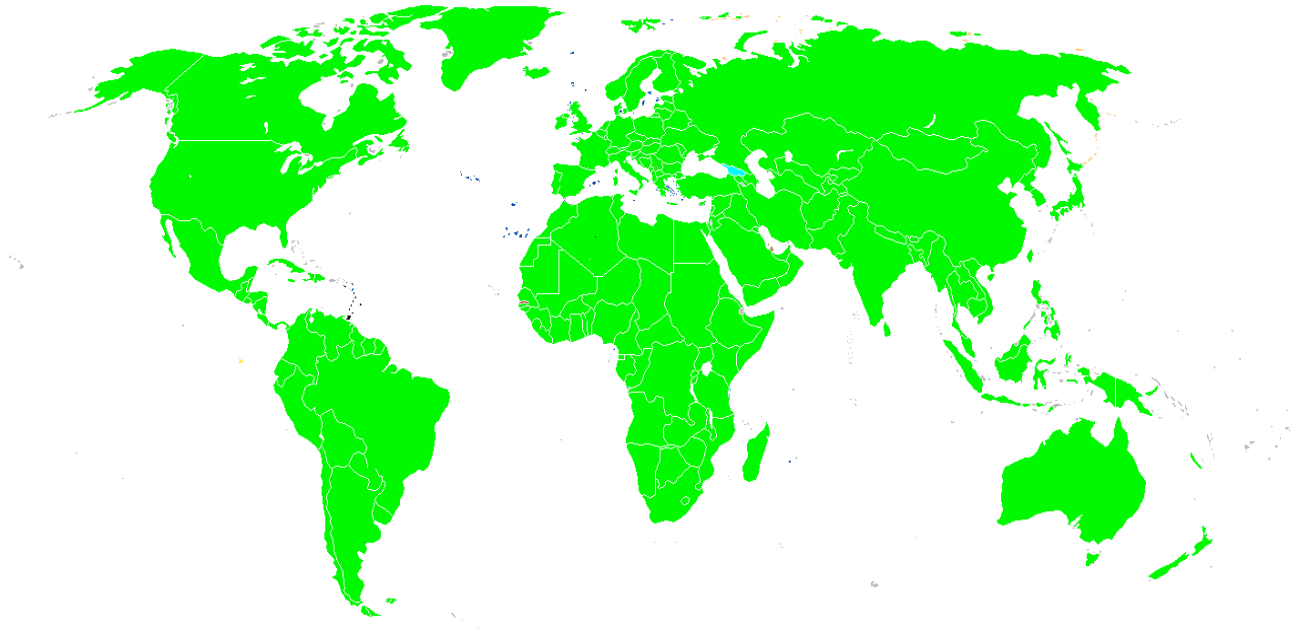
**Picture 1: Big Picture of Georgia's Trade (Goods and Services) Balances**



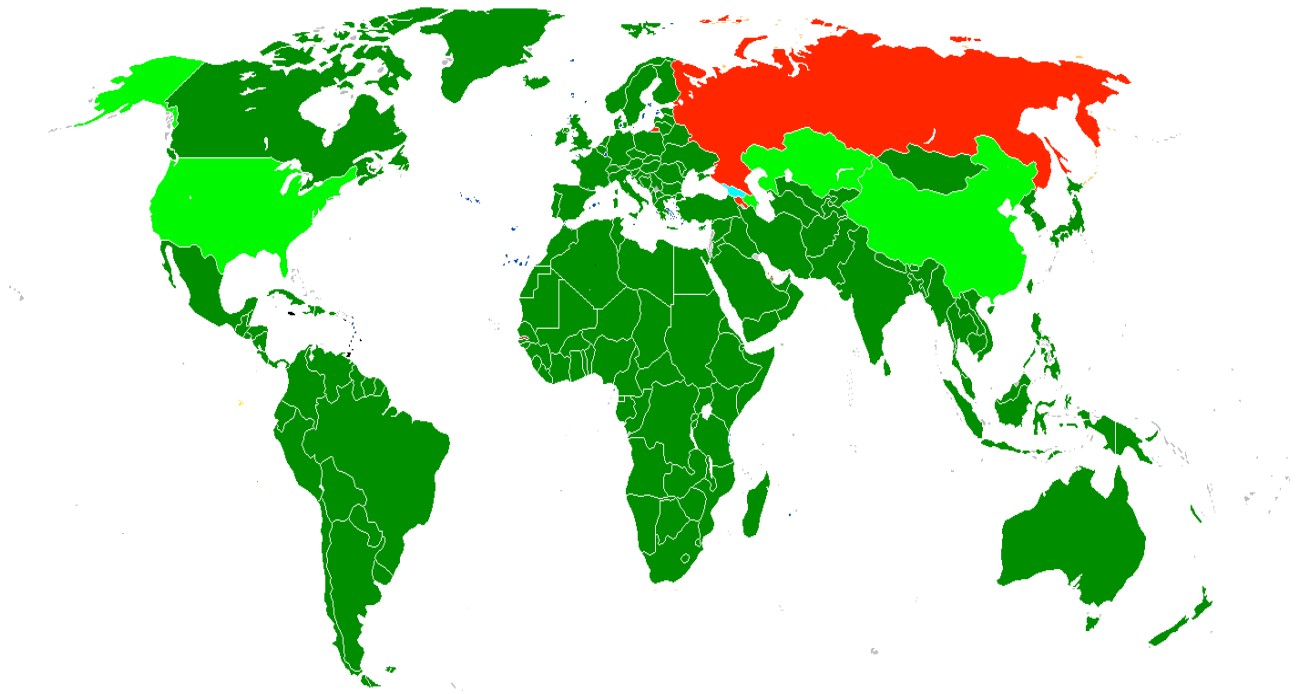
**Picture 2: Big picture of Georgia's Current Account Balances**



**Picture 3: Big Picture of Georgia's Capital Account Balances**



**Picture 4: Big Picture of Georgia's Financial Account Balances**



**Picture 5: Big Picture of Georgia's Overall (except change in reserves) Balances**

