

Project

Economic Crime and Money Laundering

Topic

Problems of selling American humanitarian wheat on Georgian Market
(Report – brief summary)

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Extremely complicated political and economic events taking place in the recent history of the country, mistakes made by authorities in administration of economy and what's especially interesting – decisions made based on private interests of specific groups stimulated situations that very much predisposed regular violations of tax and customs legislation (turnover of smuggled and unregistered goods) in bread-making industry. This, on its side, predetermined larger scale corrupt deals made with public officials at different levels.

The review of general economic potential of the sector and turnover of illegal goods is extremely important to gain some insight about the extent of law violation usual in wheat and flour business for years. This review is presented in the introductory part of our report based on relevant data of 1996-2004 of the State Department of Statistics and the Ministry of Agriculture of Georgia. In particular, utilization of nutritional wheat in Georgia is 701 thousand tones in grain, i.e. 512 thousand tones as flour. In 2004 local production of flour amounted to 136.7 thousand tones. At that period legal import of flour was 225 thousand tones; i.e. total legal supply of flour to Georgian market was 360 thousand tones instead of 512 thousand. This means that 150 thousand tones of unregistered flour were supplied to the market. As nutritional wheat constituted about 80 thousand tones out of 186 thousand tones produced on Georgian market in 2004, total of 280 thousand tones of nutritional wheat was supplied to the Georgian market (wheat import in 2004 was 200 thousand tones). About 196 tones of flour should have been produced out of 280 thousand tones of wheat. Local production of wheat in 2004 amounted to 136.7 thousand tones; i.e. about 60 thousand tones of unregistered flour was supplied to the market, while another 90 thousand tones should have been supplied to the market only as smuggled. There is no other explanation to this event. Unfortunately absolutely same trends were observed in the first two months of the current year.

All above-mentioned clearly indicates that the authorities have to implement urgent set of measures in order to regulate the situation on the flour market, including urgent regulation of service of wheat donated to the Government of Georgia by the Government of the US as humanitarian aid.

Simultaneously, current entrepreneurial and tax legislation of Georgia was rather instable and had a number of important characteristics. On the one hand, mentioned situation has hindered the development of entrepreneurship significantly; while on the other hand it has catalyzed law violations and certain corrupt deals.

From our point of view, the regime of imposing VAT on wheat processing plants could be considered as one of the shortcomings. According to the articles 220 and 221 of the new Tax Code a person is considered as a VAT payer if s/he undertakes entrepreneurial activities and total amount of VAT-taxable operations performed by him/her exceeds GEL 100 thousand during any uninterrupted 12 calendar months. Above-mentioned statement acknowledged as one of the levers for the implementation of the state policy for support of small entrepreneurship deserves positive evaluation. Though considering very undesirable reality that is based on the mentioned statement and established in wheat processing industry in Georgia today, the necessity of correction of this statement should be regarded as a very topical issue. The report describes a vicious mechanism - possibility of its use could not be eradicated by the new Code, and the practice demonstrates that this mechanism is one of the main reasons of the current non-competitive environment on wheat and wheat product market. Attention towards this issue is generated by the fact that similar “mechanism” could be easily used with regards to wheat received as American humanitarian aid, as according to the intergovernmental agreement American humanitarian wheat has to be sold VAT-free. Therefore, according to the situation on the consumer market wheat produced in small enterprises established via mentioned scheme is cheaper by 20% compared to wheat produced by relatively large, VAT-paying and - what’s the most important – law observant enterprises. This results in the inequality of enterprises operating on the wheat market and restriction of the free competition.

According to above-mentioned the problem should undoubtedly be solved on legal/normative level; moreover, one of the requirements of the intergovernmental agreement between the US and Georgia on the issue of humanitarian wheat is exactly the condition, when selling of humanitarian wheat should not be damaging to local producers of wheat and wheat products. Therefore, the expediency is justified in the Report in order to make Georgian executive power consider the introduction of a rule of significantly reduced tax rate, differentiated according to various product groups, compared to existing 20% VAT.

Most part of the Report is dedicated to service problems of receiving, storage and selling of American humanitarian wheat. The US donates large amount of nutritional wheat to Georgian government annually; revenues from its marketing are used for the development of our agriculture. In the recent years the state announced open tender for the purchase of the mentioned service and the service is provided by the winner. Simultaneously, established tradition of receiving-storage-marketing services of wheat in a non-competitive environment is characterized by a number of shortcomings, mainly determined by imperfect legal basis of tendering and subsequent service procedures.

On the basis of an agreement made between the governments of the US and Georgia in 2004 Georgia received 50.000 tones of free humanitarian nutritional wheat.

Studied materials and undertaken interviews revealed that the open tender for the procurement of receiving-storage-marketing services of American humanitarian wheat was held by the Ministry of Agriculture with serious shortcomings; in particular:

- Tender documents for the procurement of goods were used in the tender instead of tender documents for service procurement;
- Criteria reflecting service quality (qualitative characteristics of receiving, storage, transportation and marketing services of wheat) envisaged by current statement were not considered during the evaluation of tender except wheat allocation scheme;

- Qualification indicators of an applicant were evaluated in parallel with the tender evaluation; this contradicts the law “On State Procurement.”

- Following procedures were violated: familiarization of applicants with tender documents, procedure and rules of return of documents to them, timeframe and rules for appealing and concluding the agreement.

Study of the international open tender materials on service procurement of receiving-storage-marketing of American wheat, materials provided by the tender participants, as well as the study and analysis of answers and opinions on questionnaires sent to the Ministry of Agriculture of Georgia, State Procurement Agency of Georgia, US Embassy, US Department of Agriculture and Agricultural Attaché, participants of exchange trade and numerous experts - their contradictory and mutually exclusive character proved the elementary truth that shortcomings of the existing legislation were main causes of problems related to service of wheat donated as humanitarian aid by the US government to Georgia. Therefore, to overcome disagreement and strain on the issue in the future we think it would be reasonable to analyze the legislation and develop recommendations for its improvement. In order to correct shortcomings of the current legislation we consider necessary to make certain amendments in standard documents. In order to implement these amendments we developed projects on amendments to relevant standard acts; these projects are provided as appendices to this Report. We would like to mention some of them.

We think that amendments should be introduced to the current legislation in force in order to clearly differentiate qualification data of procurement applicants and evaluation of presented tenders during state procurement process.

We think that criteria for tender evaluation and their priority coefficients in tender documentation for procurement services of receiving-storage-marketing of American wheat should be changed necessarily.

In particular, following five criteria and their priority coefficients are suggested:

Cost of the tender - 0,40;

Wheat allocation scheme - 0,10;

Wheat storage conditions _ 0,20;

Activities for the maintenance of qualitative and quantitative indicators of wheat on different stages of service _ 0,15;

Conditions of wheat marketing - 0,15.

We think that the introduction of mentioned amendments to the existing legislation would eliminate serious problems customary for the state procurement processes.