ADB

Report and Recommendation of the President to the Board of Directors

Project Number: 54271-001
October 2020

Proposed Programmatic Approach and Policy-Based Loan for Subprogram 1
Georgia: Fiscal Resilience and Social Protection Support Program

Asian Development Bank

CURRENCY EQUIVALENTS
(as of 13 August 2020)

Currency unit	–	lari (GEL)
GEL1.00	=	$0.3248
$1.00	=	GEL3.0785

ABBREVIATIONS

ADB	–	Asian Development Bank
CARES	–	COVID-19 Active Response and Expenditure Support
COVID-19	–	coronavirus disease
GDP	–	gross domestic product
IMF	–	International Monetary Fund
MEL	–	monitoring, evaluation, and learning
MOF	–	Ministry of Finance
NBG	–	National Bank of Georgia
PPA	–	power purchase agreement
PPP	–	public–private partnership
SOE	–	state-owned enterprise
TA	–	technical assistance

NOTE

In this report, “$” refers to United States dollars.

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PROGRAM AT A GLANCE

1. Basic Data — **Project Number:** 54271-001

Project Name	Fiscal Resilience and Social Protection Support Program (Subprogram 1)	**Department/Division**	CWRD/CWPF
Country	Georgia	**Executing Agency**	Ministry of Finance
Borrower	Government of Georgia		
Country Economic Indicators	https://www.adb.org/Documents/LinkedDocs/?id=54271-001-CEI		
Portfolio at a Glance	https://www.adb.org/Documents/LinkedDocs/?id=54271-001-PortAtaGlance		

2. Sector	**Subsector(s)**	**ADB Financing ($ million)**
✓ **Public sector management**	Public expenditure and fiscal management	90.00
	Reforms of state owned enterprises	10.00
	Social protection initiatives	75.00
Finance	Money and capital markets	25.00
	Total	**200.00**

3. Operational Priorities

✓ Addressing remaining poverty and reducing inequalities
✓ Accelerating progress in gender equality
✓ Strengthening governance and institutional capacity

Climate Change Information

GHG reductions (tons per annum)	0
Climate Change impact on the Project	Low

ADB Financing

Adaptation ($ million)	0.00
Mitigation ($ million)	0.00

Cofinancing

Adaptation ($ million)	0.00
Mitigation ($ million)	0.00

Sustainable Development Goals

SDG 1.1, 1.4, 1.b
SDG 5.1, 5.4, 5.5
SDG 8.1
SDG 10.1, 10.4
SDG 16.6

Gender Equity and Mainstreaming

Effective gender mainstreaming (EGM) ✓

Poverty Targeting

General Intervention on Poverty ✓

4. Risk Categorization: Complex

5. Safeguard Categorization — **Environment:** C **Involuntary Resettlement:** C **Indigenous Peoples:** C

6. Financing

Modality and Sources	**Amount ($ million)**
ADB	**200.00**
Sovereign Programmatic Approach Policy-Based Lending (Regular Loan): Ordinary capital resources	200.00
Cofinancing	**0.00**
None	0.00
Counterpart	**0.00**
None	0.00
Total	**200.00**

Currency of ADB Financing: Euro

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a (i) proposed programmatic approach for the Fiscal Resilience and Social Protection Support Program, and (ii) a proposed policy-based loan to Georgia for subprogram 1 of the Fiscal Resilience and Social Protection Support Program.[1]

2. The proposed program is part of a comprehensive and integrated package of support from the Asian Development Bank (ADB) to the Government of Georgia to help mitigate the adverse health, social, and economic impacts of the coronavirus disease (COVID-19) pandemic.[2] The program supports Georgia's return to inclusive economic growth by addressing the longstanding institutional fragilities in social protection, fiscal, and debt management that were exacerbated by the pandemic and require immediate response. The proposed policy actions are critical in dealing with the economic impact of COVID-19 and ensuring macroeconomic stability in the medium to long term, while continuing to protect the livelihoods of those most affected by the crisis. Delaying the policy actions would expose the government to unplanned increases in the fiscal deficit because of fiscal risks that are more likely to materialize during the ongoing crisis, continued accumulation of foreign-currency-denominated debt, and higher exposure to currency and refinancing risks. At the same time, immediate reforms are needed to safeguard the well-being of older adults, many of whom have lost some of their supplementary sources of income as a result of the COVID-19 pandemic. The program is aligned with ADB's country partnership strategy, 2019–2023 for Georgia.

II. PROGRAM AND RATIONALE

A. Background and Development Constraints

3. **Georgia's public health response broadly effective in containing spread of COVID-19.** As of 29 September 2020, Georgia had confirmed 5,552 cases since the outbreak of COVID-19, with 2,054 recoveries and 32 fatalities.[3] From the outset, the country imposed health checks on incoming air passengers and ramped up restrictions on movement as the first cases emerged. The government's clear and consistent communication strategy was instrumental in avoiding widespread contagion. The phased lifting of lockdown measures was underpinned by recommendations from health professionals to help prevent a resurgence of cases,[4] and public compliance with these recommendations kept the incidence low. Despite a sharp increase in the number of confirmed cases in September 2020, Georgia's number of confirmed cases remains one of the lowest in the region and remains retain one of the lowest case-mortality rates among Organisation for Economic Co-operation and Development (OECD) countries.

4. **The COVID-19 pandemic has had a significant negative impact on Georgia's economy.** While the drop in remittances and exports was less severe than initially envisioned, it did not offset the adverse impact of a marked slowdown in the tourism industry and foreign direct investment. Gross domestic product (GDP) growth is now forecast to decelerate to –5.0% in 2020.[5] The revised projections are based on recent data indicating a contraction in growth of 12.6% year-over-year for the second quarter of 2020, and an overall 5.8% contraction for the first

[1] Asian Development Bank (ADB). 2020. *ADB's Comprehensive Response to the COVID-19 Pandemic*. Manila.
[2] ADB put together a comprehensive package of support in response to the Government of Georgia's official request for assistance submitted on 26 March 2020.
[3] Government of Georgia. StopCoV – Prevention of Coronavirus in Georgia (accessed 29 September 2020).
[4] Government of Georgia. 2020. *Measures Implemented by Georgia Against COVID-19: Report*. Tbilisi.
[5] ADB. 2020. Asian Development Outlook Update: Wellness in Worrying Times. Manila.

half of 2020. In the second quarter of 2020, tourism revenues fell by $849 million year-over-year. The impact of this on Georgia's external balance was partly offset by a reduced trade balance (–$497 million year-over-year) as imports (–31.8%) fell more than exports (–24.7%).[6] Also, incoming remittances rebounded in June 2020 with a year-over-year increase of 17.8%, after economic lockdowns across the globe had caused a sharp drop in April. The lari, which had hit a record low in March 2020, appreciated by 6.9% quarter-on-quarter against the United States dollar, reflecting adequate monetary policy responses by the National Bank of Georgia (NBG), as well as external funding support and resilient remittances. Annual inflation in June 2020 was 6.1%, driven by food price increases because of supply chain disruptions and stronger influence of foreign exchange pass-through.[7]

5. **Impact on public finances more severe than expected**. The COVID-19 pandemic significantly weakened Georgia's fiscal position.[8] Revenue and grants are expected to decline by 10.5% in the revised budget, compared with the original budget for 2020, led by a 12.1% drop in tax revenues, while expenditure is expected to increase by 10.2%.[9] To accommodate the significant increase in public expenditure needed to finance Georgia's Anti-Crisis Plan, the government sought to create fiscal space in the revised budget 2020.[10] Recurrent expenditure on wages and salaries was lowered by 2.7%, and on goods and services by 1.6%, compared with the original 2020 state budget. But despite these efforts, the financing gap for 2020 widened to $1.6 billion, from an estimated $1.5 billion in May 2020 (footnote 9). To bridge this financing gap, external borrowing is expected to increase by an additional GEL4.3 billion, and domestic debt is set to rise by GEL649 million. Despite the lari's continued depreciation during 2014–2019, Georgia's ratio of general government debt to GDP remained below 42% during 2017–2019. However, general government debt will increase sharply to 57.9% of GDP in 2020, from 41.2% in 2019. While the authorities have a medium-term plan to gradually reduce government debt as a share of GDP to 54.3% by 2024,[11] rollover, currency, and contingency risks may disrupt this trajectory (footnote 7). The fiscal deficit increased sharply to 8.5% in 2020, from 2.2% in 2019, well above the 3.0% ceiling of the Economic Liberty Act.[12]

6. **External general government debt magnifying vulnerabilities to economic shocks.** Domestic markets in Georgia are not sufficiently liquid to fund the public financing needs entirely. To address this shortcoming, the government is seeking foreign currency financing from development partners to fund its ambitious countercyclical development expenditure program. As a result, the share of foreign-currency-denominated government debt as a share of GDP in Georgia is expected to increase from 31.5% in 2019 to 45.9% in 2020.[13] This in turn increases public exposure to foreign currency and refinancing risks.[14] The rising costs of foreign-currency-denominated debt repayments associated with depreciation of the lari may pose a significant burden on public finances, crowding out essential social spending and threatening

[6] National Bank of Georgia (NBG). 2020. Monetary Policy Report: August 2020. Tbilisi.
[7] NBG. 2020. Monthly Review: July. Tbilisi.
[8] Government of Georgia. 2020. Revised State Budget. Tbilisi.
[9] The tax–GDP ratio will drop from 23% in the original 2020 budget to 21.4% in the revised budget.
[10] The increase in expenditure was primarily led by a 28.6% increase in social benefit spending.
[11] The government plans to reduce government debt as a share of GDP to 55.9% in 2021, 55.9% in 2022, 55.4% in 2023, and 54.3% in 2024. Ministry of Finance (MOF). 2020. Basic Economic and Financial Indicators (accessed 06 October 2020).
[12] The Economic Liberty Act, adopted in 2011 and effective since 2014, established numerical upper limits for general government debt (60% of GDP), and the budget balance (3% of GDP). Public debt and budget balance rules have been adhered to since their introduction..
[13] MOF. 2020. Basic Economic and Financial Indicators (accessed 15 August 2020).
[14] The large share of foreign currency debt affects the figure for general government debt as a share of GDP, which fluctuates in line with the exchange rate.

macroeconomic stability needed for economic recovery. Despite efforts to diversify the currency composition of the government debt portfolio, external debt accounts for roughly 80% of general government debt, and most of that is denominated in United States dollars.[15] The continued reliance on external and foreign-currency-denominated financing undermines efforts to deepen domestic debt markets and increases public exposure to external risks, while limiting the effectiveness of countercyclical monetary and fiscal policies.

7. **Medium-term plan to narrow fiscal deficit**. As a response to the sharp increase in the fiscal deficit in 2020, the authorities adopted a medium-term plan to gradually bring the fiscal deficit below 3% by 2024.[16] However, the risk of a protracted crisis may prompt the extension of the temporary social protection measures and lead to lower growth and revenues in 2021 (footnote 8). This could create a need for more expenditure going into 2021 and, depending on how global, regional, and domestic economic dynamics unfold, may slow the rebound in economic activity and keep revenues below expectations. Higher than planned fiscal deficits in the medium term could frustrate the government's plan to minimize its borrowing needs and, in the absence of deeper domestic markets, increase the exposure to refinancing and currency risks.[17] It is therefore imperative that the government continue to deepen money markets for government securities, thereby increasing overall market liquidity and predictability, while further creating an enabling policy and legislative environment for capital market development.[18]

8. **Increasing the share of lari-denominated general government debt.** Between 2017 and 2019, the government began to gradually reduce its reliance on external debt. Domestic debt as a share of GDP increased from 7% in 2017 to 9.7% in 2019, whereas external debt as a share of GDP declined from 32.4% to 31.5% in the same period. Likewise, domestic debt as a share of total government debt increased from 17.8% in 2017 to 23.5% in 2019. While the COVID-19 pandemic partly disrupted this balance—the share of domestic debt as a share of total government debt declined from 23.5% in 2019 to 20.7% in 2020—the government remains committed to this policy objective. During 2020–2024, it plans to gradually increase domestic debt as a share of government debt from 20.7% to 30.0%. The proposed program supports the government in this endeavor by promoting institutional reforms that further deepen the domestic debt market for government securities.[19] This will help minimize public exposure to stability-threatening refinancing and currency risks, which is a prerequisite for economic recovery.[20] The program therefore supports policy actions that further strengthen money market infrastructure for government securities on the one hand, while simultaneously supporting the development of capital markets on the other hand. Deepening the market for treasury securities is an essential precondition for the good functioning of other components of the capital market, since the treasury yield curve plays an important role in the pricing of the other securities (footnote 17). The program supports continued and enhanced collaboration between the Ministry of Finance (MOF) and the NBG to expand the issuance of benchmark bonds and thereby boost the liquidity, transparency, and predictability of the market. This will increase investors' interest in domestic government securities and correspondingly expand the investor base. In turn, the development of capital markets will accelerate the de-dollarization process and improve monetary policy transmission on

[15] International Monetary Fund (IMF). 2020. Georgia: Technical Assistance Report – The Public Sector Balance Sheet and State Owned Enterprises. IMF Country Report No. 20/223. Washington, DC.
[16] The 2021 State Budget (first draft) heralds a gradual reduction in the fiscal deficit to 5.1% in 2021, 4.4% in 2022, 3.3% in 2023, and 2.6% in 2024. MOF. 2020. Basic Economic and Financial Indicators (accessed 5 October 2020).
[17] MOF. 2019. General Government Debt Management Strategy 2019-2021. Tbilisi.
[18] NBG. 2016. Recommendations for Development of Capital Market in Georgia. Tbilisi.
[19] The share of domestic debt stood at 9.7% of GDP in 2019 and is expected to reach 12% of GDP in 2020.
[20] IMF. 2020. Debt Management Responses to the Pandemic – Special Series on COVID-19. Washington, DC.

aggregate demand and, eventually, on price level.[21] Better capital market infrastructure will also help deepen the secondary market for government securities, making additional lari-denominated financial resources available to market participants, including the public sector (footnote 17).

9. **Contingent liabilities threatening fiscal stability and economic recovery.** Although Georgia's public sector balance sheet is relatively healthy,[22] increased exposure to fiscal risks arising from power purchase agreements (PPAs) and state-owned enterprises (SOEs) jeopardize the short- and medium-term fiscal sustainability during the COVID-19 crisis (footnote 15). The large SOE segment, with its high exposure to foreign exchange risks, represents a net draw on the budget—SOEs' imminent financing needs of about 18% of GDP[23] threaten the fiscal stability that underpins an economic recovery.[24] A reclassification of state enterprises confirmed the existence of 196 SOEs in the general government sector—highlighting the dependence of many SOEs on government funding and the role of government in their management decisions. Moreover, of the six largest SOEs, only one generates sufficient operating profits to cover its capital costs, while all others incur significant losses. Overall, the SOE segment has drawn a cumulative 6% of GDP from the government budget between 2015 and 2020. By IMF estimates, a 30% depreciation of the lari from its August 2020 rate would reduce the net worth of the largest SOEs by about 4% of GDP, affecting the health of the government's fiscal position (footnote 15). Several major SOEs are also exposed to significant foreign exchange mismatches in their assets and liabilities.[25]

10. Existing guarantees under PPAs are set to increase fiscal pressures, threatening the path to macroeconomic stability. Although the payment of PPA guarantees is to be met largely through user fees, residual payments are worth 22% of GDP over 40 years.[26] These payments could double under plausible scenarios, highlighting the need to manage these risks effectively (footnote 15). Recent fiscal projections on the long-term implications of more than 150 PPAs commit the government to ensuring minimum revenues—or in some cases, returns—to power generators over a 50-year-plus period worth about 65% of GDP. The major challenge posed by fiscal risks stemming from PPAs and SOEs is the lack of data and difficulty of incorporating it into the budgeting process. Failure to properly reflect contingent liabilities in the budget framework, especially during a crisis, can lead to expenditure overruns and fiscal pressures. Such a risk would further jeopardize an inclusive and sustainable recovery in the country and require immediate action.

[21] G. Abuselidze. 2018. Georgia's Capital Market: Functioning problems and development directions in association with European Union. Journal of Applied Economic Sciences, 13(7):1929-1938.

[22] Total assets across all government-controlled entities equal 149% of GDP, while liabilities are worth 81% of GDP, leaving a positive net worth of 68% of GDP (footnote 15).

[23] It is estimated that the gross financing requirements of the six major SOEs total about GEL7.6 billion (18% of GDP) during 2021–2024. This includes about $350 million and €150 million by Georgian Oil and Gas Corporation (GOGC), and $400 million by Georgia Rail (footnote 15).

[24] SOEs have been a large financial drain on government finances, with little contribution to public revenues. During 2014–2018, net flows to SOEs totaled GEL2.6 billion, while the government's GEL4.6 billion equity investment generated very little or no dividends. The costs of SOE financing could place additional strain on the fiscal balance in the future, widening the fiscal deficit and, as a result, the ratio of general government debt to GDP. Moreover, SOEs require gross financing of GEL7.6 billion during 2020–2022, partly for refinancing and new financing (footnote 15).

[25] Some SOEs, such as Georgia Rail, do receive revenues in foreign currencies, providing a partial hedge against currency fluctuations, but overall the major SOEs are heavily exposed to depreciations—particularly against the United States dollar and the euro—since most of their debt is denominated in foreign currency (footnote 15).

[26] Annual payments for existing guarantees under PPAs are set to peak in 2024 at 0.6% of GDP under a favorable scenario (footnote 15).

11. **Strengthening the management of fiscal risks.** The government's ability to gradually narrow the fiscal deficit to the 3% ceiling specified in the Economic Liberty Act hinges on its capacity to avert unplanned fiscal expenditures that may arise when fiscal risks materialize. These risks include (i) the materialization of obligations to provide minimum guarantees under some PPAs, as described in para. 9; (ii) exposure to natural disaster risks; and (iii) foreign exchange exposure and potential recapitalization requirements of the large SOE sector (footnote 15). Institutional reforms that make it possible to identify, disclose, and prepare for such risks can help avert unplanned fiscal pressures and the associated impacts on the fiscal deficit and general government debt. International experience indicates that the materialization of contingent liabilities, especially when coupled with exchange rate depreciation, was one of the most common causes of unexpected increases in the general government debt–GDP ratio during 2007–2019.[27] Contingent liabilities stemming from natural disasters, for example, have historically been as high as 10% of GDP in some countries.[28]

12. Experience from the global financial crisis of 2008—and the numerous episodes of SOE and bank recapitalization, and materialization of obligations to provide minimum guarantees under public–private partnerships (PPPs) and PPAs—serves to remind us how disruptive such risks can become to fiscal and debt stability.[29] This includes fiscal risks from unfunded or underfunded policy mandates executed by SOEs. In addition to providing a more stable macroeconomic environment, insulating public exposure to these unplanned fiscal pressures helps minimize opportunity costs for scarce public resources, which in turn creates additional fiscal space for key social spending and public investment priorities.

13. **COVID-19's impact on social welfare indicators**. Preliminary estimates from the Monitoring, Evaluation, and Learning (MEL) Lab—set up with ADB support under the COVID-19 Active Response and Expenditure Support (CARES) Program—suggest that the Anti-Crisis Plan will mitigate a considerable surge in poverty incidence and loss of income across the income groups.[30] While the impact of the COVID-19 crisis would have certainly been much worse if no Anti-Crisis Plan had been in place, the poverty head-count is expected to increase in 2020 across various poverty lines (Table 1).

Table 1: Impact of COVID-19 on Poverty Head-count Under Different Scenarios And Different Poverty Lines

Scenario	National Poverty Line	$1.9 PPP	$3.2 PPP	$5.5 PPP	$10 PPP
Baseline (2019)	19.5	4.5	15.7	42.9	77.9
Impact of COVID without Anti-Crisis Plan	43.3	19.9	37.5	63.0	87.7
Impact of COVID with Anti-Crisis Plan	28.5	8.6	23	49.7	80.1
Mitigating impact of the Anti-Crisis Plan	**14.8**	**11.3**	**14.5**	**13.3**	**7.6**

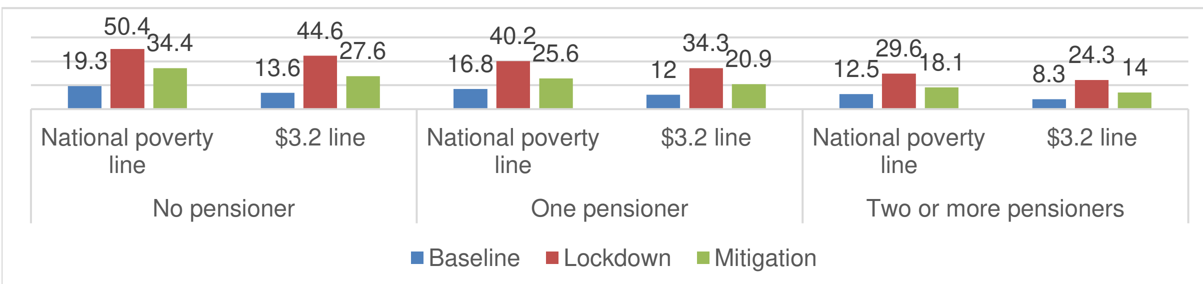
COVID-19 = coronavirus disease, PPP = purchasing power parity.
Source: Asian Development Bank estimates.

14. **Reforms to protect the elderly.** Senior citizens are more vulnerable to the COVID-19 crisis than the general population in two important ways.[31] First, older adults are at a significantly increased risk of severe disease following a coronavirus infection. This is compounded by the fact that senior citizens have less access to household amenities that could minimize the risk of

[27] IMF. 2020. *Managing Fiscal Risks Under Fiscal Stress*. Washington, DC.
[28] IMF. 2003. *Dealing with Increased Risk of Natural Disasters: Challenges and Options.* Washington, DC.
[29] IMF. 2015. From Systemic Banking Crises to Fiscal Costs: Risk Factors. Washington, DC.
[30] ADB. 2020. *Report and Recommendation of the President to the Board of Directors: Proposed Countercyclical Support Facility Loan to Georgia for the COVID-19 Active Response and Expenditure Support Program*. Manila.
[31] ADB. 2016. Georgia Social Protection Index 2015. Manila.

contagion, such as a bath or shower, and water supply and sewerage services.[32] Second, older adults are disproportionately affected by physical distancing measures because they typically rely on multiple income sources, including informal labor income, savings, and financial support from family members—all of which suffered as a result of the COVID-19 lockdown.[33] The pandemic curtailed most sources of income for senior citizens with the exception of pension payouts. This highlights the importance of an adequate and reliable social pension system to avoid a sharp increase in the old-age poverty incidence. This is particularly important for women, who constituted 71% of all universal pension beneficiaries in August 2020 and who rely on pension payouts for their livelihoods. Women's life expectancy (78.2 years) is higher than men's (69.7 years), suggesting that women's reliance on the pension system is also higher than men's—on average, women live 17.2 years and men live 3.6 years on a pension. The COVID-19 crisis also highlighted that the pension system, in addition to providing a financial lifeline to the elderly, helps prevent a steeper resurgence of poverty levels in households with at least one pension recipient. As the figure below illustrates, households with one or more pensioners witnessed a proportionally smaller increase in the poverty incidence. Overall, the COVID-19 crisis shed light on how the right reforms to the pension system can ensure the social well-being of the largest group of vulnerable people in Georgia, i.e., not only senior citizens but also households with at least one pension beneficiary.[34]

Figure 1: Poverty Headcount by Households (none, one, or two pensioners, Scenario Analysis



Source: Asian Development Bank estimates.

15. **Reforms to the pension system.** Structural and institutional reforms to the pension system are needed to protect the livelihoods of older adults, who are disproportionately exposed to the adverse health and socioeconomic impacts of COVID-19. The reform of the pension system began in 2014–2015 with an assessment of the existing arrangements, after which the cabinet adopted a pension reform policy proposing to (i) link future increases of the universal basic pension to inflation and (ii) introduce an additional contributory (Pillar II). The initial assessment, undertaken by the Ministry of Economy and Sustainable Development and supported by ADB technical assistance (TA), concluded that while the universal pension system did play a significant role in reducing poverty, it did not provide a decent standard of living to its beneficiaries.[35] Projections on future liabilities taking into account demographic trends[36] suggested that the

[32] United Nations Population Fund (UNFPA). 2014. General Population Census in Georgia. Tbilisi.
[33] Geostat. Living Conditions (accessed 14 July 2020).
[34] In addition to a general lack of access to labor income sources, adults aged 60 are also much more likely to live with disabilities than young adults. About 20.5% of old-age pensioners are classified as disabled (58.6% of the total number of disabled people in the country.). Moreover, a majority (57.6%) of persons aged 65 and over consider themselves unhealthy (in bad or very bad health). Geostat. Living Conditions (accessed 14 July 2020).
[35] Sector Assessment (Summary): Social Protection (accessible from the list of linked documents in Appendix 2).
[36] UNFPA projections, based on the 2014 Census, suggest that the share of people 65 and older will reach 18.9% in 2030 (732,000 people) and will further increase to 25.3%—one in four persons—in 2050 (880,000 people). UNFPA. 2017. Ageing and Older Persons in Georgia. Tbilisi.

universal pension system was not fiscally sustainable, given that it was to be financed exclusively from the state budget.[37] Specifically, the practice of ad-hoc indexation of the universal basic pension resulted in unplanned fiscal pressures, thwarting efforts to achieve better budget predictability. The assessment report recommended that (i) universal pension payouts be raised to subsistence levels to avoid rises in old-age poverty; (ii) the government adopt a mechanism for the indexation of universal pensions to maintain their purchasing value; (iii) the government establish and operationalize a contributory pension savings scheme (Pillar II); and (iv) the universal pension scheme and contributory pension scheme be complemented with a fully private pension scheme (Pillar III).[38] In line with these policy recommendations, the government (i) gradually increased universal pension payouts to a pre-determined subsistence level and provided an additional increase for those aged 70 and above; and (ii) effectively established and operationalized the contributory pension scheme (Pillar II), which is administered by the Pension Agency, a legal entity of public law. These measures are particularly beneficial for women, who constitute 71% of all universal pension beneficiaries and roughly 65% of universal pension beneficiaries older than 70. Further, to ensure fiscal sustainability of the pension system more broadly, an indexation mechanism has been recently approved and the operationalization of the contributory pension scheme was completed. This way, Georgia's pension scheme can maintain its role of poverty alleviation at fiscally affordable levels. The purchasing power of pensioners will remain stable since ad-hoc increases in the pension amount will no longer be common practice (footnote 32). The government remains committed to establishing a fully private pension scheme as soon as possible while continuing to improve the efficiency of the Pillar II pension scheme.

16. **Anti-Crisis Plan expected to contain rise in unemployment.** Formal unemployment rose from 11.6% at the end of 2019 to 12.3% in the second quarter of 2020.[39] The full impact of COVID-19 on unemployment levels will not be evident until the end of 2020. That said, preliminary estimates suggest that in 2020 roughly 385,000 people, or about 23.4% of the employed, face a high risk of job displacement.[40] The impact on the self-employed might be milder since roughly 75% of them work in agriculture, which was less affected during the lockdown than other sectors (footnote 40). At the same time, the below-average baseline earnings of the self-employed may require special policy emphasis.[41] To try and mitigate mass retrenchment and loss of income, the government adopted ambitious employment preservation measures: (i) an unemployment assistance benefit (direct transfer of GEL1,200 over 6 months); (ii) an income tax waiver for low-income citizens (exempting firms from income tax for citizens with monthly incomes of less than GEL750, provided workers are kept on the payroll); and (iii) informal sector assistance (one-off payment of GEL300).[42] As the economy begins to recover and these benefits are gradually lifted, it is expected that significant parts of the population will not have job opportunities and the unemployment rate will widen. Employment preservation and cash transfer measures targeting the poorest members of society are expected to limit the increase in poverty incidence. Table 1 shows that even if the government's Anti-Crisis Plan mitigates the increase in the poverty headcount index across the income distribution curve as anticipated, the increase is nonetheless expected to be substantial. The government is acutely aware of the need to reform the social protection systems to mitigate the medium-term impact of COVID-19 on unemployment and poverty, and to do so in a fiscally sustainable and gender-sensitive fashion. As of 2018, 24% of

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[37] Ministry of Economy and Sustainable Development. 2016. *Sustainability of the Pension System and Recommendations for Reform*. Tbilisi.
[38] These policy recommendations were accepted and adopted by cabinet on 21 March 2016.
[39] Geostat. Employment and Unemployment (accessed 27 August 2020).
[40] L. Pavlenishvili. 2020. *The Social Impacts of COVID-19—Case for a Universal Support Scheme?* Tbilisi: International School of Economics at TSU Policy Institute.
[41] Geostat. Wages (accessed 20 August 2020).
[42] Government of Georgia. 2020. 'Giorgi Gakharia presented an Anti-Crisis Economic Plan' (accessed 25 August 2020).

Georgians were beneficiaries of at least one social protection scheme, and women accounted for 64.9% of all recipients, which highlights the need for a gender-sensitive approach to social protection reform. The MEL Lab will help provide the necessary sex-disaggregated data to inform a policy that aims to avoid a rise in unemployment and provides adequate cash transfer support to the poorest members of society.

B. Policy Reform and ADB's Value Addition

17. The proposed programmatic policy-based loan supports the government's efforts to ensure macroeconomic stability without compromising key social spending to protect the livelihoods of those most affected by the COVID-19 crisis. To this end, the program is composed of two subprograms that assist the government's reform efforts across three main areas: (i) strengthening the management of public exposure to fiscal risks, which was magnified by the COVID-19 crisis; (ii) deepening the domestic debt markets for government securities to mitigate public exposure to risks associated with external shocks, such as the need for further fiscal stimulus to cushion the socioeconomic impacts of COVID-19; and (iii) strengthening the adequacy and fiscal sustainability of social protection programs to safeguard the livelihoods of those most affected by the COVID-19 crisis. The institutional challenges across these three areas require a phased and programmatic approach. The focus of subprogram 1 is on policy actions that either address an immediate need or that lay the foundation for more tangible policy reforms under subprogram 2. The total budget support provided under the program is $300 million, of which €170,823,000 ($200 million equivalent) are to be disbursed upon approval of subprogram 1 in October 2020, and $100 million under subprogram 2 in 2021.

18. **Reform area 1: Strengthening management of public exposure to fiscal risks.** The objective is to strengthen the management of public exposure to fiscal risks stemming from PPPs, PPAs, and/or SOEs to mitigate the risk of a hidden deficit and avoid a further decrease in fiscal space to support an inclusive and sustainable recovery. Under subprogram 1, MOF fully operationalized the Fiscal Risk Management Division, a dedicated unit to assess and quantify public exposure to fiscal risks stemming from SOEs and PPPs, which are more likely to materialize as a result of the COVID-19 crisis; the division numbers at least six technical staff, and at least 75% of them are women. MOF also approved the PPP Guidelines, which include a guide to the assessment of contingent liabilities and a value-for-money approach to PPP evaluations, completing a PPP framework that ensures adequate identification, monitoring, and reporting of fiscal risk stemming from PPPs. MOF, through the Fiscal Risk Management Division, expanded the scope of its fiscal risk statement to include (i) disclosure and discussion of methodological instructions to identify, quantify, finance, and report the quasi-fiscal activities of SOEs; (ii) assessment of COVID-19 impacts on the likelihood that fiscal risks stemming from SOEs materialize in the short-to-medium term; (iii) expansion of the fiscal risk analysis of SOEs from 12 to 13 individual entities; (iv) discussion on the effect of SOE sectorization on public finance statistics, including the impact on the Law of Georgia on Public Debt; (v) analysis of SOEs from a sector perspective, with the aim of normalizing financial statements from SOEs; (vi) assessment of the stock of PPP liabilities based on International Public Sector Accounting Standards (IPSAS32) and on the value-for-money approach to PPP evaluations (included in the recently approved PPP Guidelines); and a draft discussion of fiscal risks stemming from natural disasters and affecting municipalities.

19. Under subprogram 2, the government will revise the legislative framework for the SOE segment, increase MOF's role in SOE-related fiscal risk management, develop a formal system to account and fund community service obligations, and increase SOEs' accountability. Second, MOF will publish a ministerial statement that covers (i) the rationale for SOE ownership; (ii) the

competitive neutrality of SOEs; (iii) an analysis of corporate governance practices against OECD guidelines; and (iv) merit-based appointments of supervisory boards for all SOEs defined as public interest entities with regard to 90% of their annual turnover. This ministerial statement will inform reforms to SOEs' corporate governance. Third, MOF will define and disclose fiscal risks stemming from natural disasters, including climate-change-related disasters, and publish them on its website to ensure comprehensive identification and reporting of fiscal risks. Finally, MOF will submit to Parliament an amendment to the Law of Georgia on Public Debt to expand the coverage of public sector debt statistics, which will help strengthen the management of fiscal risks.

20. **Reform area 2: Deepening domestic market for government securities.** The objective is to manage the adverse effects associated with high public sector exposure to foreign-currency-denominated debt, which was amplified by the COVID-19 crisis. To this end, the program promotes institutional reforms that help further deepen the domestic debt market for government securities and, ultimately, reduce the share of general government debt denominated in foreign currency. This will help minimize public exposure to the refinancing and currency risks that threaten macroeconomic stability, which is a prerequisite for economic recovery. Under subprogram 1, MOF and the NBG commenced a primary dealer pilot and defined the rights, obligations, and rules for a future primary dealer system to promote activity in the primary and secondary markets to reduce public reliance on external debt to finance future fiscal stimulus packages such as the Anti-Crisis Plan. Second, MOF issued a ministerial decree mandating that the debt management strategy be updated, approved, and published on its website on an annual basis to increase the predictability of the market for the government's domestic debt securities. Third, MOF issued benchmark bonds with a cumulative nominal value of at least GEL2 billion in 2020 to boost investor interest in Georgian government securities and promote capital market development, which in turn will ensures the growth of lari liquidity. Finally, Parliament approved the Investment Funds Law defining the legal, regulatory, and tax framework for investment funds, to create an enabling environment for the development of capital markets in Georgia.

21. Under subprogram 2, MOF and NBG will add at least one new tenor to the primary dealer pilot and publish their plan for moving to a full-fledged primary dealer system. Second, MOF will mandate primary dealers to disclose and make publicly available all pre-trade and post-trade figures for all securities included in the primary dealer system. Third, MOF will approve a new debt management strategy for 2021–2023, which includes an increase in the stock of domestic debt to at least 10% of GDP by October 2023 to deepen the domestic debt market for government securities. Fourth, MOF will adopt a strategy to develop retail participation in the government bond market, which, subject to deliberations with the NBG, may include a savings-certificate-style market issued electronically. Fifth, the government, in collaboration with the NBG, will approve a capital market development strategy to promote the mobilization of domestic private financial resources available to the government, which will minimize its reliance on external financing. Sixth, the government will submit to Parliament a draft Law on Securitization to deepen capital markets by creating a new class of debt instruments and allowing market access to new participants, such as corporate players. Finally, the government will submit a draft law on covered bonds to deepen domestic capital markets by widening the range of investment instruments available to investors.

22. **Reform area 3: Ensuring adequacy and fiscal sustainability of social protection programs that were expanded during the crisis.** The COVID-19 pandemic had a significant impact on the financial well-being of senior citizens. To manage this issue, the government embarked on reforms to ensure the adequacy and fiscal sustainability of the pension scheme. The pandemic also highlighted the need to reform other social protection systems, so as to ensure that all those affected are given adequate financial support and to increase the social resilience of the country in case of a new crisis. The ADB program will support the government in these

initiatives to ensure that Georgia's social protection infrastructure can underpin an inclusive return to economic growth. Under subprogram 1, Parliament approved the revised 2020 budget, which includes an increase of at least GEL30 in the universal pension payouts to beneficiaries aged 70 and above, 65% of whom are women; this will mitigate the adverse impact of the COVID-19 crisis on old-age poverty. Parliament also approved an amendment to the Law of Georgia on State Pensions, which introduces a rules-based mechanism for increases in universal pension payouts to beneficiaries, 70% of whom are women. Further, the government established and operationalized the independent Pension Agency to administer the new supplementary contributory pension scheme (Pillar II pension scheme); at least 50% of the agency's staff are women. The Pension Agency then ensured the registration of 100% of formal employers and collected contributions from at least 90% of registered employers, as well as associated contributions from the government and employees. Finally, the Pension Agency adopted an interim Cash and Cash Equivalent Investment Policy, which allows investments to be managed without any undue risk and ensures the transfer of all contribution payments into individual, interest-bearing accounts. Under subprogram 2, the NBG and the Pension Agency will approve an investment policy for a pension savings scheme to guide the long-term investments of contributions. The Pension Agency, in coordination with MOF, will approve an enforcement mechanism for pension scheme contributions to strengthen compliance by all formal employers with the Law of Georgia on Pension Savings. To complement the Pillar II pension scheme, the government will submit to Parliament the draft Law on Third Pillar Pensions to enable Georgian workers to accumulate additional voluntary savings, whenever possible, and generate a third source of old-age income.

23. **ADB's value addition.** The program forms part of a broader package of support to Georgia to manage the health and socioeconomic impacts of COVID-19. It complements the CARES Program approved in May 2020[43] by supporting long-term institutional reforms that also help address the immediate institutional fragilities exposed by the COVID-19 crisis, and which pave the way for sustainable and inclusive economic recovery. The need to accelerate long-term institutional reforms to manage an immediate crisis situation justifies the use of the fast-track procedure. The program builds on more than a decade of close cooperation across key policy reform areas, such as fiscal risk management, public debt management, and social protection. Since 2014, ADB has been continuously engaged in policy dialogue with the government, and the fiscal management and social protection reforms supported by ADB TA helped strengthen public debt management and fiscal risk management while supporting government efforts to reform its public pension system[44]—the largest social protection program in the country.[45] The MEL Lab, an innovative solution forged under the CARES Program, helped guide the policy discussions around the proposed program and will keep on providing the evidence needed to inform the final shape of policy actions under subprogram 2. The lab provides ADB and the government with live data on the evolution of key socioeconomic indicators, necessary to support an adequate and timely policy response to emerging needs. ADB has maintained a clear position with regard to gender and poverty alleviation in these discussions with the government and will continue to do so in the future. ADB's financial support will help the government bridge its financing gap for 2020 at less onerous terms than it would otherwise be able to achieve, thus contributing to debt sustainability in the long run. The financing support provided under the program is complemented by other ADB sector development loans and policy-based loans, which

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[43] ADB. 2020. *Report and Recommendation of the President to the Board of Directors: Proposed Countercyclical Support Facility Loan to Georgia for the COVID-19 Active Response and Expenditure Support Program*. Manila.

[44] ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loans for Subprogram 1 to Georgia for the Improving Domestic Resource Mobilization for Inclusive Growth Program*. Manila.

[45] ADB. 2018. *Preparing the Second Domestic Resource Mobilization Program: Technical Assistance Report*. Manila.

together contribute roughly 30% of Georgia's financing gap for 2020. Finally, and to complement ADB's support to Georgia's inclusive economic recovery agenda, ADB is also providing a grant.[46]

24. **Lessons.** Underpinned by strong country knowledge, the program is also informed by lessons from previous policy-based support to Georgia.[47] Most importantly, ADB's previous engagement in structural and politically sensitive policy reforms in Georgia, such as the reform of the pension system and the development of a domestic debt market, highlighted the importance of flexibility and sequencing in managing bottlenecks.[48] A programmatic approach for policy-based lending, combined with TA, was deemed a suitable modality because it ensures flexibility and allows for adequate sequencing of reforms across the subprograms.

25. **Alignment with Strategy 2030.** The program is fully aligned with ADB's Strategy 2030, specifically the operational priorities of addressing poverty and reducing inequality (through its support for social protection, which is expected to mitigate an increase in poverty incidence); accelerating progress in gender equality (through gender-sensitive targets integrated into the policy actions); and strengthening governance and institutional capacity (through support to public debt management and fiscal risk management functions).[49]

C. Impacts of the Reforms

26. The country's overarching development objective is sustained and inclusive growth based on macroeconomic stability, as enshrined in the government's socioeconomic development strategy, Georgia 2020.[50] The effect of the reforms supported under the program will be the return to sustainable and inclusive economic growth, minimizing the exposure of Georgia's fiscal position to shocks caused by COVID-19 while safeguarding the welfare of the most vulnerable members of society. These reforms will primarily work through three transmission channels reflected in the Public Financial Management Reform Strategy:[51] (i) management of public exposure to fiscal risks strengthened; (ii) domestic debt market for government securities deepened; (iii) adequacy and fiscal sustainability of social protection programs strengthened.

D. Development Financing Needs and Development Partner Coordination

27. **Development financing needs for 2020**. Despite the government's efforts to reprioritize expenditure and create additional fiscal space, the financing gap for fiscal year 2020 (ending 31 December 2020) remains considerably high at $1,613 million. The financing gap is to be closed primarily through loans and grants from development partners as well as domestic borrowing; government deposits are available to weather downside risks, if necessary. Besides ADB, the Asian Infrastructure Investment Bank, the IMF, the World Bank, and selected bilateral partners have committed to assist Georgia in accessing finance (Table 2). ADB's budget support in 2020 will tentatively total $530 million, or 30% of the total financing gap.

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[46] ADB. 2020. Regional Support to Address the Outbreak of Coronavirus Disease 2019 and Potential Outbreaks of Other Communicable Diseases: Technical Assistance Report. Manila.
[47] ADB. 2017. Improving Domestic Resource Mobilization for Inclusive Growth Program: Project Completion Report. Manila.
[48] ADB. 2018. Georgia: Improving Domestic Resource Mobilization for Inclusive Growth Program: Validation Report. Manila.
[49] ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.
[50] Government of Georgia. 2014. Social-Economic Development Strategy of Georgia. Tbilisi.
[51] Government of Georgia. 2018. Public Financial Management Reform Strategy to 2018-2021. Tbilisi.

Table 2: Development Financing Needs and Budget Support (USD million)

Item	2019	2020 forecast	2020 forecast revised	2021 forecast
Revenues	4,336	4,407	3,944	4,375
of which taxes	3,852	3,978	3,496	3,932
Expenditure	4,631	4,792	5,282	5,157
of which recurrent	3,417	3,712	4,281	4,101
Financing gap		**261**	**1,613**	**569**
Budget support (estimated as of September 2020)		**234**	**1,782**	**145**
Asian Development Bank			530	
Asian Infrastructure Investment Bank			150	
European Union			223	
France (Agence Française de Développement)			205	
Germany (KfW)			294	
International Monetary Fund			200	
World Bank			180	

Source: Asian Development Bank estimates.

28. As of August 2020, expected budget support from development partners exceeds the financing gap by $169 million. First, although $1,782 million in budget support have been discussed with development partners, only $1,157 million have been signed by 24 August 2020, of which only $615 million have been disbursed thus far. As such, there is a risk that some of these budget support programs are cancelled or delayed to 2021. Second, there is the possibility that some cash and in-kind transfers under the Anti-Crisis Plan need to be extended beyond their initial 6-month term. If this happens the financing gap would have to be revised again. Third, should these resources be disbursed and the financing gap kept at $1,613 million, the Government of Georgia would be able to create a fiscal buffer of GEL2.7 billion which could also be utilized if unexpected liquidity pressures materialize in 2021.[52]

29. **Close coordination with development partners.** The ADB team consulted and closely coordinated with all development partners that are providing budget support to Georgia in 2020, especially those providing TA to public debt management, fiscal risk management, and social protection reform.[53] Coordination with the IMF has been particularly important to ensure the complementarity of ADB's support with the IMF's Extended Financing Facility, especially the coordination of structural benchmarks and quantitative performance criteria with regard to the coverage and monitoring of fiscal risks, and the strengthening of SOEs' corporate governance.

30. The government has requested a loan of €170,823,000 ($200,000,000 equivalent) from ADB's ordinary capital resources to help finance the program. The loan will have a 15-year term, including a grace period of 3 years; an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; a commitment charge of 0.15% per year; and such other terms and conditions set forth in the draft loan agreement. Based on the straight-line method, the average loan maturity is 9.25 years and there is no maturity premium payable to ADB.

E. Implementation Arrangements

31. MOF will be the executing agency. The Ministry of Economy and Sustainable

[52] IMF. 2020. Sixth Review Under the Extended Arrangement and Requests for a Waiver of Nonobservance of Performance Criterion, Modification of Performance Criteria, and Augmentation of Access; Press Release; Staff Report; and Statement by the Executive Director for Georgia. *IMF Country Report No. 20/149*. Washington D.C.

[53] ADB coordinated closely with the IMF on public debt management and fiscal risk management support, and with Agence Française de Développement, the European Union, and the World Bank on reforms to the pension system.

Development, the NBG, and MOF are the proposed primary implementing agencies. The indicative implementation periods are December 2018–October 2020 for subprogram 1 and October 2020–October 2021 for subprogram 2. The proceeds of the loan will be disbursed in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time).[54]

III. DUE DILIGENCE

32. **Governance**. Georgia's public financial management systems have improved significantly thanks to the implementation of the Public Financial Management Reform Strategy—minimizing the risks associated with poor financial management of the proposed program. According to the most recent Public Expenditure and Financial Accountability (PEFA) Assessment, Georgia has sound systems in place for strategic budget planning, execution, and accounting and reporting.[55] Notable improvements in fiscal discipline are reflected in (i) less variance of expenditure outturn from the budget, i.e., fewer administrative transfers of budgetary funds; (ii) robust execution rates for revenue; and (iii) stronger oversight of aggregate fiscal risk from SOEs and PPPs, which the program supports. Georgia also improved its strategic allocation of resources through its multi-year budgeting tool and the preparation of costed sector strategies. Finally, the use of resources for service delivery has become more efficient, with more effective payroll controls, internal audit, timelier and more regular reconciliation of accounts, and an expansion of the scope and nature of follow-up audits.

33. **Poverty and gender.** The proposed program supports the government of Georgia in managing the adverse impacts of the COVID-19 pandemic on the most vulnerable, in particular the elderly, who are disproportionally exposed to the consequences. Despite substantial gains, households in Georgia remain highly vulnerable to shocks, such as those associated with the outbreak of COVID-19, which is estimated to increase the national poverty headcount from 20.1% in 2019 to 28.5% in 2020.[56] Further, while absolute poverty ($1.90/day) has declined sharply from 12.2% in 2010 to an estimated 3.7% in 2020, the effects of COVID-19 could increase the poverty incidence to 8.6%.[57] Georgia's current social welfare system covers a relatively high share of the population but may not be sufficient to meet the needs of its poorest citizens. As of 2018, only 11.7% of Georgians receive a subsistence allowance under the targeted social assistance, against 20.1% of people living under the national poverty line, suggesting that wider coverage may be necessary. The proposed program introduces structural and institutional reforms that seek to mitigate increases in poverty incidence, especially old-age poverty, while also including proactive gender mainstreaming features. Increases in pension payouts for people aged 70 and above is particularly relevant for women, who make up roughly 65% of all beneficiaries in this age bracket and who are disproportionately vulnerable to the adverse health and economic effects of the COVID-19 crisis (para. 14). Further, indexing increases in pension payouts to maintain their purchasing power shields the women who benefit from the universal pension scheme (71% of beneficiaries) against gradual loss of income and poverty. The program also ensures that newly or recently created public agencies are staffed in a gender-sensitive manner. For instance, at least 50% of technical staff recruited for the Pension Agency are women. Likewise, 85% of all technical staff in the Fiscal Risk Management Division are women. The program is classified as *effective gender mainstreaming*.

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54 List of Ineligible Items (accessible from the list of linked documents in Appendix 2).

55 PEFA Secretariat. 2018. Georgia: Public Expenditure and Financial Accountability (PEFA) Assessment 2017. Washington, DC: World Bank.

56 Geostat. Living Conditions (accessed 14 August 2020).

57 ADB's updated estimates assume an average decline in income and consumption of 26.6%. ADB. 2020. *COVID-19 and Poverty: Some Scenarios Based on Grouped Distribution Data on Household Consumption*. Manila.

34. **Safeguards.** The loan is categorized *C* for environment, involuntary resettlement, and indigenous peoples. The loan funds are not expected to cause land acquisition or adverse impacts on the environment or indigenous peoples. Investment activities prohibited under ADB's Safeguard Policy Statement (2009) will be excluded.

35. **Risks and mitigation measures.** Major risks and mitigating measures are summarized in Table 3 and described in detail in the risk assessment and risk management plan.[58]

Table 3: Summary of Risks and Mitigating Measures

Risks	Mitigating Measures
Incidence of coronavirus disease (COVID-19) increases substantially, placing significant burden on public health systems and triggering another nationwide lockdown.	Cooperate with the Ministry of Internally Displaced Persons from the Occupied Territories, Labour, Health and Social Affairs; international financial institutions; specialized donors; and specialized United Nations agencies to support the government's immediate and longer-term efforts to contain the spread of COVID-19 and strengthen health care service delivery and capacity. Utilize existing technical assistance (TA) resources to provide technical support to the ministry and use grant resources made available under a regional TA facility to help procure medical supplies and equipment.
The regional and global economic outlooks worsen, putting pressure on Georgia's external balance and its currency, increasing the burden of debt denominated in foreign currency, and causing inflationary pressure.	In the short term: (i) Continue to closely monitor the evolution of the macroeconomic situation with the Ministry of Finance and international financial institutions. (ii) Use existing TA resources—particularly the Monitoring, Evaluation, and Learning Lab—to provide evidence-based policy recommendations on how to best address the adverse impacts of a weaker lari on the economy. In the medium term: (i) Support Georgia's ability to effectively identify and manage fiscal risks, especially those stemming from the foreign exchange exposure of both general government debt and state-owned enterprises. (ii) Support the government's efforts under Georgia 2020 to further develop the domestic debt market to increase the share of domestic debt and minimize foreign currency exposure.

Source: Asian Development Bank.

IV. ASSURANCES

36. The government has assured ADB that the implementation of the program shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the loan and grant agreements.

V. RECOMMENDATION

37. I am satisfied that the proposed policy-based loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve (i) the programmatic approach for the Fiscal Resilience and Social Protection Support Program, and (ii) the loan of €170,823,000 to Georgia for subprogram 1 of the Fiscal Resilience and Social Protection Support Program from ADB's ordinary capital resources on regular terms, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 10 years, including a grace period of 3 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Masatsugu Asakawa
President

8 October 2020

[58] Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

DESIGN AND MONITORING FRAMEWORK

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Overarching Development Objective Inclusive economic recovery from the COVID-19 crisis[a]			
Effect of the Reform More effective management of risk exposure by the public sector, and enhanced and fiscally responsible social protection of vulnerable people	By October 2023: External government debt–GDP ratio is contained below 40% of GDP. (2020 baseline: 42.5% of GDP) Share of domestic debt increased to at least 25% of total general government debt (2018 baseline: 18.7%) Share of total formal employees registered under the contributory pension scheme increases to at least 80% (December 2018 baseline: 0%)	MOF Economic and Financial Indicators IMF EFF Staff Review; MOF Economic and Financial Indicators Pension Agency report; Geostat	Incidence of COVID-19 increases substantially, placing a significant burden on public health systems and triggering another nationwide lockdown.
Reform Areas under Subprogram 1 1. Management of public exposure to fiscal risks strengthened	**Policy Actions, by October 2020:** MOF fully operationalized a dedicated Fiscal Risk Management Division to assess and quantify public exposure to fiscal risks stemming from SOEs and PPPs, which are more likely to materialize as a result of the COVID-19 crisis; the division has at least 6 technical staff, of whom at least 75% are women. (October 2018 baseline: Fiscal Risk Management Division staffed with 1 person) MOF approved the PPP Guidelines, which include a guide to the assessment of contingent liabilities and a value-for-money approach to PPP evaluations, and completed a PPP framework that ensures adequate identification, monitoring, and reporting of fiscal risks stemming from PPPs. (June 2020 baseline: no PPP Guidelines or value-for-money approach approved) MOF, through the Fiscal Risk Management Division, expanded the scope of its fiscal risk statement to include (i) disclosure and discussion of methodological instructions to identify, quantify, finance, and report quasi-fiscal activities of SOEs; (ii) assessment of impact of COVID-19 on the likelihood that fiscal risks stemming from SOEs materialize in the short or medium term; (iii) expansion of fiscal risk analysis of SOEs from 12 to 13 individual SOEs; (iv) discussion on effect of SOE sectorization on public finance statistics, including impact on the Law of Georgia on Public Debt; (v) analysis of SOEs from sector perspective, with the aim	Sex-disaggregated staff list of MOF's Fiscal Risk Management Division PPP Guidelines MOF's fiscal risk statement	Regional and global economic outlooks worsen, putting pressure on Georgia's external balance and its currency, increasing the burden of debt denominated in foreign currency, and causing inflationary pressure. Changes in government may affect its commitment to the reform measures envisaged under ADB support. Measures provided under the Anti-Crisis Plan are phased out prematurely because of fiscal pressures, which leads to a sharp increase in unemployment and poverty levels.

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	of normalizing financial statements from SOEs; (vi) assessment of stock of PPP liabilities based on International Public Sector Accounting Standards (IPSAS32) and value-for-money approach to PPPs (included in the recently approved PPP Guidelines); (vii) draft discussion of fiscal risks stemming from natural disasters and affecting municipalities. (August 2020 baseline: scope of 2019 fiscal risk statement does not include these analyses)		
2. Domestic debt market for government securities deepened	MOF and the NBG commenced the primary dealer pilot and defined the rights, obligations, and rules for a future primary dealer system, so as to promote activity in the primary and secondary markets, and lower public reliance on external debt to finance future fiscal stimulus packages, such as the one needed to mitigate the adverse socioeconomic impacts of COVID-19. (September 2020 baseline: no primary dealer pilot in place)	Memorandum of understanding between MOF, NBG, and commercial banks	
	MOF issued a ministerial decree mandating that the debt management strategy be updated, approved, and published on its website on an annual basis to increase the predictability of the market for the government's domestic debt securities. (2018 baseline: no decree mandating annual updates and publication of the debt management strategy)	MOF's ministerial decree	
	MOF issued benchmark bonds with cumulative nominal value of at least GEL2 billion in 2020 to increase investor interest in Georgian government securities and promote capital market development, which in turn will ensure the growth of lari liquidity. (2018 baseline: MOF issued benchmark bonds with cumulative nominal value of GEL855 million)	MOF's benchmark bond emission notice	
	Parliament approved the Investment Funds Law defining the legal, regulatory, and tax framework for investment funds, to create an enabling environment for the development of capital markets in Georgia. (June 2020 baseline: no law on investment funds)	Investment Funds Law	
3. Adequacy and fiscal sustainability of social protection programs strengthened	Parliament approved the revised budget for 2020, which includes an increase of at least GEL30 in the universal pension payout to pensioners aged 70 and above, 65% of whom are women, to mitigate the adverse impact of the COVID-19 crisis on old-age poverty. (June 2020 baseline: monthly payout to pensioners aged 70 and above is GEL220)	Revised budget for 2020	

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	Parliament approved an amendment to the Law of Georgia on State Pensions, which introduces a rules-based mechanism for increases in the universal pension payout to beneficiaries, 70% of whom are women. (August 2020 baseline: no rules-based mechanism for indexation of pension payouts) Government of Georgia establishes and operationalizes the independent Pension Agency to administer the new supplementary contributory pension scheme (Pillar II pension scheme); at least 50% of the agency's staff are women. (June 2018 baseline: no contributory pension scheme or Pension Agency established) Pension Agency ensured the registration of 100% of formal employers and collected contributions from at least 90% of registered employers, as well as associated contributions from the government and employees. (January 2019 baseline: Pension Agency did not have any employers registered and did not collect contributions.) Pension Agency adopted an interim Cash and Cash Equivalent Investment Policy allowing investments to be managed without any undue risk and ensuring transfer of all contribution payments into individual interest-bearing accounts. (January 2020 baseline: contributions not transferred into individual interest-bearing accounts)	Law of Georgia on State Pension, budget documents Law of Georgia on Pension Savings, and Pension Agency's sex-disaggregated staff list Pension Agency's annual report Pension Agency's Cash and Cash Equivalent Investment Policy	

Budget Support
Asian Development Bank: $200 million (ordinary capital resources loan)

COVID-19 = coronavirus disease, Geostat = National Statistics Office of Georgia, GDP = gross domestic product, IMF EFF = International Monetary Fund's Extended Fund Facility, MOF = Ministry of Finance, NBG = National Bank of Georgia, PPP = public–private partnership, SOE = state-owned enterprise.

[a] Socio-economic Development Strategy of Georgia: Georgia 2020.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

http://www.adb.org/Documents/RRPs/?id=54271-001-3

1. Loan Agreement
2. Sector Assessment (Summary): Financial Sector and Public Sector Management
3. Development Coordination
4. Country Economic Indicators
5. International Monetary Fund Assessment Letter[1]
6. Summary Poverty Reduction and Social Strategy
7. Risk Assessment and Risk Management Plan
8. List of Ineligible Items

Supplementary Documents

9. Sector Assessment (Summary): Social Welfare
10. Supplementary Note on Pension Reform

[1] The IMF confirmed on 15 September 2020 that the attached Press Release No. 20/202 may serve as the IMF assessment letter.

DEVELOPMENT POLICY LETTER

საქართველოს
ფინანსთა მინისტრი
Minister of Finance
of Georgia

№ 07-05/113442
18 / 09 / 2020

DEVELOPMENT POLICY LETTER

Masatsugu Asakawa
President
Asian Development Bank
Manila, Philippines

Dear President Asakawa,

I thank the Asian Development Bank (ADB) for its support to Georgia's efforts to overcome the challenges posed by the COVID-19 pandemic to the wellbeing of our people. ADB is a trusted partner of the government and the development impact of our cooperation has been tremendous over the past years. The COVID-19 outbreak had significant adverse effects on the Georgian economy and disrupted a trajectory of inclusive economic growth. We have reacted rapidly and effectively to contain and mitigate the health risks associated with the pandemic, protect our thriving private sector, especially small and medium enterprises, and protect people's livelihoods through expansion of existing social program. While we continue to provide immediate relief to the most affected members of society, the government of Georgia has also already began paving the way for a quick return to inclusive economic growth. Our mission within the next months is to ensure that the Georgian economy returns to pre-crisis levels of economic growth, underpinned by macroeconomic stability, whilst maintaining the livelihoods of those most affected by the crisis. To this end, we have undertaken several significant institutional reforms which to strengthen the resilience of our public financial system, ensuring that Georgia can return to a solid fiscal position without compromising critical social spending.

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As part of our efforts to strengthen the resilience of our public finances, we have undertaken a number of significant and structural reforms to the way we manage our exposure to fiscal risks. While these reforms have been in preparation for a number of years now, partly thanks to the support of ADB and the IMF, we have taken concrete steps to ensure that public exposure to fiscal risks stemming from PPPs/PPAs and SOEs is adequately quantified and integrated into our broader budgetary cycle. This will minimize unplanned fiscal pressures stemming from the materialization of fiscal risks and which can significantly disrupt macroeconomic stability. In light of the current economic outlook in Georgia and globally, the government expedited these reforms to ensure that our return to inclusive economic growth is not hindered by unplanned fiscal pressures.

Another key reform area which we consider critical to address to effects of the COVID-19 crisis in the medium term pertains to the development of domestic market of government securities, which implies increasing liquidity, transparency and predictability of the market going forward. Under the development of government securities market one of the main issue is the growth of existing securities volume, in order to increase investors' interest towards domestic government securities. A more developed domestic market should decrease the budget expenses on debt service and reduce risks in the medium and long-term, freeing up fiscal space for key social spending and economic recovery efforts. Developed government securities market will support the development of domestic capital market, which in turn will create additional GEL denominated financial resources available for the market participants. It will also help reduce Georgia's reliance on external debt to finance countercyclical expenditure programs should the current crisis be prolonged.

Finally, and parallel to our institutional reforms to fiscal risk management and public debt management, Georgia has also accelerated key institutional reforms to existing social protection systems in order to ensure adequate financial support to the most vulnerable members of society in a fiscally responsible way. ADB has been an important partner of Georgia in the reform of its pension system, the largest social protection program in Georgia, providing significant TA resources to help implement and operationalize a new supplementary contributory pension scheme, to be administered on a fully funded basis, in addition to the universal pension scheme. The intent being to reduce the expectation from the universal pension scheme, maintaining it as a poverty alleviation program, and enhancing adequacy of old age income of citizens by accumulating additional savings to generate old age income. With ADB's support, the Government of Georgia developed a legal framework for the new supplementary contributory pension scheme (i.e. a Pillar II pension scheme) that defined the Pension Savings Scheme and established and operationalized an independent public Pension Agency for its administration. The introduction of the Pension Savings Scheme and approval of a legal framework guiding indexation of payout increases, is expected to substantially enhance old-age income in a fiscally responsible way. Going forward, Georgia will continue working with ADB to help develop an additional voluntary pension savings scheme (Pillar III), to generate a third source of old-age income to achieve full adequacy. The outbreak of the COVID-19 pandemic highlighted the importance of these reforms in ensuring that older adults, high risk citizens who depend on pension payouts from their livelihoods, continue to be supported in a fiscally responsible way.

We welcome ADB's support rethinking the layout of our existing social welfare system to make it more inclusive and progressive yet fiscally sustainable. ADB has a significant role to play in these reforms given its proven familiarity with the country context. We would appreciate continued policy dialogue on these specific reform areas within the coming years.

Once again, I express my sincere gratitude to ADB for the support it has extended to the Government of Georgia in the most difficult of times. We are committed to working closely with you and other development partners under a strong and coordinated approach to ensure that all our interventions are complementary and help us overcome the critical challenges we now face.

Sincerely,

Ivane Matchavariani

POLICY MATRIX

REFORM AREAS	SUBPROGRAM 1 POLICY ACTIONS (DECEMBER 2018 – SEPTEMBER 2020)	SUBPROGRAM 2 INDICATIVE POLICY ACTIONS (OCTOBER 2020 – OCTOBER 2021)
1. Management of public exposure to fiscal risks is strengthened.	1. MOF fully operationalized a dedicated Fiscal Risk Management Division, which assess and quantify public exposure to fiscal risks stemming from SOEs and PPPs which are more likely to materialize as a result of the COVID-19 crisis, staffed with at least 6 technical staff of which at least 75% are women. 2. MOF approved PPP Guidelines which include methodological guidelines for the assessment of contingent liabilities and VfM methodology for PPP evaluations and completes PPP framework that ensures adequate identification, monitoring and reporting of fiscal risk stemming from PPPs. 3. MOF, through the Fiscal Risk Management Division, expanded the scope of the Fiscal Risk Statement to include (i) disclosure and discussion of methodological instructions to identify, quantify, finance and report Quasi Fiscal Activities of SOEs; (ii) assessment of impact of COVID-19 on the likelihood that fiscal risks stemming from SOEs materialize in the short-medium term; (iii) expansion of fiscal risk analysis of SOEs from 12 to 13 individual SOEs; (iv) discussion on effect of SOE sectorization on Public Finance Statistics, including impact on the Law of Georgia on Public Debt=; (v) analysis of SOEs from sectoral perspective, with the aim of normalizing financial statements from SOEs; (vi) assessment of stock of PPP liabilities based on International Public Sector Accounting Standards (IPSAS32) and VfM methodology for PPPs included in the recently approved PPP guidelines; (vii) Include draft discussion of fiscal risks stemming	1. GoG revises legislative framework of the SOE sector, increasing MOF's role in SOE related fiscal risk management, developing a formal system to account and fund community service obligations, and increasing SOE accountability. 2. MOF publishes a ministerial statement which includes (i) a rationale for SOE ownership; (ii) competitive Neutrality of SOEs; and (iii) an analysis of corporate governance practices in comparison with the OECD guidelines on transparent and (iv) a merit-based appointments of supervisory boards for all SOEs defined as Public Interest Entities comprising 90% of annual turnover. This statement will inform reforms to SOE corporate governance. 3. MOF identifies and discloses fiscal risks stemming from Natural Disasters, including climate change related disasters and published it on MOF's website to ensure comprehensive and adequate identification and reporting of fiscal risks.

REFORM AREAS	SUBPROGRAM 1 POLICY ACTIONS (DECEMBER 2018 – SEPTEMBER 2020)	SUBPROGRAM 2 INDICATIVE POLICY ACTIONS (OCTOBER 2020 – OCTOBER 2021)
	from natural disasters affecting municipalities.	
2. Domestic debt market for government securities is deepened.	4. MOF and NBG commenced Primary Dealer Pilot with appropriate rights and obligations and PD rules published and Primary Dealers System to promote activity on the primary and secondary markets, ensuring decreased public reliance on external debt to finance future fiscal stimulus packages as the one needed to mitigate the adverse socio-economic impacts of COVID-19. 5. MOF issued ministerial decree which mandates that the Debt Management Strategy is updated, approved and published on its website on an annual basis to increase predictability of the market for government domestic debt securities. 6. MOF issued benchmark bonds with nominal value of at least GEL2 billion in 2020 to increase investor interest towards Georgian government securities and promote capital market development, which in turn ensures the growth of GEL liquidity. 7. Parliament approved new Investment Funds Law needed to develop investment fund legal, regulatory and tax framework and creating an enabling environment for the development of capital markets in Georgia.	4. MOF and NBG add at least one new tenor to the PD Pilot and publish the plan of moving towards full-fledged PD System. 5. MOF mandates Primary dealers to disclose and make publicly available all pre-trade and post-trade figures for all securities included in the PD system. 6. MOF approves new Debt Management Strategy 2021–2023 which include an increase in the stock of domestic debt to at least 10% of GDP by October 2023 to deepen the domestic debt market for government securities. 7. MOF adopts strategy to develop retail participation in Government bond market which may include a savings certificate style market issued electronically distributed by PO or Banks subject to deliberation with NBG. 8. GoG in collaboration with NBG approve Capital Market Development Strategy to promote mobilization of domestic private financial resources available to government and minimize reliance on external financing. 9. GoG submits the law on Securitization to the Parliament to deepen capital markets by creating a new class of debt instruments and allowing access to new participants—corporates and others—to the market. 10. GoG submits the law on Covered Bonds to deepen domestic capital markets by

REFORM AREAS	SUBPROGRAM 1 POLICY ACTIONS (DECEMBER 2018 – SEPTEMBER 2020)	SUBPROGRAM 2 INDICATIVE POLICY ACTIONS (OCTOBER 2020 – OCTOBER 2021)
		widening the range of investment instruments available to investors.
3. Adequacy and fiscal sustainability of social protection programs strengthened.	8. Parliament approved revised budget in 2020 which includes an increase of at least GEL 30 in universal pension payout for pensioners aged 70 and above, 65% of whom are women, to mitigate the adverse impact of the COVID-19 crisis on old-age poverty. 9. Parliament approved amendment to the Law of Georgia on State Pensions which introduces a rules-based mechanism for increases in payouts for universal pension beneficiaries, 70% of whom are women. 10. Government of Georgia establishes and operationalizes an independent public Pension Agency for administration of the new supplementary contributory pension scheme (Pillar II pension scheme) where at least 50% of staff are women. 11. Pension Agency ensured registration of 100% of formal employers and collected contributions from at least 90% of registered employers, as well as and associated contributions from Government and employees. 12. Pension Agency adopted an interim Cash and Cash Equivalent Investment Policy allowing investments to be managed without any undue risk and ensuring transfer of all contribution payments into individual interest-bearing accounts.	11. NBG and Pension Agency approve long term investment policy for Pension Savings Scheme to guide long term investment strategy of contributions. 12. Pension Agency, in coordination with MOF, approve enforcement mechanism for pension scheme contributions to ensure increased compliance by all formal employers with the Law of Georgia on Pension Savings. 13. GoG submits Law on Third Pillar Pensions to Parliament to enable Georgian workers to accumulate additional voluntary savings, when possible, and generate a third source of old-age income.

COVID-19 = coronavirus disease, GDP = gross domestic product, GOG = Government of Georgia, IPSAS = International Public Sector Accounting Standards, MEL = Monitoring, Evaluation and Learning, MOESD = Ministry of Economy and Sustainable Development, MOF = Ministry of Finance, NBG = National Bank of Georgia, OECD = Organisation for Economic Co-operation and Development, PPP = public–private partnership, SOE = state-owned enterprises, VFM = value-for-money.
Source: Asian Development Bank.