ADB

Report and Recommendation of the President to the Board of Directors

Project Number: 48044-005
July 2016

Proposed Policy-Based Loans for Subprogram 3 Georgia: Improving Domestic Resource Mobilization for Inclusive Growth Program

Asian Development Bank

CURRENCY EQUIVALENTS
(as of 8 July 2016)

Currency unit	–	lari (GEL)
GEL1.00	=	$0.42735
$1.00	=	GEL2.34

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
EDA	–	Entrepreneurship Development Agency
GDP	–	gross domestic product
GITA	–	Georgia Innovation and Technology Agency
IFI	–	international financial institution
IMF	–	International Monetary Fund
MOESD	–	Ministry of Economy and Sustainable Development
MOF	–	Ministry of Finance
MSMEs	–	micro, small, and medium-sized enterprises
PPP	–	public–private partnership
SOE	–	state-owned enterprise

NOTE

In this report, "$" refers to US dollars.

Vice-President	W. Zhang, Operations 1
Director General	S. O'Sullivan, Central and West Asia Department (CWRD)
Director	R. Hartel, Public Management, Financial Sector, and Trade Division, CWRD
Team leader	T. Niazi, Principal Public Management Specialist, CWRD
Team members	R. Aquino, Operations Analyst, CWRD
	A. Julian, Young Professional, CWRD
	G. Luarsabishvili, Economics Officer, Georgia Resident Mission, CWRD
	D. Perkins, Senior Counsel, Office of the General Counsel
	M. Van der Auwera, Senior Financial Sector Specialist (Social Security), CWRD
	M. C. Yabut, Operations Assistant, CWRD
Peer reviewer	A. Chatterjee, Principal Financial Sector Specialist, Sustainable Development and Climate Change Department

CONTENTS

PROGRAM AT A GLANCE

1. **Basic Data**			**Project Number:** 48044-005
Project Name	Improving Domestic Resource Mobilization for Inclusive Growth Program, Subprogram 3	**Department /Division**	CWRD/CWPF
Country	Georgia	**Executing Agency**	Ministry of Finance
Borrower	Ministry of Finance		

2. **Sector**	**Subsector(s)**	**ADB Financing ($ million)**
✓ **Public sector management**	Public expenditure and fiscal management	25.00
Finance	Finance sector development	5.00
	Insurance and contractual savings	50.00
	Money and capital markets	20.00
	Total	**100.00**

3. **Strategic Agenda**	**Subcomponents**	**Climate Change Information**	
Inclusive economic growth (IEG)	Pillar 3: Extreme deprivation prevented and effects of shocks reduced (Social Protection)	Climate Change impact on the Project	Low

4. **Drivers of Change**	**Components**	**Gender Equity and Mainstreaming**	
Governance and capacity development (GCD)	Institutional development Public financial governance	Effective gender mainstreaming (EGM)	✓
Knowledge solutions (KNS)	Knowledge sharing activities		
Partnerships (PAR)	Implementation Private Sector		
Private sector development (PSD)	Conducive policy and institutional environment		

5. **Poverty Targeting**		**Location Impact**	
Project directly targets poverty	No	Nation-wide	High

6. **Risk Categorization:** Complex

7. **Safeguard Categorization** **Environment:** C **Involuntary Resettlement:** C **Indigenous Peoples:** C

8. **Financing**

Modality and Sources	**Amount ($ million)**
ADB	**100.00**
Sovereign Programmatic Approach Policy-Based Lending (Loan): Asian Development Fund	50.00
Sovereign Programmatic Approach Policy-Based Lending (Loan): Ordinary capital resources	50.00
Cofinancing	**0.00**
None	0.00
Counterpart	**0.00**
None	0.00
Total	**100.00**

9. **Effective Development Cooperation**

Use of country procurement systems	Yes
Use of country public financial management systems	Yes

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on proposed policy-based loans to Georgia for subprogram 3 of the Improving Domestic Resource Mobilization for Inclusive Growth Program.[1]

2. The proposed program aims to improve domestic resource mobilization to achieve more inclusive growth in Georgia through better debt and fiscal risk management, more efficient revenue and public expenditure management, generation of domestic savings, and mobilization of private resources for investment.[2] Inequality of income and opportunity is addressed by improving access to markets and making the regulatory environment more conducive for businesses and individuals, and through redistributive fiscal policy, specifically in tax and social expenditure.

II. THE PROGRAM

A. Rationale

3. With real gross domestic product (GDP) growth of 2.8% in 2015, down from 4.6% in 2014, Georgia's economy was clearly affected by the recession in the Russian Federation and weak economic performance in Azerbaijan, Turkey, Ukraine, and other trading partners, which reduced investment growth, exports, and the inflow of remittances.[3] Despite the expansion of domestic demand and fiscal stimulus, GDP growth declined to 2.6% during the first quarter of 2016 compared with the same period in 2015, and the government expects modest annual GDP growth of 3% for 2016. As a result of a 23% drop in exports and a concurrent 10% drop in imports, as well as revaluation effects related to currency depreciation, the current account deficit widened to 11.8% of GDP. Inflation increased to 4% in 2015, gaining pace during the second half of the year, from 3.1% in 2014. Lower global hydrocarbon prices had only a limited positive impact on inflation because the depreciation of the lari and low competition led only to a modest decline of domestic fuel prices. Any boost to consumption was partially offset by declining remittances from the Russian Federation, which fell by 25% in 2015. The budget deficit increased to 3.8% of GDP in 2015, up from 2.9% in 2014. Total public debt rose to 41.5% of GDP in 2015 from 35.6% in 2014, partly reflecting 28.5% depreciation of the lari vis-à-vis the dollar. However, rising global oil prices, a weaker dollar, and increasing foreign exchange receipts from tourism and exports so far in 2016 contributed to an appreciation of the lari by 15.0% from March to early June 2016. The government expects to incur fiscal deficits that require consolidation over the next 3-5 years.[4] With deteriorating fiscal and external balances, domestic borrowing costs increased by about 200 basis points to 9.7%, as the treasury bill yield curve steepened.

4. Finance sector risks have moderately increased: the banks' nonperforming loan ratio rose from 7.8% in March 2015 to 8.6% in March 2016 since the debt service capacity of borrowers suffers in the context of slower growth and significant exposure to credit-induced foreign exchange risk for those who borrow in US dollars. Strengthening macroeconomic policy frameworks and the finance sector is essential to improve stability in this volatile environment.

[1] The design and monitoring framework is in Appendix 1.
[2] The proposed program is included in ADB. 2014. *Country Operations Business Plan: Georgia, 2015–2017*. Manila.
[3] National Bank of Georgia. 2016. *Monetary Policy Report*. Tbilisi.
[4] The Ministry of Finance (MOF) projects a fiscal deficit of 4.2% for 2016 compared with 3.8% for 2015. IMF has expressed concern at the widening deficit over the medium term and government is committed to take measures to keep the deficit at around 3-4%.

Fiscal policy needs to strike a balance between managing the fiscal deficit and stimulating economic activity, as well as protecting social expenditures over the medium term. Continuing structural reforms are needed to facilitate adjustment by boosting medium-term economic prospects, improving competitiveness, and creating jobs. From a macroeconomic perspective, reform of contractual savings arrangements and provision of long-term finance are critical to expand the fiscal space available to the government.

5. **Pensions and contractual savings**. The state-funded universal pension is the main pillar of Georgia's pension system, accounting for almost 82% of total public pension expenditures. It provides all citizens with a flat-rate pension from the age of 60 for women and 65 for men, favoring women because of its flat-rate nature. While the pension amount paid has doubled from 2010 to 2015, it remains modest by international standards, providing a monthly pension equal to 18% of the average wage, marginally above the subsistence level. The universal pension is the main mechanism to keep a large part of the population out of poverty. Financing the universal pension constitutes the largest social spending item, accounting for 16.0% of public expenditure in 2015 and 4.1% of GDP. This expenditure item is expected to grow as the number of pensioners grows. Even if the current universal pension amount remained unchanged, the required budget could exceed 10% of GDP by 2050 because of the changing demographic circumstances. This will strain Georgia's long-term fiscal sustainability.[5] Additional mechanisms to encourage private savings are needed to allow the working population to build pension assets that will provide an adequate pension income. Such an additional pillar would supplement the universal pension and relieve the pressure on the state budget.

6. For this reason, the government is introducing a supplementary private pension savings scheme with defined contributions from beneficiaries and employers, thereby increasing retirement income with very limited contributions from the state budget.[6] This mostly privately funded pension will generate additional benefits by improving the mobilization of long-term savings that can be invested in long-term investments through the finance sector. Domestic long-term funding capacity for investments is limited in Georgia, which results in overreliance on foreign funding and contributes to significant volatility in the finance sector as well as dollarization. Pension funds follow long-term investment strategies, with a primary focus on maintaining real asset values and providing stable pension income. The private pension funds are useful in providing stable funding for the country's infrastructure needs and help develop domestic currency bond markets and security exchanges.

7. **Local bond markets and financing**. The Government of Georgia views limited access to domestic long-term financial resources as a critical obstacle to the country's economic development, since it constrains savings and limits long-term funding for investments.[7] Georgia has a highly concentrated banking industry characterized by banks' dominance as investors in the domestic securities market. Widening the range to other institutional and retail investors will promote competition and financial innovation. The structural reforms of the pension system, including the development of private pension funds, will support their investment in domestic

---

[5] Government of Georgia, Ministry of Economy and Sustainable Development. 2016. *Reform of the Universal Pension Benefit and Introduction of a Supplementary Pension Scheme*. Tbilisi (final report).

[6] Georgia's pension system will have three pillars. A zero pillar provides a noncontributory universal pension, funded by the budget. Pillar II will be a quasi-mandatory private pension with an opt-out option, where employees will contribute 2% of their gross salary, and the same amount is provided by both the employer and the government. Pillar III is a private pension savings scheme voluntarily funded by the beneficiaries.

[7] The World Economic Forum's Global Competitiveness Report 2015–2016 ranked Georgia 109th out of 140 countries for ease of access to loans from the banking system, and 74th for affordability of financial services.

debt and help develop secondary markets for fixed-income securities. The government aims to deepen local bond markets to create a more inclusive financial system and channel resources to support investment and business growth.

8. Local currency bond markets are important to increase access to finance for businesses, reduce dollarization of debt, and limit risk exposures of business borrowers by matching the currency of their revenue, the lari, with that of their debt service, and provide an opportunity for diversifying the portfolios of pension funds away from sovereign debt. Local currency bonds issued by international financial institutions (IFIs) can support the development of the domestic bond market and enable Georgian banks to expand their local currency lending to micro, small, and medium-sized enterprises (MSMEs). The impact will reduce MSMEs' currency risk exposure, support their access to the European Union markets, and help improve gender-specific gaps in access to finance.

9. **Government efforts and development coordination**. The government has initiated pension reforms to improve the adequacy, fairness, and sustainability of the pension system. The Pension Reform Unit established in the Ministry of Economy and Sustainable Development (MOESD) in 2014 was further strengthened to prepare the legal and operational framework for the private pension savings scheme. Under the capital market development strategy approved by the cabinet in May 2016, the government is developing the domestic debt market by encouraging greater market participation and availability of investment resources. The government is also boosting the availability of finance to MSMEs with increased budget allocations to the Entrepreneurship Development Agency (EDA) and the Georgia Innovation and Technology Agency (GITA), which in turn provide matching grants to MSMEs and financing for innovation and technology development.

10. Bilateral and multilateral development agencies are supporting the country's economic development. The World Bank supports strengthening the fiscal oversight of public institutions, upgrading the quality and coverage of social services, and deepening the finance sector through policy-based lending during 2015–2017. The United States Agency for International Development is supporting pension reform and capital market development. In 2014, the European Parliament ratified the European Union's Association Agreement with Georgia, including an agreement on a deep and comprehensive free trade area spanning 2014–2017, which, together with political association and market opening, aims for the approximation of Georgian systems and norms with those of the European Union. In 2014, Georgia entered into a 3-year standby arrangement with the International Monetary Fund (IMF) that provides a cushion against external balance-of-payment shocks, and supports a framework for discipline in macro-fiscal policies.

11. **ADB's value additions and lessons**. The support provided under subprograms 1 and 2 led to cabinet approval of the pension reform strategy in March 2016. The Asian Development Bank (ADB) was instrumental in the preparation of the strategy and continues to provide technical support for the development of the new private pension savings scheme, including the preparation of relevant legislation and its operations. Given Georgia's limited private pension experience, continued technical support is critical.

12. ADB is working closely with the government to update capital market legislation and regulations that will improve the transparency of price discovery of issuers and traders, deepen investor protection, and increase public awareness. The policy actions completed by the government under this ADB program since 2014 induced IFIs to issue local currency bonds (and attract local investors) by articulating and communicating the government's strategy to the

market and providing a more robust legal and regulatory framework for local corporate bond issues. The Law on Registration Fees, amended and approved by Parliament, facilitates the issuance of lari-denominated bonds.[8] In fact, ADB, the Black Sea Trade and Development Bank (BSTDB) and the European Bank for Reconstruction and Development issued $99 million equivalent in lari-denominated bonds in 2016, and since financial inclusion of MSMEs is an important objective of the program, the borrowing financial institutions are onlending the proceeds of the ADB bonds mostly to farmers and MSMEs.[9]

13. Relevant lessons on the need for policy reforms, a stronger focus on inclusive growth, and longer-term engagement in public sector reforms were incorporated from the evaluation findings of Georgia's country program portfolio into the program design, and continue to be applied throughout the program cluster. The need to provide longer-term technical assistance during the implementation of the program and beyond was also factored in.

B. Impact and Outcome

14. The impact will be citizens, particularly women, benefiting from higher living standards and more employment opportunities. The outcome will be the effective mobilization of domestic resources for increased public and private investment.

C. Outputs

15. The program has three subprograms that all support the government's reforms in four areas: (i) improving treasury management of debt, cash, and fiscal risk; (ii) strengthening public revenue and expenditure management; (iii) enhancing generation of domestic savings; and (iv) increasing mobilization of private resources for investment. Subprogram 3 has 25 policy actions, all of which have been completed. Subprogram 3 includes the following three additional policy actions that were completed in 2016: (i) issuance of lari bonds by IFIs equivalent to $99 million to facilitate the financing of MSMEs, (ii) passage of the Law on Registration Fees to facilitate these issuances, and (iii) establishment of accounting standards aligned with EU norms to facilitate the issuance of corporate securities.

16. **Output 1: Improved management of debt, cash, and fiscal risk**. The objective of this output is to strengthen public debt, cash, and fiscal risk management for better fiscal consolidation. Subprogram 1 strengthened government debt management processes, increased transparency, and developed analytical and forecasting capabilities. Fiscal risk management was improved through a strategy that entails managing different fiscal risks and identifying budgetary and contingent liabilities related to large state-owned enterprises (SOEs). Subprogram 2 further strengthened public debt and cash management through the preparation of a medium-term debt management strategy covering debt portfolio management and policies for issuing new debt, and a plan to strengthen the analytical and advisory capability through the new Middle Office of the Public Debt and External Financing Department. Under subprogram 2, the Ministry of Finance (MOF) established a fiscal risk management function in charge of managing contingent liabilities of SOEs and fiscal risks related to public–private partnership

---

[8] The Law on Registration Fees supports an investment environment that is conducive to capital market development and securities issuance by IFIs, in particular public tender of a particularly large issuance of securities. The National Bank of Georgia used to charge a registration fee of 0.1%, which for large issuances amounts to a sizable sum. The new law imposes a cap of GEL5,000 per issuance and further exempts market participants from the registration fee until 2020.

[9] ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Georgia for the Financial Inclusion for Micro and Small Business Growth*. Manila.

(PPP) projects. MOF carried out the first assessment of macro risk, public debt sustainability, and review of risk associated with loan guarantees and other similar contingent liabilities.

17. Under subprogram 3, debt and cash management was strengthened further through (i) legal amendments underpinning the government's debt strategy submitted to Parliament, (ii) an upgraded debt management and risk analysis system in the Middle Office integrated with e-budget and e-treasury systems, and (iii) reporting of the value of guarantees issued by the government in the government's financial statements. Fiscal risk management was strengthened further by (i) covering information on the debt of SOEs and contingent liabilities of SOEs and PPPs as a supplement to the state budget documents, and (ii) carrying out the first complete assessment of finance sector risk and SOE fiscal risks.

18. **Output 2: Strengthened revenue and expenditure management**. The objective of this output is to increase the effectiveness and efficiency of revenue collection, improve public expenditure management, and strengthen local government transfers. To achieve this objective, actions under subprogram 1 established an administrative department under the Georgia Revenue Service, devised an action plan to replace external auditors with in-house tax auditors, and integrated budgeting and budget execution functions of government entities into the public financial management system and the treasury single account. Under subprogram 2, tax arrears were recovered from active taxpayers amounting to GEL80 million, and the statutory time limitation on tax notices and taxpayer notices was reduced from 6 to 5 years. The number of in-house tax auditors was increased to 286, of which 147 are women, and legal and regulatory gaps relating to the preparation, due diligence, and implementation of PPP projects were identified. To strengthen local government finances, proposals for amendments to the Budgetary Code defining the separation of revenues between the budgets of state, autonomous regions, and municipalities were submitted to Parliament.

19. Subprogram 3 built on the accomplishments made under subprograms 1 and 2. The effectiveness and efficiency of revenue collection was further increased by (i) writing off tax arrears of defunct businesses on the basis of legally approved categories; (ii) reducing the statutory time limitation of tax notices and taxpayer notices from 5 to 3 years (instead of the targeted 4 years), shortening the tax liability imposition period and providing relief to taxpayers; and (iii) phasing out external tax auditors completely and increasing the number of in-house tax auditors to 330, of whom 175 are women (a significant increase over the original target of 150). Under subprogram 3, public expenditure management was further improved by the preparation of draft regulations to address legal and regulatory gaps for PPP projects. Local government financing was also strengthened by increasing of intergovernmental transfers by GEL65 million in the 2016 budget.

20. **Output 3: Enhanced generation of domestic savings**. The objective of this output is to reform the existing pension system to help prevent old-age poverty and provide an adequate replacement income. Affordability for the fund contributors and sustainability are essential. Measures include streamlining the universal pension, and creating a supplementary private pension savings scheme. Subprogram 1 established the Pension Reform Unit to prepare a pension reform policy. Under subprogram 2, the unit completed a diagnostic of the pension system, issued a consensual paper setting out the supplementary private pension savings scheme, and prepared a public awareness campaign on pension reforms.

21. Policy actions under subprogram 3 were consolidated and regrouped to represent universal pension; administration of the new, privately funded pension system; legislation for the private pension system; and a related public communication campaign, but covering the same

outputs as envisaged under the overall program. On the universal pension, the cabinet approved revisions in lieu of the overall policy, including indexation of the pension to improve income security of pensioners, while maintaining equitable treatment of men and women. As for the supplementary private pension savings scheme, the cabinet approved its outline, while MOESD set out the structure and the sequence of steps for its implementation, and provided additional staff in the Pension Reform Unit to prepare the launch of the scheme. The government undertook the legal drafting and its submission for approval to the Economic Council under a single legislation covering the supplementary private pension savings scheme (pillar II) and the voluntary private pension savings scheme (pillar III). Submission to Parliament, as originally envisaged, will be done later in 2016. MOESD launched a nationwide public awareness campaign on the benefits of the pension savings schemes, including gender aspects.

22. **Output 4: Increased mobilization of private resources for investment**. The objective of this output is to mobilize long-term finance and enhance access to finance for MSME financing, including gender targeting. Under subprogram 1, an interagency working group was established to initiate capital market development, and EDA and GITA were created to provide matching grants to MSMEs and support private innovation and technology development. EDA launched the Produce in Georgia program with a component focusing on MSME development in rural areas. GITA created Geolab, a mobile training and knowledge-exchange platform; and fablab, which will assist research and development to disseminate knowledge through mobile technology. Under subprogram 2, the government prepared and submitted a capital market reform strategy and action plan for cabinet approval, and allocated budgets to EDA and GITA for financing to MSMEs, of which 30% were earmarked for businesses owned by women.

23. Under subprogram 3, capital market development was supported by (i) a public awareness campaign on the benefits of capital market reforms, including investor protection, financial instruments for investment, long-term savings, and the links with pension reform, as well as gender aspects; (ii) a review of laws, bylaws, and regulations essential for managing investments and private pension funds, and for governance, risk management, and fund managers; and (iii) enhancing money market development regulations by approving accounting and prudential regulations for repurchase orders and securities lending. Access to finance for MSMEs was broadened by (i) providing GEL25 million from the state budget to EDA, (ii) expanding matching grants to MSMEs by GEL5 million, with 40% financing earmarked for women-led businesses; (iii) providing GEL8 million to GITA; and (iv) expanding private innovation and technology development by GEL4.5 million, of which 40% is earmarked for women-led businesses. Under subprogram 3, gender targeting is being enhanced as summarized in a government gender action plan and public disclosure of measures that promote gender equity, including MSME training and financing.

24. Under subprogram 3, the following additional actions were implemented. ADB, the BSTDB, and the European Bank for Reconstruction and Development issued lari bonds of $99 million equivalent to improve the availability of local currency credit for MSMEs. The Law on Registration Fees approved by Parliament waived bond issuance fees to IFIs to stimulate the development of the local currency capital market. In addition, the Law on Accounting, Reporting, and Auditing was drafted to set standards for corporate securities and align the legal acts to comply with the European Union directives. The lari bond issuances are the result of improvements to the market infrastructure, and of related laws and regulations instituted under the program.

D. Development Financing Needs

25. The total program funding is estimated at $250 million equivalent for 2014–2016.[10] Subprogram 3 amounts to $100 million equivalent. Subprograms 1 and 2 each amounted to $75 million equivalent, disbursed in 2014 and 2015. To help finance subprogram 3, the government has requested (i) a loan in various currencies equivalent to SDR35,818,000 ($50 million equivalent) from ADB's Special Funds resources, and (ii) a loan of $50 million from ADB's ordinary capital resources. The Asian Development Fund loan will have a 25-year term, including a grace period of 5 years, an interest rate of 2.0% per annum, and such other terms and conditions set forth in the draft loan agreement.[11] The ordinary capital resources loan will have a 15-year term, including a grace period of 3 years, straight-line amortization, 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. On this basis, the average loan maturity is 9.25 years, with no maturity premium payable to ADB.

26. The government's development-related financing gap is estimated at GEL1,395 million in 2016.[12] The government intends to borrow both from domestic (14.3%) and foreign (85.7%) sources to finance the gap. Domestic borrowing will comprise GEL200 million raised through treasury securities. Foreign borrowing will be at long tenor projected at GEL680 million, and anticipated budget support from development partners is GEL515 million equivalent in 2016.[13] ADB's loan under subprogram 3 for $100 million equivalent will help to narrow the government's development financing gap from development partners by 46.6% in 2016. Budget support is necessary to finance part of the development financing needs, especially covering the period from the introduction of reforms under the ADB program to the realization of fiscal benefits.

E. Implementation Arrangements

27. MOF is the executing agency, and MOESD and MOF are the implementing agencies for the program. A program steering committee chaired by the deputy minister of finance comprises senior officials from the two ministries, and meets semiannually to review the progress in achieving the agreed policy actions. The proceeds of the loan will be disbursed to Georgia in accordance with the provisions of ADB's *Loan Disbursement Handbook* (2015, as amended from time to time).[14] The implementation period for the overall program is from January 2014 to September 2016, while the implementation period for subprogram 3 is from October 2015 to September 2016.

---

[10] The initial funding amount was $200 million. The increased amount is justified by government's increase of the universal pension rate in 2016 costing $75 million and additional actions as outlined in para 15.

[11] Georgia will graduate from access to Asian Development Fund resources on 1 January 2017. In accordance with ADB's Special Operations Loan Regulations (2006), Georgia's graduation will require modification to each outstanding ADF loan to Georgia in order to, at Georgia's election, either accelerate repayment of each ADF loan or increase the interest rate applicable to each ADF loan. Once an election has been made, the required modification will also apply to the ADF loan proposed for this subprogram 3. ADB. 2006. *Special Operations Loan Regulations.* Manila.

[12] Government of Georgia, MOF. 2015. *Basic Data and Directions for 2016–2019*. Tbilisi.

[13] GEL240 million equivalent by ADB, GEL240 million equivalent by the World Bank, and GEL35 million equivalent by the European Union.

[14] ADB. 1998. *Simplification of Disbursement Procedures and Related Requirements for Program Loans*. Manila.

III. DUE DILIGENCE

A. Economic and Financial

28. The reforms supported by the program entail direct and indirect fiscal costs to the government—the cost of implementing and monitoring the reforms—along with fiscal savings in the medium to long term. The reforms bear both the direct and operating costs of dedicated public functions and agencies established under the program. [15] Higher government expenditures are therefore warranted over the short term to realize these savings, necessitating the need for budgetary support. Over time, these reforms will generate a positive fiscal feedback by creating a wider and more diversified economic base and stronger management of macroeconomic risks. The reform program will result in cost savings and additional gains due to (i) a reduced burden on public finances from the universal pension in the long term thanks to the introduction of a supplementary pension savings scheme; (ii) financial savings from more efficient and effective use of public resources through better cash, debt, and fiscal risk management; and (iii) financial gains from additional revenues thanks to stronger mobilization of private investment capital and finance for MSMEs, greater coverage of enterprises in the formal economy, and increased collection of tax arrears.

29. Pension reforms alone will have major budgetary cost implications. Pension expenditures have more than quadrupled since 2005, reaching GEL1.39 billion or 4.1% of GDP in 2015. Given the regular increases in the universal pension rate and number of pensioners, the government will incur GEL7.37 billion in universal pension payments for 2016–2020.[16] The indexation cost related to the increase of the universal pension rate from GEL150 to GEL160 in 2015 is costing the state budget an additional GEL180 million in 2016. The supplementary pension savings scheme cost to the government will include matching contributions from the government, employer contributions where the government is the employer, and forgone tax revenue on contributions to and withdrawals from the pension fund. As a result, the supplementary pension savings scheme will cost the government a projected GEL360 million in the first 3 years, and GEL726 million in the first 5 years of implementation.[17]

30. Development of the medium-term debt strategy under the program aims to meet the government's public financing needs and payment obligations while minimizing long-term costs. The reforms will lead to additional benefits and savings associated with fiscal discipline and with improvements in core budgetary and fiscal risk management within MOF. Additional revenues of GEL100 million were realized in 2016 from the recovery of tax arrears, and increased intergovernmental transfers of GEL65 million were made. Developing capital markets to mobilize long-term finance will spur growth and increase the efficiency of MSMEs through greater access to finance, better gender targeting, and a stronger regulatory framework. Mobilizing private resources for investment is important given the low national savings rate, which compounds the twin deficit of fiscal and external imbalances with a low reliance on internal sources of financing. Implementation of the supplementary pension savings scheme is estimated to accumulate savings of GEL316 million in the pension fund after the first year, and is forecast to reach GEL16.7 billion by 2030. Such increased savings in national currency will support de-dollarization and stimulate investment for further development of capital markets.

---

[15] The costs incurred to public agencies are in terms of monitoring, implementation, and enforcement, including expenses associated with establishing statutory agencies, budget increases, expenditure programs, and forgone revenue. Indirect fiscal costs include staff time and other expenses.

[16] MOF estimates (assuming pension rate growth indexed to inflation)

[17] Detailed analyses and cost calculations of the pension reforms are provided in the Economic and Financial Analysis (accessible from the list of linked of documents in Appendix 2).

B. Governance

31. Significant reforms have taken place to strengthen public financial management. These include the introduction of a medium-term budget framework, program-based budgeting, a budget classification system based on the IMF's Government Finance Statistics Manual 2001,[18] and a rules-based system for fiscal transfers from the central government to local governments. In addition, state financial transactions were unified under a treasury single account, and an electronic budget management system was established. Problems remain, however, such as poor monitoring and analysis of government contingent liabilities, non-inclusion of revenues and expenditure of some legal entities of public law in budget execution reports, inadequate predictability and transparency of intergovernmental transfers, limited internal audit capacity, and weak legislative scrutiny of external audit reports.[19] The State Procurement Agency continues to improve transparency in public procurement processes by adopting international standards. A new module was recently integrated into the e-procurement system, which now provides for the procurement needs of multilateral development banks. The government made fighting high-level corruption a priority. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with MOF and MOESD.

C. Poverty and Social

32. The universal pension plays an important role in poverty reduction and is a valuable tool for welfare distribution. Without the universal pension, the poverty rate would increase from 24% to 33%, and inequality would increase the Gini coefficient from 37.7 to 40.9.[20] Subprogram 3 is categorized *effective gender mainstreaming* since it takes measures against unequal access to assets and resources, and against insufficient attention to gender in economic development policy. Pension reforms will ensure equitable treatment for men and women, allowing both to accumulate sufficient pension assets to have an adequate retirement income, while mitigating the risk of old-age poverty through the universal pension. The Georgia Revenue Service is hiring an equal number of men and women as in-house tax auditors. Nationwide public awareness campaigns conducted on pension reforms and on capital market development included gender aspects. EDA has allocated 40% of matching grants to women entrepreneurs for business development. GITA has allocated funds to support private sector innovation and technology development, of which 40% are earmarked for women entrepreneurs. The government will implement its gender action plan, with actions to boost women's participation in economic and business development.[21]

D. Safeguards

33. Program activities are limited to policy and institutional reforms. None of the activities will lead to involuntary resettlement, or affect indigenous peoples. No adverse environmental impacts were identified. The policy-based loan will not involve any construction works or have an impact on the environment. The safeguard categories for environment, involuntary resettlement, and indigenous peoples are all C.

---

[18] IMF. 2001. *Government Finance Statistics Manual, 2001.* Washington, DC.

[19] Sector Assessment (Summary): Public Sector Management and Finance (accessible from the list of linked documents in Appendix 2)

[20] World Bank. 2009. *Georgia Poverty Assessment*. Washington, DC.

[21] Gender Action Plan (accessible from the list of linked documents in Appendix 2).

E. Risks and Mitigating Measures

34. External economic shocks experienced since early 2015—from the deepening recession in the Russian Federation to currency devaluations in trading partner countries—have created trading partner macroeconomic stability risks for Georgia. These will be mitigated through efficient public financial management, while maintaining capital expenditures and diversification of trade partners, including the European Union. Pressure on the widening fiscal deficit from increased social expenditures and lower revenues will be reduced through the introduction of the supplementary pension savings scheme. Broader access to finance for businesses and export promotion is being facilitated through EDA and GITA. Public financial management related risks are identified as weakness in monitoring of continent liabilities, unpredictable local government finances, and incomplete coverage of public finances channeled through the treasury single account. The risks are being mitigated with support from the program by improving MOF's reporting on contingent liabilities and its assessment of SOE fiscal risks. The coverage of public finances channeled through the treasury single account has been enhanced, integrating all levels of budgets and revenue generated from all public entities through user fees and charges into the public financial management information system. The integrated benefits of the program are expected to outweigh the costs. Major risks and mitigating measures are described in detail in the risk assessment and risk management plan.[22]

IV. ASSURANCES

35. The government has assured ADB that implementation of subprogram 3 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 documents. The government has agreed with ADB on certain covenants for subprogram 3, which are set forth in the loan agreements.

V. RECOMMENDATION

36. I am satisfied that the proposed policy-based loans would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

(i) the loan in various currencies equivalent to SDR35,818,000 to Georgia for subprogram 3 of the Improving Domestic Resource Mobilization for Inclusive Growth Program, from ADB's Special Funds resources, with an interest charge at the rate of 2.0% per annum during the grace period and thereafter; for a term of 25 years, including a grace period of 5 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; and

(ii) the loan of $50,000,000 to Georgia for subprogram 3 of the Improving Domestic Resource Mobilization for Inclusive Growth Program, from ADB's ordinary capital resources, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 15 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.

Takehiko Nakao
President

14 July 2016

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

DESIGN AND MONITORING FRAMEWORK

Impact the Program is Aligned with
Citizens, particularly women, benefit from higher living standards and more employment opportunities[a]

Results Chain	**Performance Indicators with Targets and Baselines**	**Data Sources and Reporting Mechanisms**	**Risks**
Outcome Effective mobilization of domestic resources for increased public and private investment	By December 2016, domestic savings as a percentage of GDP increased to at least 13.5% (2014 baseline: 12.3%)	National Statistics Office of Georgia	External environment deteriorates and delays reforms to improve fiscal consolidation
Outputs 1. Improved management of debt, cash, and fiscal risk	1a. By September 2016, a medium-term public debt management framework is implemented 1b. By September 2016, MOF published information on debts and contingent liabilities of SOEs in the state budget documents 1c. By September 2016, an assessment of fiscal risks for SOEs completed by MOF	1a. Minutes of consultation board of MOF 1b. State budget documents 1c. Published risk assessment on MOF website	Lack of assessment and monitoring of contingent liabilities causes fiscal risk
2. Strengthened revenue and expenditure management	2a. By September 2016, at least GEL80 million of tax arrears paid in the current tax year 2b. By September 2016, the number of GRS in-house tax auditors increased to 330, of which 175 are women 2c. By September 2016, GRS reduced the statutory time limit of tax notices from 6 to 3 years 2d. By September 2016, draft amendments to cover gaps in the legal and regulatory framework of PPPs prepared	2a. Report published on GRS website 2b. Report published on GRS website 2c. Relevant law published on GRS website 2d. Report published by MOESD	Limited coverage of public financial management affects expenditure and fiscal consolidation

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
3. Enhanced generation of domestic savings	3a. By September 2016, cabinet approved revisions to the universal pension (zero pillar) that ensure continuity of equitable treatment of men and women	3a. Cabinet approval of pension reform policy document	
	3b. By September 2016, MOESD developed a structural and implementation framework for the supplementary pension savings scheme (pillar II) and further staffed the Pension Reform Unit to undertake the preparatory work	3b. MOESD report on pension structural and operational framework and staffing plan	
	3c. By September 2016, the legal framework for the quasi-mandatory supplementary pension savings (pillar II) and voluntary pension savings (pillar III) scheme drafted and submitted to the economic council, including draft amendments to tax and other existing laws	3c. Draft legal framework submitted to Economic Council	
4. Increased mobilization of private resources for investment	4a. By September 2016, MOESD completed a review of laws and regulations on investment	4a. MOESD policy brief	
	4b. By September 2016, MOESD contributed to money market development by approving accounting and prudential regulations for repos and securities lending	4b. Government approval of capital market strategy covering money market, accounting, and prudential regulations for repos and securities lending	
	4c. By September 2016, $99 million in local currency bonds issued by IFIs to increase access of local currency credit for SMEs (including issues by ADB, EBRD, and BSTDB)	4c. MOF certification of local currency bonds issued by IFIs	

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	4d. By September 2016, at least GEL12 million provided to SMEs as a matching grant facility to spur investments, with 40% allocated to women entrepreneurs 4e. By September 2016, at least GEL9.5 million provided as financial instruments to small businesses for encouraging innovation and technology, with 40% allocated to businesses owned or run by women	4d. Report published by MOESD or MOF 4e. Report published by MOESD or MOF	

Key Activities with Milestones
Not applicable

Inputs
Subprogram 3 = $100 million (ADF: $50 million, OCR: $50 million)

Assumptions for Partner Financing
Not applicable

ADB = Asian Development Bank, ADF = Asian Development Fund, BSTDB = Black Sea Trade and Development Bank, EBRD = European Bank for Reconstruction and Development, GDP = gross domestic product, GRS = Georgia Revenue Service, IFI = international financial institution, MOESD = Ministry of Economy and Sustainable Development, MOF = Ministry of Finance, OCR = ordinary capital resources, PPP = public–private partnership, SMEs = small and medium-sized enterprises, SOE = state-owned enterprise.

[a] Government of Georgia. 2014. Socio-Economic Development Strategy of Georgia (Georgia 2020). Tbilisi.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

http://www.adb.org/Documents/RRPs/?id=48044-005-3

1. Loan Agreement: Special Operations
2. Loan Agreement: Ordinary Operations
3. Sector Assessment (Summary): Public Sector Management and Finance
4. Contribution to the ADB Results Framework
5. Development Coordination
6. Economic and Financial Analysis
7. Country Economic Indicators
8. International Monetary Fund Assessment Letter
9. Summary Poverty Reduction and Social Strategy
10. Gender Action Plan
11. Risk Assessment and Risk Management Plan
12. List of Ineligible Items

DEVELOPMENT POLICY LETTER

KA020135294186016

საქართველოს
ეკონომიკისა და მდგრადი
განვითარების მინისტრი

MINISTER OF ECONOMY
AND SUSTAINABLE
DEVELOPMENT OF GEORGIA

0108 თბილისი, ჭოველიძის ქ. №10ა (ყოფილი ზელინსკი)
10A, Chovelidze str., 0108 Tbilisi, Georgia

Tel.: (+995 32) 2 99 11 05
Tel.: (+995 32) 2 99 11 11

№ 09/4354 **2016 / 07 /06**

Mr. Takehiko Nakao
President, Asian Development Bank
Manila, Philippines

Dear President Nakao,

Let me begin by thanking the Asian Development Bank for its strong and continued support to Georgia's successful development efforts in the recent past. Our objective is to ensure sustained economic growth that is broad based and inclusive.

Growth is expected to remain around 3% in 2016 before increasing to around 5,5% in 2017. Domestic demand is expected to remain the main source of growth, reflecting fiscal support for consumption and investment. Greater clarity in policy and political environment, greater emphasis in agriculture and manufacturing sectors, and improvements in investor sentiment are acting as catalysts to the reform agenda of the government.

To address large unmet social needs, the government has introduced universal health insurance and increased social sector funding significantly. The government has increased universal pension to GEL160 in 2015 and aims to implement comprehensive pension reforms. The government is deepening the debt markets, and extending concessional credit to farmers and to new startups in the micro, small and medium size enterprise (MSME) sector with a particular focus on women to achieve the inclusive growth goal. This is in line with the 2014-2016 National Action Plan for Implementation of Gender Equality Policy in Georgia and ADB's improving domestic resource mobilization program.

The Government identified limited access to financial resources as a critical obstacle to the country's economic development due to insufficient savings and internal resources necessary for investments, and inadequately developed financial products. To this end, measures are being implemented to boost the MSME sector and increase availability of funding to this sector. Two agencies were established under Ministry of Economy and Sustainable Development (MOESD) to promote financial support, development and ease market entry for small businesses as well as to support businesses in adaptation of Deep and Comprehensive Free Trade Area (DCFTA) requirements. Entrepreneurship Development Agency (EDA) Innovation and Technology Agency (GITA) implements Government's policy, to help create new innovative businesses as well as promotes application of innovative technologies in business activities, and helps to commercialize innovative R&D for a knowledge-based economy.

In 2015 GITA in cooperation with private sector and academia created a mobile and web-based applications laboratory, Geolab, which is a teaching and training knowledge-exchange platform for individuals wishing to pursue the mastery of development of software products and services. Another related project on startup accelerators allows students and individuals to explore entrepreneurial ideas and launch business ventures. In January 2016 GITA opened the first Technology Park which unites business incubators, educational centers, laboratories, team and show rooms and serves as a platform to develop product prototypes and to contribute to the process of creating knowledge-based small and medium-sized enterprises. After opening the first fablab in Tbilisi, expansion of the fablab network is underway in the regions of Georgia. Both agencies have a special gender focus by providing increased financing and entrepreneur training opportunities to women's businesses.

Another program, "Produce in Georgia" began in June 2014, to provide funding to startups in agriculture and in other sectors of the economy, in an effort to bolster domestic production capacity. By the end of June 2016, 182 projects were supported and the investment value reached GEL385,3 million with over 7,800 jobs to be created. Under the industry support component of the program Enterprise Georgia managed to support 113 businesses, out of which 48 are new business ventures. The estimated investment value of Enterprise Georgia's portfolio is GEL228,6 million, with anticipated creation of 4,400 direct and indirect jobs, 75 state-owned properties were transferred by the National Agency of State Property (within the Ministry of Economy and Sustainable Development of Georgia) to business people in exchange for investment by the private entities in these assets with total market value of GEL 22 Million.

In 2015 under the "Produce in Georgia" program a new Micro and Small Business Support project was launched which aims to promote novel business initiatives, implement innovations and support existing micro and small business development plans. The program provides support for online registration of business ideas, training in business plan preparation and follow up advisory services as well as funding and monitoring. This project turned out to be particularly successful since for the first round of the project up to 1,770 entrepreneurs were financed with estimated job creation of 3,843. About 3,118 beneficiaries have already undergone the training courses. Currently the agency launched the second round of the project and received almost doubled number of applications. Although the number of new businesses is quite impressive, the share of MSMEs in GDP remains below 20%, a much smaller share than in the region. A draft 2016-2020 Small and Medium-sized Enterprises Development Strategic Plan was prepared that aims to improve the legislative, institutional and business environment, improve financial accessibility, develop small and medium-sized enterprise management skills, support export and promote innovations and research activities.

In recent years, the government has made great strides in improving public financial management processes and systems. These include the implementation of results-based budgeting and performance management; the move to accruals and IPSAS compliant reporting; improved local government financing; and modern treasury management, consolidating debt and cash management. Tax revenues as a share of GDP have been increasing consistently from only 12.0% in 2003 to 21.6% in 2007, 25.5% in 2012, 24.8% in 2013, 24.8% in 2014 and 25.3% in 2015. The state's dominant role in the dispute resolution has been curtailed.

In 2015 the Revenue Service of the Ministry of Finance (MOF) presented a new tax payment reform, whereby 125 treasury codes for tax payments were reduced to one. With the new initiative, tax payment transactions decreased considerably as will the refund time for overpaid taxes (from 3 months to 1 month), which improves the business enabling environment. In 2015, MOF further augmented its capacity to provide detailed budget information on LEPLs, along with analysis of financial sector risks including macro scenario analyses, the impact of macroeconomic indicators on public finances, fiscal implications and cash flow forecasting, integrated assessment of the public debt with e-budget and e-treasury, and a comprehensive public debt sustainability analysis. In 2016 customs declaration procedures were simplified which afforded traders the option of advance declaration and provision of a certificate of origin of goods prior to their importation. The government is introducing further tax measures from 2017 to support businesses, such as a zero corporate profit tax on reinvested profit.

The government has embarked on a capital market development program by addressing gaps in legal and regulatory framework and improving market infrastructure. In January 2016 the MOESD discussed the Capital Market concept that foresees provision of long-term financial resources in local currency in the financial sector, the introduction of various financial instruments, such as corporate bonds, derivatives and equity securities and improvement of the market infrastructure. Government's Capital Market Development Strategy provides strategic vision on the development of the capital market, timeframe and practical steps for its implementation and links to market-related reforms. The document provides broad guidance on principles, directions and development stages of the capital market, and outlines steps to achieve targets set for the short and medium term and highlights the roles of various stakeholders. The Strategy aims to support development of a liquid capital market through facilitating diversification of the financial system, increasing availability of the investment resources, supporting de-dollarization of the economy and increasing the resilience of the financial sector against shocks.

A major step in developing the capital markets has been the issuance of local bonds by the IFIs. In November 2015, Black Sea Trade and Development Bank issued a GEL45 million 3-year floating-rate bond to support the development of the country's capital market and provide funding to SMEs. In 2014, the EBRD issued the first-ever local currency 2-year bond totaling GEL50 million (€20.7 million) which was followed by another issue of $50 million in June 2016. ADB and IFC also issued bonds denominated in local currency in 2015 in the amounts of $48.5 million (ADB) and $15.0 million (IFC). ADB made a second bond issue after EBRD's most recent placement in 2016. Bond issues such as this support the development of the local capital market and help attract the diversified investor base necessary to provide sufficient liquidity and demand in the domestic market.

The government has also initiated pension reforms. The principal focus is on the introduction of a supplementary private pension savings scheme (Pillar II), combined with voluntary private pension savings scheme (Pillar III). The proposed Pillar II will be equitable in nature as accrued pension will depend on an individual's lifetime earnings and the contributions made into the pension fund, while the local capital market will receive significant boost by serving as a mechanism to channel pension savings into the local economy. The new system is designed to offer an average wage replacement rate of 18% in real terms and will initially supplement the existing universal pension, whose ultimate goal is poverty alleviation based on improved targeting. Contribution rates will be shared between the employer, employee and government, each of them contributing 2% monthly into the personal account of the employee for a total of a 6% payment. The pension account will grow based on contributions and return on investment.

To address the lack of internal resources, the government is improving the mobilization of domestic savings. Ongoing pension reform and the planned development of private retirement funds will help in this regard, as private pools of savings promise to create demand from sources other than banks for government securities in local currency. In addition, these pools of savings will provide longer-term private sector financing, including bond issuance. Developing secondary markets for government bonds and other fixed-income securities would help develop capital markets, including nonbank sources of government finance. Measures such as these would strengthen demand for local currency securities while promoting a financial system better able to channel resources toward productive uses that support investment and growth.

We have been working closely and efficiently with all development partners, including ADB, to mobilize resources allowing us to plan and execute projects with tangible impacts. At this stage the government priority is budget support given a still-weak external environment, and the increasing need to support social and investment activities through the budget. In December 2015, all EU member countries finalized ratification of the EU's Association Agreement with Georgia, including provisions for a DCFTA, which builds on the European Neighborhood and Partnership (ENP) Instrument, with cumulative financing of €452 million (2007-2013) and further allocations of up to €410 million in 2014-2017. In November 2015 the EU allocated €100 million to support a set of reforms related to the EU-Georgia Association Agreement in the key areas of agriculture, energy, transport, electronic communications, environment and climate change.

ADB's program is contributing significantly in improving domestic resource mobilization to help achieve inclusive growth in Georgia. The program supports more efficient revenue and public expenditure management, generation of domestic savings, and mobilization of private resources for investment. The program is assisting the government in maintaining macroeconomic stability, streamlining public spending and establishing access to finance. The two major reforms on pensions and capital market pursued under the program are the most significant and far reaching reforms that the government is pursuing. The implementation of these reforms in the coming years will lead to increased availability of financing and investment opportunities as well as ensuring better social protection.

We deeply appreciate the support of ADB in the implementation of the strategic actions outlined above. We are looking forward to our continued successful partnership with ADB, including in the context of the proposed policy based program on improving domestic resource mobilization for inclusive growth.

Mr. President, I take this opportunity to extend my esteemed regards.

Sincerely,

First Vice Prime Minister of Georgia

Minister Dimitry Kumsishvili

POLICY MATRIX

Policy Actions	Subprogram 1 2014	Subprogram 2 2015	Subprogram 3 2016
Output 1: Improved Management of Debt, Cash and Fiscal Risk			
Strengthened debt and cash management	MOF approves internal procedures manual for external borrowing for investment project financing and budget support describing the scheme of process including roles of NBG, MOESD, Ministry of Justice and the parliament for signing, ratification and effectivity	MOF prepares and approves a Debt Strategy for medium term debt management covering loan portfolio, goals and principles of incurring new debt and issues of debt sustainability	MOF submits to parliament any required amendments to the public debt legislation underpinning the Debt Strategy
	MOF approves procedure manuals for the processing of public debt service, debt data recording and validation for efficient debt management and monitoring process	MOF prepares an action plan to strengthen the Middle Office (analytical) function of the PDEFD for advising on terms of funding for government projects and evaluating public debt portfolio	MOF strengthens Middle Office with an upgraded debt management and risk analysis system integrated with the e-budget and e-treasury systems
	MOF publishes on its web site: (a) information on projects and programs financed by external sources covering total loan amounts, disbursed amounts and reflected in the State Budget, and (b) a statistical bulletin on public debt presenting overall performance, treasury securities issuances and transactions on primary markets	MOF develops a systematic process for debt and loan guarantees recordkeeping, reporting and validation MOF sets up a dedicated analytical function for cash flow forecasting with adequate budget and personnel	MOF reports on guarantees in government's financial statements covering face value
Strengthened management of fiscal risk	MOF conducts an inventory indicating fiscal position of large SOEs and their audited financial situation	MOF establishes a dedicated staffed and budgeted function to manage fiscal risks including contingent liabilities of SOEs and PPP projects	MOF provides information on the debt of SOEs and contingent liabilities of SOEs and PPPs as a supplement to the state budget documents
	MOF develops a strategic template for monitoring and dealing with all types	MOF establishes procedures, assigns institutional	MOF carries out a first complete assessment of: (i) financial sector risks;

Policy Actions	Subprogram 1 2014	Subprogram 2 2015	Subprogram 3 2016
	of fiscal risk confronting the country	responsibilities, and sets aside adequate human and financial resources to monitor and advise on the management of the different types of fiscal risk confronting the government MOF carries out a first complete assessment of: (i) macro risk assessment; (ii) external debt sustainability analysis; and (iii) review of risk associated with loan guarantees and other similar contingent liabilities	and (ii) assessment of fiscal risks SOEs represent
Output 2. Strengthened Revenue and Public Expenditure Management			
Increased effectiveness and efficiency of revenue collection	GRS implements strengthened tax collection procedures by establishing a new dedicated and budgeted Administrative Department GRS approves a strategy to reduce the statutory time limitation of tax notices and taxpayer notices incrementally from 6 to 3 years to shorten tax liability imposition period providing relief to taxpayers GRS approves an action plan to phase out the Alternative Audit Program and to increase capacity of in-house audit, including in specialized sectors	GRS recovers arrears from active tax payers amounting to at least GEL80 million for the current tax year GRS reduces the statutory time limitation of tax notices and taxpayer notices from 6 to 5 years, shortening tax liability imposition period providing relief to taxpayers GRS increases the number of in-house tax auditors to 286 (out of which 147 are women), correspondingly decreasing the number of alternative auditors	GRS starts the process of writing off tax arrears of defunct businesses on the basis of legally approved categories GRS reduces the statutory time limitation of tax notices and taxpayer notices from 5 to 3 years, shortening tax liability imposition period providing relief to taxpayers GRS completes the phasing out of alternative auditors by increasing the number of in-house tax auditors to 322, out of which 170 are women
Improved public expenditure management	MOF prepares amendments to the budget code to allow for LSG and LEPL finances to be managed through the	All cash operations of LSGs and LEPLs (except schools and kindergartens) are channeled through the	

Policy Actions	Subprogram 1 2014	Subprogram 2 2015	Subprogram 3 2016
	electronic PFMS and their payments and receipts through the TSA MOF provides supplementary information on types and funding of capital projects in the state budget documents	TSA and the budgeting, budget execution and accounting processes through the PFMS The relevant government agencies identify gaps in the legal and regulatory framework for preparation, appraisal and implementation of public private partnership projects	The relevant government agencies prepare drafts of regulations to address any identified gaps in the legal and regulatory framework of public-private partnership projects and any required legal amendments
Strengthening of local government finances	Parliament approves the Local Self Governance Code in February 2014 paving the way for reforms in intergovernmental finances including capital transfers and special transfers	Government submits to parliament proposals for amendments to the Budgetary Code defining the separation of revenues among the budgets of state, autonomous regions and municipalities	Government ensures that intergovernmental transfers increase by GEL65 million in the current budget year
Output 3. Enhanced Generation of Domestic Savings			
Streamlining Universal Pension–Zero Pillar		MOESD, MOF, and MOLHSA complete forecast of present and future cost of Universal Pensions under various scenarios using Prost Modeling and other approaches MOESD, MOF, and MOLHSA submit to government pension system revisions which ensure continuity of equitable treatment for men and women	Cabinet approves the pension system revisions, including the indexation mechanism for the universal pension, and ensures continuity of equitable treatment of men and women
Establishing sustainable private pension savings system with quasi-mandatory elements – Hybrid or Joint Pillar (combination of pillars II and III)	MOESD establishes a pension reform unit with adequate budget and staffing and an interagency working group to devise a time- bound action plan on designing a new pension system	MOESD completes analysis of the key areas of pension system design and structure, including continued equitable treatment of men and women, and hybrid/ joint nature incorporating mandatory and voluntary dimensions	MOESD develops a structural and implementation framework for the Supplementary Pension Savings Scheme (pillar II), and further staffs the pension reforms unit to undertake preparatory work

Policy Actions	Subprogram 1 2014	Subprogram 2 2015	Subprogram 3 2016
	MOESD issues a public notification on the broad concept and direction of pension reforms including mandatory and voluntary systems	MOESD issues consensual paper on the nature of hybrid pillar including issues like membership, contributions, tax considerations, benefits, gender, and relationships with zero pillar MOESD submits to Cabinet for approval a strategy and time-bound action plan for pension reforms, including legal and regulatory gaps, data privacy and tax legislation MOESD and MOF develop approach for public awareness programs for zero and hybrid/joint pillars, outlining specific measures for continuity of equitable treatment of men and women MOESD completes the review of existing structure of private pensions to incorporate any required changes in the related legislation	MOESD drafts and submits to the Economic Council single legislation for both the quasi-mandatory Supplementary Pension Savings Scheme (pillar II) and the voluntary Supplementary Pension Savings Scheme (pillar III), as approved under the Pension Policy Reform, allowing for subsidiary legislation to be introduced later MOESD launches communication campaign with nation-wide public awareness drives on benefits of the supplementary private pension savings scheme, including gender aspects.
Output 4. Increased Mobilization of Private resources for Investment			
Developing capital markets for mobilizing long-term finance	Government approves Socio-Economic Development Strategy of Georgia 2020 in June 2014 committing to policies to mobilize investments and develop financial intermediation Government together with NBG establishes an	MOESD issues a public notification on the concept and direction of capital market reforms, including corporate securities, expanding bond market and money market instruments for secured interbank trading MOESD submits to the Economic Council, as	MOESD launches a public awareness campaign on benefits of capital market reform plan including investor protection, financial instruments for investment, long- term savings, gender aspects and close link with pensions reforms MOESD completes the review of laws, bylaws,

Policy Actions	Subprogram 1 2014	Subprogram 2 2015	Subprogram 3 2016
	interagency working group to devise a time bound action plan on capital market reform and development	precursor to Cabinet, for approval a strategy and time-bound action plan for capital market reforms, including addressing legal and regulatory gaps and improving the structure and efficiency of the market infrastructure	regulations on investment, governance, risk management and fund managers essential for managing investments, including private pension savings captured in a policy brief MOESD contributes to money market development by approving accounting and prudential regulations for repos and securities lending Additional: GEL denominated IFI bonds issued totaling $99 million to increase access of local currency credit for SMEs, including (i) $20 million by BSTDB in November 2015, (ii) $49 million by EBRD in June 2016, and (iii) $30 million by ADB in July 2016 Additional: Law on Registration Fees approved by the Parliament waiving bond issuance fees by IFIs to support capital market development and securities issuance by IFIs Additional: To facilitate the issuance of corporate securities and align the accounting and auditing standards with EU directives, the draft Law of Accounting, Reporting and Auditing prepared and submitted to the Economic Council
Enhancing access to finance for small business financing and	MOESD establishes the EDA with adequate staffing, work plan and budget of GEL110 million for 2014–2018 allocating	MOESD allocates a budget of GEL21 million to the Entrepreneurship Development Agency	MOESD allocates a budget of GEL25 million to the Entrepreneurship Development Agency

Policy Actions	Subprogram 1 2014	Subprogram 2 2015	Subprogram 3 2016
development with gender targeting	GEL19 million for 2014		
	MOESD establishes the Innovation and Technology Agency with adequate staffing, work plan and allocated budget of GEL20 million for 2014–2016 allocating GEL6 million for 2014	MOESD allocates a budget of GEL6 million to the Georgia Innovation and Technology Agency	MOESD allocates a budget of GEL8 million to the Georgia Innovation and Technology Agency
	EDA (within its budget) establishes a concept for a matching grant facility and other financial products for micro, small and medium-sized enterprises with GEL3 million with 20% earmarked for women's businesses	EDA (within its budget) expands matching grant facility for micro, small and medium-sized enterprises by GEL4 million, depending on performance/fund utilization, with 30% earmarked for women businesses	EDA (within its budget) expands matching grant facility for micro, small and medium-sized enterprises by GEL5 million, depending on performance/fund utilization, with 40% financing earmarked for women businesses
	GITA (within its budget) establishes financial instruments like mini grants, matching grants and innovation vouchers to support private sector innovation and technology development with GEL2 million, with 20% earmarked for women businesses	GITA (within its budget) expands financial instruments to support private sector innovation and technology development with GEL3 million, depending on performance/fund utilization, with 30% earmarked for women businesses	GITA (within its budget) expands financial instruments to support private sector innovation and technology development with GEL4.5 million, depending on performance/fund utilization, with 40% earmarked for women businesses
	Government adopts Gender Action Plan, which ensures equal participation of men and women in economic and business activities, equal participation in professional and business educational programs. Special attention is paid to business training for women that will increase access to finance for female entrepreneurs	Government implements the gender action plan and publicly reports on results included in the program policy areas such as small business training and financing	Government implements the gender action plan and publicly reports on results included in the program policy areas such as small business training and financing
		Additional. EDA launches a new program "Produce in Georgia" targeting micro and small enterprises development in rural	

Policy Actions	Subprogram 1 2014	Subprogram 2 2015	Subprogram 3 2016
		areas with an allocated budget of GEL20 million Additional. GITA creates a training and knowledge-exchange platform Geolab and a research and development fablab with a budget of GEL1.1 million	

BSTDB = Black Sea Trade & Development Bank, EBRD = European Bank for Reconstruction and Development, EDA = Entrepreneurship Development Agency, EU = European Union, GDP = gross domestic product, GEL= Georgian Lari, GITA= Georgia Innovation and Technology Agency, GRS = Georgia Revenue Service, IFI = international financial institution, LEPL = legal entities of public law, LSG = local self-government, MOESD = Ministry of Economy and Sustainable Development, MOF = Ministry of Finance, MOLHSA= Ministry of Labor, Health and Social Affairs, NBG= National Bank of Georgia, , PDEFD = Public Debt and External Financing Department, PFMS = public financial management system, PPP = public–private partnership, SMEs = small and medium sized enterprises, SOEs = state-owned enterprise, TSA = treasury single account.