Document of
The World Bank

FOR OFFICIAL USE ONLY

Report No. 114787 -GE

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT

ON A PROPOSED LOAN

IN THE AMOUNT OF EUR 44.6 MILLION

(US$50.00 MILLION EQUIVALENT)

TO GEORGIA

FOR THE

SECOND PROGRAMMATIC PRIVATE SECTOR COMPETITIVENESS

DEVELOPMENT POLICY OPERATION

June 27, 2017

Trade & Competitiveness Global Practice
South Caucasus Country Unit
Europe and Central Asia Region

GEORGIA: GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of June 1, 2017)

Currency Unit   Georgian Lari (GEL)

US US$1.0   GEL 2.415

ABBREVIATIONS AND ACRONYMS

A&A	Accounting, Reporting and Auditing
AA	Association Agreement
ADB	Asian Development Bank
AFD	Agence Française de Dévelopment (France Development Agency)
BAU	Business as usual scenario
CIIP	Competitive Industries and Innovation Policy
CIS	Commonwealth of Independent States
CNG	Compressed Natural Gas
CPF	Country Partnership Framework
CPI	Consumer Price Index
CPS	Country Partnership Strategy
DCFTA	Deep and Comprehensive Free Trade Agreement
DIS	Deposit Insurance System
DPO	Development Policy Operation
DSA	Debt Sustainability Analysis
EE	Energy Efficiency
EA	European co-operation for Accreditation
EBRD	European Bank for Reconstruction and Development
EDA	Entrepreneurship Development Agency
EFF	Extended Fund Facility
EU	European Union
FDI	Foreign Direct Investment
FSAP	Financial Sector Assessment Program
FTA	Free Trade Area
G4G	Governance for Growth
GAC	The Georgian Accreditation Centre
CEA	Georgia Country Environmental Analysis
GDP	Gross Domestic Product
GeoSTM	Georgian National Agency for Standards and Metrology
GITA	Georgian Innovation and Technology Agency
GNCC	Georgian National Communication Commission
GRS	Grievance Redress Service
Georgia 2020	Socio-economic Development Strategy "Georgia 2020"
ISSSG	Insurance State Supervision Service of Georgia
MCR	Minimum capital requirements
NBG	National Bank of Georgia
NEEAP	National Energy Efficiency Action Plan
NDC	Nationally Determined Contribution
NQI	National quality infrastructure

PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PPP	Purchasing power parity
PTB	Physikalisch-Technische Bundesanstalt (National Metrology Institute of Germany)
R&D	Research & Development
RIA	Regulatory Impact Assessments
ROSC	Report on the Observance of Standards and Codes
SARAS	Service for Accounting, Reporting and Auditing Supervision
SBA	Stand-By Arrangement
SCD	Systematic Country Diagnostic
SDR	Special Drawing Right
SDSS	Special Data Dissemination Standards
SMEs	Small and Medium Enterprises
SPA	State Procurement Agency
STAREP	Strengthening, Auditing, and Reporting in the Countries of the Eastern Partnership
TA	Technical Assistance
TAIEX	Technical Assistance and Information Exchange
TFP	Total Factor Productivity
USAID	The United States Agency for Development
WBG	World Bank Group

Regional Vice President:	Cyril Muller
Country Director:	Mercy Miyang Tembon
Senior Practice Director:	Anabel Gonzalez
Practice Director:	Cecile Fruman
Practice Manager:	Lisa Kaestner
Task Team Leader:	John Gabriel Goddard

GEORGIA

SECOND PROGRAMMATIC PRIVATE SECTOR COMPETITIVENESS DEVELOPMENT POLICY OPERATION

TABLE OF CONTENTS

List of Tables and Figures

The proposed Second Programmatic Private Sector Competitiveness DPO was prepared by a World Bank Group team consisting of: Trade and Competitiveness Global Practice (GP) (John Gabriel Goddard, Task Team Leader; Hiroyuki Tsuzaki; Natalia Tsivadze; Ekaterine Avaliani; Shawn Tan; Khatuna Didbaridze; Lela Ghongadze; Rusudan Mandzhgaladze; Djamilya Salieva); Finance & Markets GP (Angela Prigozhina; Eugene Gurenko; Ketut Kusuma; Jan Philipp Nolte; Djurdjica Ognjenovic; Fiona Stewart); Macroeconomics & Fiscal Management Global Practice (Mona Prasad; Mariam Dolidze); Poverty GP (Cesar Cancho; Nistha Sinha; Ana Maria Munoz Boudet); Social, Urban, Rural and Resilience GP (Sophia Georgieva; Ursula Casabonne; Michelle Rebosio); Social Protection & Labor GP (Anita Schwarz); Governance GP (Galina Alagardova; Natalia Manuilova, Sandro Nozadze); Transport & ICT (Siddhartha Raja; Natalija Gelvanovska); Environment & Natural Resource GP (Darejan Kapanadze); Energy and Extractives GP (Joseph Melitauri); and Climate Change CCSA (Anne Schopp). The team would like to thank: the Results and Quality team of T&C GP (Kamal Sablini), and the IFC (Jan van Bilsen) for their support and inputs. The team is grateful for overall guidance provided by Mercy Miyang Tembon, Lisa Kaestner, Rolf Behrndt, Andrew Mason, Javier Suarez, Wolfgang Fengler, Sarah Michael, Genevieve Boyreau, Ozan Sevimli and Rashmi Shankar. The team gratefully acknowledges the excellent collaboration of the Georgian authorities, development partners, as well as the support and guidance of peer reviewers, Feyi Boroffice, Jorge Araujo and Rinku Chandra.

SUMMARY OF PROPOSED LOAN AND PROGRAM
GEORGIA
SECOND PROGRAMMATIC PRIVATE SECTOR COMPETITIVENESS DEVELOPMENT POLICY OPERATION

Borrower	Georgia
Implementation Agency	Ministry of Finance/ Ministry of Economy and Sustainable Development
Financing Data	IBRD Loan of EUR 44.6 million
Operation Type	Programmatic Development Policy Operation (2nd of 2)
Pillars of the Operation and Program Development Objective(s)	The proposed Program Development Objective is to increase private sector competitiveness through second generation business environment reforms, establishing enabling conditions for financial sector deepening and diversification, and increasing firms' capacity to innovate and to export. The operation has three pillars: Pillar 1 - Second generation business environment reforms; Pillar 2 - Establishing enabling conditions for financial sector deepening and diversification; and Pillar 3 - Increasing firms' capacity to innovate and to export.
Results Indicators	*Pillar 1 - Second generation business environment reforms* • At least four (4) major economic reforms reviewed by the Investors Council • 8,000 Small and Medium Enterprises (SME) and entrepreneurs using services provided by the new Entrepreneurship Development Agency (EDA) • Registered users in the e-Procurement system increase by 85 percent • State Procurement Agency tenders monitored for unlawful practices *Pillar 2 - Establishing enabling conditions for financial sector deepening and diversification* • Deposit insurance coverage for household deposits is in effect from January 1st, 2018 • The Pension Agency is established, an Investment Board has been selected, and the information technology systems are set up to accept contributions • Public Interest Entities file financial statements based on IFRS from 2017, large and medium companies start the process in 2018, and the statements are published on an e-portal • 10 quality reviews of the audit firms have been conducted by the Service for Accounting, Reporting and Auditing Supervision (SARAS) • Insurance companies are in compliance with EU solvency I margin requirements in 2018 *Pillar 3 - Increasing firms' capacity to innovate and to export* • Incremental investment in the telecommunications sector of US$ 50 million • Broadband Internet subscriptions increase by 12 percent • 300 entrepreneurs and startups obtain innovation finance from the Georgian Innovation and Technology Agency (GITA) • GITA's technology parks and fabrication laboratories are functioning • 150 percent increase in the number of certificates issued by the Georgian National Agency for Standards and Metrology (GeoSTM)
Overall risk rating	Moderate
Operation ID	P155553

IBRD PROGRAM DOCUMENT FOR A PROPOSED

SECOND PROGRAMMATIC PRIVATE SECTOR COMPETITIVENESS DEVELOPMENT POLICY OPERATION FOR GEORGIA

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed Second Programmatic Private Sector Competitiveness Development Policy Operation (DPO2) to Georgia in the amount of EUR 44.6 million aims to support the government's efforts to enhance the country's competitiveness in order to spur inclusive economic growth.** This is the second in a series of DPOs to achieve more inclusive economic growth through policies to stimulate private sector productivity, foster long-term savings and investment, strengthen financial and social safety nets, and create a fair business environment that enables growth of small and medium enterprises (SMEs) and new firms. Taken together, the package of reforms provides a clear signal about the government's intention to implement a policy framework that can boost business confidence and spur economic growth, while maintaining macroeconomic stability.

2. **The Georgian government is committed to developing a competitive economy in which the private sector can effectively leverage the trade and investment opportunities that come from the country's geography and close relationship with the European Union and Asia.** In its "Georgia 2020" development strategy of 2014, the government outlined a vision for inclusive development in which private sector is the main engine of economic growth. The recent Four-Point Reform Plan reiterates this economic strategy, and recognizes the need to continue to improve the business environment and put in place policies and programs that strengthen the financial and real sectors of the economy, while making the long-term investments to upgrade the human capital and infrastructure. With this in mind, the government has pursued an ambitious trade and integration agenda looking West as well as East. Recent achievements include the Deep and Comprehensive Free Trade Area (DCFTA) and Association Agreement (AA) with the European Union (EU), which was signed in 2014 and fully came into effect in 2016, and the Free Trade Agreement with China signed in May 2017. The agreements greatly enhance market access for domestic firms and have the potential to attract larger volumes of foreign direct investment (FDI), and this DPO series recognizes several major steps taken to implement Georgia's commitments and catalyze the benefits.

3. **Georgia is a top reformer, with strong results in terms of macroeconomic and financial stability, the ease of doing business, safety and the rule of law.** Starting in 2003, the country embarked on far reaching reforms including an overhaul of the public sector, deregulation for businesses, an anticorruption drive and legal, tax, and trade facilitation reforms. Improvements in the legal framework and the capacity of the public sector and key regulatory bodies, including the central bank, bore fruit in recent years as the country successfully navigated a number of external shocks, maintaining macroeconomic and financial stability. Gross Domestic Product (GDP) growth averaged 5.4 percent per year during the period of 2004-2016 despite the shocks. Georgia has received top scores in the World Bank's *Doing Business* (DB) publication, now ranking 16th (*Doing Business* 2017) among 190 countries; while Georgia's ranking improved from 90th place in 2008-2009 to 59th in the *Global Competitiveness Report* 2016-2017. After living through a surge in crime and violence after independence, the country is now one of the safest in the world according to recent rankings, a remarkable achievement which also played a major role in the growth of the tourism sector. Georgia is also actively engaged in global climate change initiatives, as evidence by the approval and coming into force of the Paris Agreement.

4. **Faster progress on eradicating poverty and promoting shared prosperity was driven by higher labor income and redistributive fiscal policy that enlarged social transfers.** The poverty rate, estimated using the US$2.5/day purchasing power parity (PPP) poverty line, fell from 46.7 percent in 2010 to 31.5 percent in 2015, and the mean consumption of the bottom 40 grew by 7.5 percent per year in the

same period, exceeding the 5 percent growth enjoyed by the overall population. The poverty rate is estimated to have declined further in 2016, although at a slower pace because of modest economic growth. In contrast with previous periods, Georgia was able to translate economic growth into poverty reduction. The main channels of transmission have been redistributive social policies introduced to counteract the impact of the global financial crisis, and increased earnings across all sectors of the economy. Despite a downward trend in poverty in recent years, large urban-rural disparities persist because of limited income opportunities in rural areas beyond subsistence farming. Rural poverty was nearly double the poverty in urban areas in 2015 (40.2 percent against 21.8 percent). Moreover, the vulnerability to fall into poverty is high in Georgia because of the large share of out-of-pocket spending on healthcare. Social and financial safety nets need to improve to ensure more inclusive growth dynamics and protect vulnerable households.

5. **Against the backdrop of these significant achievements, the country is now at a critical juncture of its economic reform process, and needs policies that ensure more and better job creation in order to reduce structural unemployment and regional disparities.** While "first generation reforms" made Georgia a more attractive destination for investors and accelerated economic growth in the past, they were not enough to close the productivity gap. New analysis undertaken for the Systematic Country Diagnostic (SCD) indicates that new and small firms have been entering domestic markets and growing over time, yet substantial productivity challenges remain at the firm level and the aggregate level. On the external front, export survival rates are substantially lower and falling in Georgia compared to European countries at similar levels of development, and this growing gap is systematically associated with low productivity and information failures. Significant employment was created, especially in the service sector, but labor shedding in the public sector and the continuing decline of traditional sectors of the economy meant there was little in the way of net job creation—overall unemployment rate fell from 16.3 percent in 2010, but it remained at 11.8 percent in 2016.

6. **This operation supports Georgia in its ambition to become a dynamic emerging market that is increasingly integrated into global value chains.** For this next phase of economic development, the government is focusing on strengthening the private sector's competitiveness, which will reduce the economy's reliance on public investment as a source of growth. The reforms will underpin long-term productivity growth and leverage the benefits of membership in the DCFTA and the AA with the EU. The three key reform areas which this operation is supporting are:

- ***Pillar 1 – Second generation business environment reforms.*** The reforms supported under this pillar focus on improving the predictability of the business environment, strengthening the consultation mechanisms for major economic reforms, and designing policies and institutions to support productivity growth and market access among SMEs. Key areas include: addressing business environment constraints through enhanced public-private dialogue (PPD) initiatives; rolling out programs to connect SMEs to markets; and strengthening the public procurement system to increase the participation of companies including local SMEs in procurement market.

- ***Pillar 2 – Establishing enabling conditions for financial sector deepening and diversification.*** Georgia needs to further deepen and diversify its financial sector to mobilize additional investments needed for investment and to develop instruments that promote financial access, especially for SMEs. To achieve greater financial and social inclusion, it is critical to encourage higher domestic long-term savings, enhance financial service regulation, and strengthen existing social and financial safety nets. Pillar 2 focuses on addressing supply- and demand-side constraints faced by the financial sector through: the introduction of a deposit insurance system geared towards small depositors; an enhanced financial reporting and disclosure framework; and reforms aimed at increasing the soundness and growth of the insurance market. A comprehensive pension reform that incentivizes savings in pension funds will deepen the social safety net and underpin future growth of the domestic capital market.

- ***Pillar 3 – Increasing firms' capacity to innovate and to export.*** To increase their competitiveness, domestic companies need to strengthen their managerial capabilities, upgrade the quality of their products, invest in new technologies, and expand their market knowledge. In addition, it is important to accelerate the adoption and development of green technologies to address the challenge of climate change. The reforms in Pillar 3 include: licensing and regulatory actions to enable the upgrading of mobile and fixed broadband services, so that Georgia's information and communications technology (ICT) infrastructure can meet the needs of a modern economy; legal amendments to underpin the innovation support framework and align it with EU practices; and fiscal measures to stimulate the introduction of more fuel efficient cars. It also supports actions to ensure international recognition by state institutions responsible for metrology and accreditation, which will reduce the "hidden costs" of trade linked to compliance testing and certification.

7. **The proposed DPO series is a core element of the Country Partnership Strategy (CPS) (FY2014-17)**. The DPOs contribute to the CPS goal of enabling the private sector to become the main driver of employment creation and a provider of income opportunities for the bottom 40 percent of the population. This operation complements the second Inclusive Growth Development Policy Operation, which was approved by the Bank's Board on April 28, 2017, and is part of a DPO series supporting the Georgian government in its effort to improve delivery of public service and to strengthen fiscal oversight. Furthermore, the French Development Agency (AFD) is preparing a parallel budget support operation which is based on the policy reform matrix supported by the DPO2 and which is scheduled to be delivered in September 2017.

8. **While the Programmatic Private Sector Competitiveness DPOs will be concluded with this second operation, the reform agenda remains highly relevant, and different development partners are supporting the next steps in implementation.** The DPO was initially planned as a series of three operations. The truncation of the programmatic series with DPO2 will enable a better alignment of future areas of cooperation between the Bank and the government with the priorities that are being identified in the SCD and the new Country Partnership Framework (CPF). At the same time, the next stage of the reforms supported by the DPO series are part of the government's Four-Point Reform Plan and several development partners are channeling budget support and technical assistance to make sure the reforms generate the expected results. In addition, the envisioned reforms in the financial sector and pensions will be supported by the International Monetary Fund (IMF) through a three-year extended arrangement under the Extended Fund Facility (EFF), which was approved on April 12, 2017.

9. **The overall risk of the operation is moderate.** The main risks arise from external vulnerabilities linked to the large current account deficit, high level of dollarization and high external debt. A stable macroeconomic environment is a necessary condition for the private sector to grow and for the government to effectively continue the supported reforms. The program of structural reforms supported by this operation will mitigate several vulnerabilities over the medium-long term. A strong focus on export-led growth is critical to reduce current account constraints, while financial sector and pension reforms will incentivize long-term savings in local currency, mobilize domestic capital, and strengthen the social safety net in a fiscally sustainable manner. The World Bank Group (WBG) and donor community are providing technical support that is helping to mitigate the technical design and institutional capacity risks for the reforms in the areas of trade and competitiveness, finance and markets, social protection, and ICT. The WBG team is in close dialogue with the government, the committees of Parliament, relevant stakeholders, the EU delegation, and the IMF.

2. MACROECONOMIC POLICY FRAMEWORK

2.1 RECENT ECONOMIC DEVELOPMENTS

10. **Economic growth moderated from 2.9 percent in 2015 to 2.7 percent in 2016, because of the weak external environment and uncertainty.** The geo-political risk emanating from the regional disturbances and the economic slowdown in Georgia's main trading partners, many of which are significantly dependent on Russia and also on hydrocarbons, have had a significant impact on Georgia. The two main direct channels of transmission of the external shock have been lower exports and remittances. The decline in exports has since bottomed out with an uptick in the last quarter of 2016 and remittances increased by 4 percent last year. Credit growth during 2016 was 17 percent (20 percent for the private sector), year-on-year. In addition, FDI and tourism have remained resilient.

11. **The current account deficit widened to 13.3 percent of GDP in 2016, primarily driven by the trade balance.** Export performance remained weak during 2016. The recession in Russia has impacted most of the Commonwealth of Independent States (CIS) countries which are major trading partners of Georgia. Georgia's main export destinations—Russia, Turkey, China, Azerbaijan, Armenia and the EU—have witnessed slow growth or a contraction in output. Export of services, primarily driven by tourism receipts, grew by 7 percent during 2016 and most of the tourist arrivals were from Turkey, Armenia and Azerbaijan. Imports (excluding Georgia's significant purchases of Hepatitis C vaccine), increased only marginally in 2016. The current account deficit was primarily financed by FDI.

12. **The National Bank of Georgia's (NBG) commitment to the floating exchange rate helped to weather the external shocks**. As a result, the Lari depreciated by 28.5 percent in nominal terms during 2015, year-on-year, and another 4.3 percent in 2016, helping the economy adjust to the shock. To avoid volatility, the NBG intervened in the foreign exchange market a few times over the past two years, with net sales of US$289 million. Despite the interventions, reserves climbed up to US$2.8 billion in 2016 (covering about 3 months of imports), compared with US$2.5 billion in 2015. A part of the increase in reserves is attributable to the higher reserve requirements for dollar deposits, a requirement that was introduced by the NBG to Banks in June 2016. Overall, the real effective exchange rate appreciated by 3.4 percent during 2016 compared with 2015 (given the relatively higher currency depreciation vis-à-vis the US Dollar observed in some of Georgia's key trading partners), which adversely impacted export competitiveness.

13. **The depreciation of the Lari, a significant increase in excise taxes and a recovery of external demand raised inflation expectations, prompting the NBG to increase the policy rate from 6.5 percent in December 2016 to 7 percent in May 2017**. Inflation inched up to 6.1 percent in April 2017, year-on-year, because of the increase in the price of tobacco and fuel (as a result of higher excise taxes) as well as higher external demand. In addition, the strengthening of the US Dollar led to a further depreciation of the Lari in the first quarter of 2017, raising inflation expectations. As a result, the NBG raised its policy rate in January and May 2017. Monetary policy is geared towards maintaining price stability within an inflation targeting framework. The NBG's inflation target is 4 percent in 2017 and 3 percent for the medium-term.

14. **Higher-than-budgeted spending led to an increase in the fiscal deficit to 3.8 percent of GDP in 2015 and further to 4.1 percent in 2016.** For both years, the government had budgeted a deficit of 3 percent of GDP. In 2015, the increase in spending was partly driven by higher net lending to state owned enterprises. In 2016, overruns were broader-based, with current expenditures exceeding the budgeted amount by 3.4 percent and capital spending higher by 6.5 percent. Most of the increase was clocked by wages and salaries, goods and services and social spending. With the introduction of universal health care (UHC) in 2013, health spending has increased from 1.6 percent of GDP in 2013 to 2.9 percent in 2016. Increase in social assistance and pensions, payments under the high mountainous regions law and higher teacher salaries also contributed to the higher spending. Despite lower growth, tax collections kept up with

budgeted numbers. With revenues in line with budget estimates and higher spending, the fiscal deficit widened.

15. **The financial sector remains stable despite the large depreciation and the high rate of dollarization. Loan dollarization stood at 65 percent and deposit dollarization at 70 percent at the end of 2016.** Despite the high loan dollarization (including to unhedged borrowers with incomes in Lari), financial sector indicators remain stable. At the end of 2016, the capital adequacy ratio stood at 15 percent (a decline from 17.5 percent a year earlier) while non-performing loans (NPLs) slightly reduced to 7.3 percent in December 2016 compared with 7.5 percent in end-2015.[1] Overall liquidity was also maintained at about 40 percent in 2016. NBG remains the integrated financial regulator with the mandate for financial stability, banking supervision, regulation of non-banks and capital markets. Strict banking supervision, prudent lending and loan loss provisioning norms, and restructuring of household foreign currency loans have helped banks to mitigate the negative impact of the large exchange rate depreciation. In order to maintain low NPLs and reduce borrowers' risks associated with a weakening Lari, the NBG announced a 10-point de-dollarization plan in end-2016. Moreover, a 3-month special program was implemented to encourage conversion of dollarized loans into local currency at a subsidized rate (with a fiscal cost of GEL 15.7 million). Earlier, in June 2016, the NBG also increased the reserve requirements for foreign exchange deposits from 15 to 20 percent and reduced the requirement for Lari deposits from 10 to 7 percent to help the process of de-dollarization.

2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

16. **Economic growth is projected to average 4 percent a year over the medium-term but downside risks to growth remain.** The pick-up in growth in 2017 will largely be driven by high investment and some recovery in the export markets. With the Russian economy inching towards growth in 2017 and some increase in oil prices, growth in Georgia's trading partners is likely to increase, raising demand for Georgian exports. FDI inflows, which largely originated from Azerbaijan and Turkey in 2016, have remained resilient. The main sectors receiving FDI inflows were transport, financial sector and the power sector. The high investment rate over the medium-term, exceeding 30 percent of GDP a year, will also support growth (Table 1). These investments are primarily in the areas of the British Petroleum financed gas pipeline, hydro power projects and in the banking sector. In the outer years, growth prospects factor in improved economic ties with the EU. The Deep and Comprehensive Free Trade Area (DCFTA) and the Association Agreement (AA) with the EU is likely to improve market access and encourage FDI.[2] In 2016, the government also signed a memorandum of understanding for a free trade agreement with China.[3] The downside risks arise primarily from a protracted period of slowdown among Georgia's trading partners.

17. **The government has indicated its commitment to fiscal sustainability through the revenue enhancing measures announced in the budget of 2017 to counter the impact of the adoption of the changed corporate tax regime.** The new tax regime, which replaces corporate income tax with dividend tax, came into effect in January 2017 and will reduce tax revenues by 1.5 percent of GDP in 2017. To compensate for this loss, the government is taking the following measures: (i) the increase in the excise for tobacco by 60 tetri will raise revenues by 0.6 percent of GDP; (ii) the doubling of excise on petrol, 150 percent increase in excise on gas and 165 percent increase in excise on diesel will raise tax collections by 0.8 percent of GDP, and (iii) the introduction of excise tax on cars will raise collections by 0.1 percent of

---

[1] NPLs calculated as per the NBG methodology according to which a loan is classified as an NPL if it is overdue for 30 days whereas the IMF classifies loans which are overdue for 90 days as NPLs.

[2] A trade sustainability impact analysis commissioned by the EU suggests a potential increase in GDP growth of 4.3 percent in the long-run.

[3] Negotiations have been concluded and the Free Trade Agreement with China was signed in May 2017. In addition, negotiations on a Free Trade Agreement with Hong Kong SAR, China has also been concluded.

GDP.[4] In addition, the government is abolishing the 'golden list' of companies which enjoy a 45 day credit period for payment of VAT on imports. This will bring forward revenues from 2018 to the extent of 0.4 percent of GDP (Table 2). The increase in excise taxes will, however, have negative distributional implications given the regressive nature of the tax. At the same time, curbing the negative environmental externalities from fossil fuels and health problems associated with tobacco consumption may justify the imposition of higher taxation. The increase in excise taxes on fuel will indirectly impact public transportation, which is mostly subsidized by local governments.

18. **The 2017 budget also indicates the government's commitment to restrain recurrent spending and increase capital expenditures.** The key measures to reduce spending include the following: (i) the wage bill will be cut by 5 percent by curtailing bonuses, to reduce spending by 0.4 percent of GDP; (ii) spending on goods and services and social expenditures will increase marginally in nominal terms, which will help reduce spending by 0.4 percent of GDP. These reductions will cut across both the central and the local governments. At the same time, capital expenditures and net lending will increase from 6.5 percent of GDP in 2016 to 8 percent in 2017.

19. **Over the medium-term, the government will need to persist on its fiscal consolidation agenda. The reduction in the fiscal deficit over the medium-term is predicated on a sustained control of current spending combined with higher growth rates.** Social spending is likely to grow at a slower pace than in the past (average of 5 percent a year in nominal terms in 2017-19). The fiscal consolidation plan could come under strain if growth is lower than anticipated or if the expected increase in excise collections do not materialize. With the orientation of spending tilted towards social expenditures and health, the government could also come under pressure to increase such spending. The government has also planned to increase capital spending significantly over the medium-term to boost growth. In addition, public contingent liabilities also pose a risk, especially, those arising from power purchase agreements (PPAs) signed by the government and from quasi-fiscal activities by state-owned enterprises. These contingent liabilities need to be carefully monitored and managed. Mitigating factors include the SOE and public investment management reforms supported by this operation, the government's commitment to fiscal consolidation as evidenced by the 2017 budget, and the requirement of macroeconomic adequacy for programs supported by donors. In addition, the government also has room to adjust its public investment program and make the increase in capital spending more gradual.

[4] Tax rates can only be modified through referendum according to the Liberty Act, with the exception of excises and property tax.

Table 1: Macroeconomic Trends and Projections

	2013	2014	2015	2016e	2017p	2018p	2019p
	Actuals				Projections		
	(Percent change, unless otherwise indicated)						
National Accounts							
GDP nominal (in billions of GEL)	26.8	29.2	31.8	33.7	36.2	38.8	41.7
GDP nominal (in billions of USD)	16.1	16.5	14.0	14.2	13.7	14.9	16.0
Real GDP growth	3.4	4.6	2.9	2.7	3.5	4.0	4.5
Consumer price index (period average)	-0.5	3.1	4.0	2.1	5.7	2.4	3.0
GDP deflator	-0.8	3.8	5.9	3.2	4.0	3.0	3.0
GDP per capita (in '000 U.S. dollars)	3.6	3.7	3.8	3.8	3.7	4.0	4.3
Gross investment (in percent of GDP)	24.8	29.8	32.1	31.8	33.4	34.9	35.6
Gross national saving (in percent of GDP)	19.1	19.2	20.1	19.4	20.5	22.4	24.1
Unemployment rate (in percent)	14.6	12.4	12.0	11.8			
	(In percent of GDP, unless otherwise indicated)						
General Government Operations							
Revenues and grants	27.5	28.0	28.1	28.6	29.3	28.6	28.5
Expenditure and net lending	30.1	31.0	31.9	32.7	33.4	32.4	32.4
Overall fiscal balance	-2.6	-2.9	-3.8	-4.1	-4.1	-3.8	-3.5
Total public debt	34.7	35.6	41.4	44.6	45.5	46.7	47.2
	(In percent of GDP, unless otherwise indicated)						
External Sector							
Current account balance	-5.8	-10.6	-12.0	-12.4	-12.9	-12.5	-11.5
Exports of goods and services	44.7	43.0	44.5	44.1	50.5	49.3	48.9
Imports of goods and services	57.6	61.1	65.3	77.4	82.0	76.4	72.5
FDI (net)	5.1	8.1	9.0	11.0	10.3	10.0	9.9
Gross International Reserves							
(Months imports of goods and services)	3.4	3.5	2.8	2.9	3.2	3.5	3.7
(In millions of dollars)	2,823	2,699	2,521	2,756	2,929	3,271	3,711
External Debt (incl. inter-company loans)	82.3	83.8	107.8	111.8	119.3	118.6	119.9
Lari per US Dollar (period average)	1.66	1.77	2.27	2.37			

Source: Georgian authorities; and Bank and IMF staff estimates and projections as of the beginning of March 2017.

20. **Georgia's public debt increased to 44.6 percent of GDP in 2016 and is likely to be maintained at about 46 percent over the medium-term.** The increase in public debt in 2015 was primarily driven by the depreciation of the Lari against the USD (Figure 3 and Table 4) while the increase in 2016 is attributable to both the larger fiscal deficit and further depreciation. About 80 percent of public debt in 2016 was external and was dominated by long-term multilateral (70 percent) and bilateral (20 percent) debt. Given the concessional nature of public debt, interest payments average at around 1-1.4 percent of GDP a year. Nearly 70 percent of external public debt is at fixed interest rates, thereby reducing interest rate risk. In addition, less than 5 percent of public debt is short-term, thereby, reducing rollover risks. The Ministry of Finance (MOF), with support from international financial institutions including the World Bank, has developed a debt management strategy but has yet to finalize it. According to the IMF's public debt sustainability analysis, Georgia's public debt is likely to be maintained at about 46 percent over the medium-term, given the moderate reduction in the fiscal deficit.

Table 2: Fiscal Indicators

	2013	2014	2015	2016e	2017p	2018p	2019p
	Actuals		Projections				
	(In percent of GDP)						
Overall fiscal balance	-2.6	-2.9	-3.8	-4.1	-4.1	-3.8	-3.5
Primary Balance	-1.7	-2.1	-2.8	-2.9	-2.7	-2.5	-2.1
Revenues and grants	27.5	28.0	28.1	28.6	29.3	28.6	28.5
Taxes	24.8	25.1	25.1	26.0	26.2	25.8	25.9
Non-tax revenues	2.7	1.9	2.0	1.8	2.0	1.8	1.7
Total expenditure and net lending	30.1	31.0	31.9	32.7	33.4	32.4	32.4
Current expenditure	24.3	25.4	24.9	26.2	25.3	24.3	23.5
Wages and salaries	5.3	5.2	5.0	5.2	4.7	4.5	4.3
Goods and services	3.8	3.9	3.8	4.1	4.0	3.8	3.5
Interest payments	0.9	0.9	1.0	1.2	1.4	1.4	1.4
Subsidies and grants	2.1	2.2	2.4	2.3	2.4	2.2	2.1
Social expenses	8.5	9.6	9.6	10.1	9.7	9.5	9.4
Other expenses	3.7	3.6	3.1	3.2	3.2	3.0	2.9
Capital expenditure and net lending	5.9	5.6	7.0	6.5	8.0	8.1	8.9
Government Financing							
External	0.6	1.7	2.1	2.2	2.9	3.2	2.6
Domestic	1.5	0.8	0.6	0.8	0.8	0.3	0.6
Privatization	0.5	0.4	1.1	1.1	0.4	0.4	0.3

Source: Georgian authorities; and Bank and Fund staff estimates and projections as of the beginning of March 2017.

21. **Subdued export demand, persistently high imports, and FDI related imports will keep the current account deficit elevated over the medium-term.** Georgia's exports are expected to recover moderately in the short to medium term because of recoveries, albeit weak, in its key trading partners. In addition, the FDI inflows and larger fiscal deficit (compared with the past) will worsen the trade balance. As a result, the current account deficit is likely to remain high at about 11-12 percent of GDP over the medium-term. In the outer years, external sustainability will be supported, to an extent, by gains from the focus on competitiveness, especially in the context of the DCFTA. The full impact of the improvements on the export front as a result of the DCFTA and other structural reforms will be fully visible only over the medium- to long-term. Given the high level of external liabilities, a more ambitious reduction in the current account deficit (CAD) is desirable but not very likely with the low domestic savings in Georgia. Nearly 80 percent of the CAD will be financed from FDI and the rest from loans (Table 3). Portfolio investments are relatively small in Georgia. Spillover effects from geopolitical uncertainties and potentially longer-term stagnation in the EU (including from strong shocks such as Brexit), could potentially dampen investment inflows to Georgia and increase external vulnerabilities.

Table 3: Balance of Payment Financing Requirements and Sources

	2013	2014	2015	2016e	2017p	2018p	2019p
	Actuals			Projections			
	(In millions of USD)						
Financing requirements	-1,975	-2,862	-2,667	-2,715	-2,768	-2,911	-2,932
Current account deficit	-938	-1,769	-1,681	-1,764	-1,775	-1,849	-1,836
Debt amortization	-1,037	-1,106	-987	-951	-993	-1,062	-1096
Financing sources	2,017	2,941	2,755	2,711	2,768	2,911	2,932
FDI and portfolio investment (net)	792	1,552	1,101	1,253	1,328	1,413	1,502
Capital grants	134	110	63	62	61	60	59
Debt disbursements	1,386	1,303	1,477	1,659	1,614	1,726	1,760
Change in reserves	45	33	99	-245	-304	-315	-423
IMF credit (net)	-382	-136	-73	-14	69	27	34
Errors and Omissions	-42	-79	-88	4	0	0	0

Source: Georgian authorities; and Bank and Fund staff estimates and projections as of the beginning of March 2017.

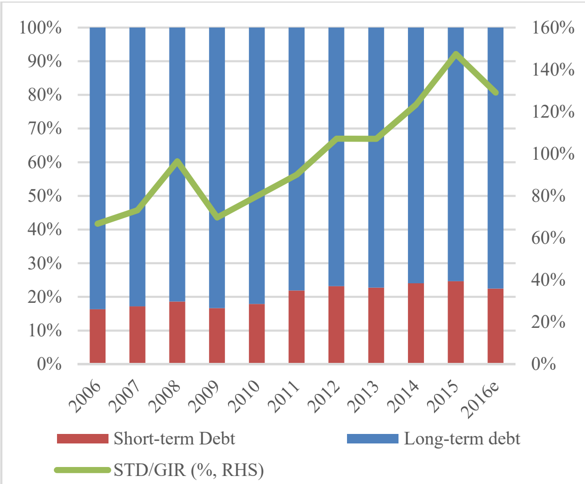
22. **External debt is an important source of vulnerability. The high reliance on foreign savings to fuel growth and the depreciation of the Lari resulted in an increase in external debt to 111.8 percent of GDP in 2016.** 76 percent of external debt is long-term and nearly two-thirds of external debt is held by the private sector (Figures 1 and 2). Inter-company external loans account for nearly 20 percent of GDP, and generally carry lower repayment risks. In addition, 6 percent of the external debt is denominated in local currency. The main holders of Georgia's private external debt include financial institutions (Bank of Georgia and TBC Bank) and non-financial corporations like the Georgian Oil and Gas Corporation (Eurobond of US$200 million), the Georgian Railways (Eurobond of 670 million), and Marabda-Kartsakhi Railway (US$560 million highly concessional loan from Azerbaijan). Banking supervision norms require banks to keep their positions closed. However, the banks' borrowers face currency mismatches in their revenue streams. The short-term debt mostly consists of trade credits owned by non-financial corporations, deposits of non-residents in the banking sector of Georgia, and short-term intercompany loans by foreign direct investors. For non-resident deposits, banking supervision norms require that if such deposits exceed 10 percent of total deposits of the bank, then the liquidity requirements are much higher. However, reserves cover only about three months of imports, while short-term debt (remaining maturity) amounted to about 130 percent of reserves in 2016. According to the IMF's external debt sustainability analysis, Georgia is most vulnerable to a 30 percent real depreciation shock which would increase external debt by 33 percentage points of GDP in the medium-term (Figure 4 and Table 4).

Table 4: Debt Sustainability Analysis

	2013	2014	2015	2016e	2017p	2018p	2019p
	Actuals			Projections			
	(In percent of GDP)						
Total public sector debt	34.7	35.6	41.4	44.9	45.5	46.7	47.2
External public sector debt	27.2	26.8	32.5	33.7	38.6	39.5	39.8
Domestic public sector debt	7.5	8.8	8.9	11.2	6.9	7.2	7.4
Gross external debt (including inter-company loans)	82.3	83.8	107.8	111.8	119.3	118.6	119.9
Gross external debt (excluding inter-company loans)	65.9	65.2	86.3	87.8	91.7	90.4	91.1

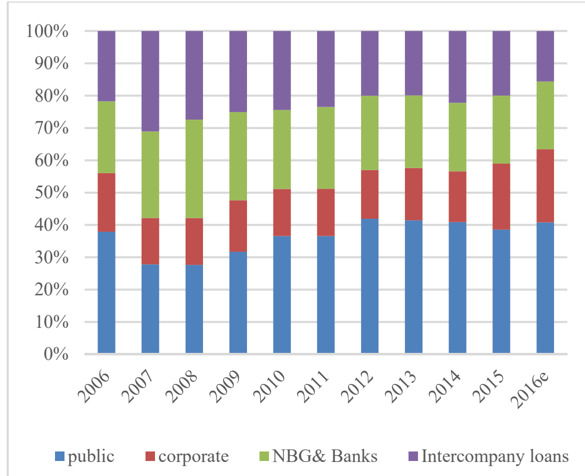
Source: Georgian authorities; and Fund staff estimates and projections as of the beginning of March 2017.

Figure 1: Maturity of External Debt



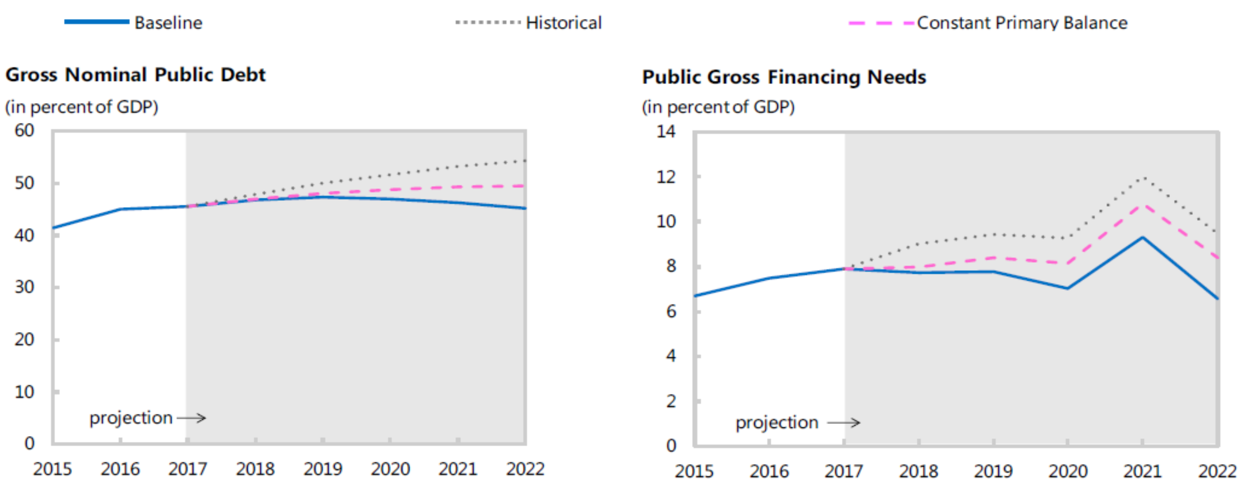
Source: NBG, World Bank staff calculation.

Figure 2: Composition of External Debt



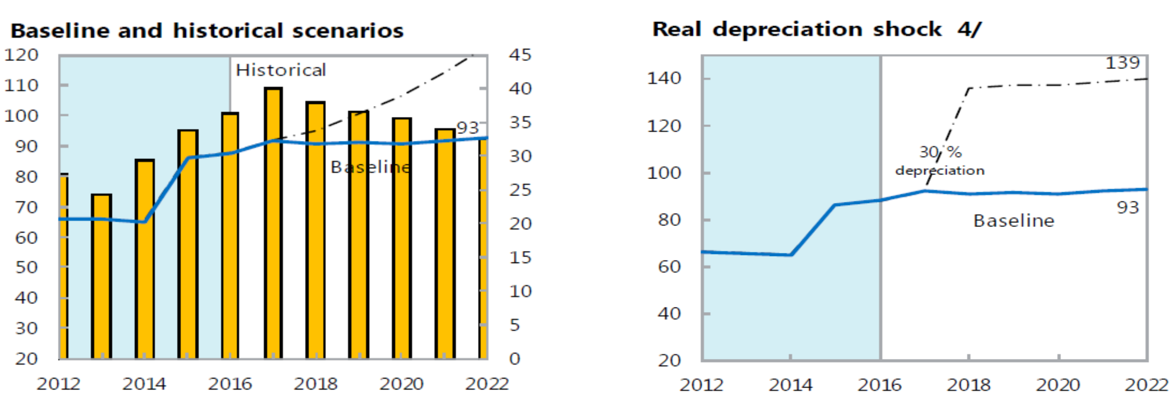
Source: NBG, World Bank staff calculation.

Figure 3: Public Debt and Financing Needs



Source: IMF Debt Sustainability Analysis.

Figure 4: External Debt Sustainability Analysis



Source: IMF debt sustainability analysis.
Note: External debt is net of inter-company loans.

23. **Georgia's overall macroeconomic policy framework is adequate for this operation.** The main concern is the possibility of increasing fiscal pressures which could challenge the consolidation agenda and impact both fiscal and external sustainability. There are also downside risks to growth arising from a protracted period of slowdown among Georgia's trading partners. Also, lower growth would add strain on the fiscal consolidation plan. The government has, however, reiterated its commitment to sound macroeconomic management with the announcement of the 2017 budget which seeks to reduce current spending and raise taxes. Effective macro management is also evident in the NBG's commitment to a floating exchange rate regime, limited interventions in the foreign exchange market, and adjustment of policy rates in response to inflation expectations. Over the medium-to long-term, structural reforms supported by this operation will encourage savings, enhance transparency of financial reporting and auditing, promote innovations and ICT sector development. These reforms, coupled with the DCFTA and the free trade agreement with China, structural reforms and continued macroeconomic stability will strengthen growth prospects and also reduce external vulnerabilities.

2.3 IMF RELATIONS

24. **The IMF Executive Board approved the SDR 210.4 million Extended Arrangement under the EFF on April 12, 2017.** The new EFF supports the government's economic program to achieve strong and more inclusive growth, preserve fiscal sustainability, reduce macroeconomic vulnerabilities, strengthen monetary and fiscal institutions, and improve financial and social safety nets. The earlier three-year Stand-By Arrangement (SBA) which was approved in July 2014 was derailed as a result of various policy decisions taken by the government in response to the external shock of 2014 and in the run up to the 2016 parliamentary elections. The proposed DPO complements the Fund program by supporting structural reforms in the areas of financial sector and improvements in business environment. The WBG closely coordinates with the Fund on macroeconomic developments, debt sustainability analysis (DSA), fiscal consolidation, public financial management, and implementation of structural reforms.

3. THE GOVERNMENT'S PROGRAM

25. **Since the announcement of the Four-Point Reform Plan to boost Georgia's development in 2016, the government has started implementing a number of important reforms to support private sector growth and the overall investment environment.** The four areas covered by the Program include private sector development, increased infrastructure investment, building of human capital, and raising the effectiveness of public administration. The implementation of this Reform Plan will ensure that key commitments under the Association Agreement with the EU are fulfilled within the agreed timetable. The details are presented below:

i. Economic reforms to promote private sector development and create more jobs. The reforms already implemented in 2016 relate to the elimination of the corporate income tax and the scale-up of the programs in support of entrepreneurship and innovation including the launch of *Startup Georgia*. The pension reform supported by this DPO is the other flagship initiative that the government will be introducing.

ii. Infrastructure development geared towards bringing more economic opportunities to underdeveloped regions, increasing regional connectivity and utilizing Georgia's potential as a transit country. It will also support tourism development, as this sector has the potential to create jobs in urban and rural areas that pull up the broader economy. In addition to largescale transport infrastructure projects, the plan intends to roll out high-speed internet throughout the country, an initiative that is directly supported by this operation.

iii. To build human capital, reforms in the education sector will focus on developing skills to bridge the gap between skills demand and supply, including through reforms to the vocational education to bring the Georgian system closer to the German dual model. While this is a long-term policy agenda, the government recognizes that it requires urgent attention, or the provision of market-relevant skills will become a bottleneck for growth.

iv. Governance reforms will be focused on improving public service delivery and involvement of the public in decision making process. Several of the planned improvements in the consultation procedures for major reforms have been supported by the DPO series. The government is now preparing to implement the *Business House*, an ambitious initiative to streamline the services the government provides to legal entities and make them available under one roof and on a single online portal. This project will apply the lessons and successful experiences of the Public Service Hall to improve the business environment for companies and especially SMEs.

26. **The Four-Point Reform Plan is consistent with the Socioeconomic Development Strategy of Georgia (Georgia 2020), which aims to achieve faster, inclusive, and sustainable growth.** Georgia 2020 sets out Georgia's medium-term strategy for economic development. The strategy acknowledges that the private sector will be the main engine of economic growth, supported by a government that promotes inclusion through better delivery of public services and more effective ways to address market failures. Georgia 2020 is based on three pillars: strengthening competitiveness of the private sector; developing human capital; and deepening access to finance. The strategy also underlines the principle of promoting a rational use of natural resources, ensuring environmental safety and sustainability.

27. **In parallel, the government is designing and introducing important financial sector reforms to promote access to finance and further improve the resilience of the financial system.** The financial sector reforms initiated by the government with support from the IMF, the World Bank, and other development partners, include new laws and regulations to protect the deposits of households up to a certain level, improve the financial health of the insurance industry, introduce motor third-party liability insurance, improve the quality of financial statements and audits across the enterprise sector, and kick-start the development of capital markets (complementing the pension reform, which will create a pool of domestic capital with a long-term investment horizon). At the same time, NBG is undertaking additional measures to address vulnerabilities in the banking sector such as strengthening the capital buffers of banks, streamlining liquidity support mechanisms and enhancing the bank resolution framework.

28. **The structural reforms and infrastructure investments underway could make a major difference for the long-term competitiveness of the economy.** The reforms will sustain Georgia's position as a reform leader on a number of fronts, and lead to gradual approximation of the legal framework and regulatory approaches with the EU. The new policy directions, combined with the affirmation of policies related to visa liberalization and economic openness, give a strong signal to the domestic and international investment community that Georgia will continue to be a business-friendly destination and is prioritizing having closer trade and integration with key partners. While legal reforms are critical, and often difficult to design and implement, it is equally important to nurture the capacity of domestic institutions that have to deliver services to companies. The policy actions supported by this DPO in the areas of entrepreneurship, innovation, ICT, quality infrastructure, will create new institutions and strengthen existing ones so that they can improve their effectiveness and their impact on productivity and jobs.

4. THE PROPOSED OPERATION

4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

29. **The program development objective is to increase private sector competitiveness through second generation business environment reforms, establishing enabling conditions financial sector deepening and diversification, and increasing firms' capacity to innovate and to export.** This DPO

will support the reforms addressed in the Georgia 2020 in two pillars: private sector competitiveness, and access to finance. Building on the reforms supported by the First Private Sector Competitiveness DPO (DPO1), this operation advances the competitiveness reform agenda and intensifies its impact on poverty reduction and shared prosperity. This is part of a larger package of reforms supported by the WBG, which also includes the Inclusive Growth DPO2 approved in April 2016 that is focused on strengthening fiscal oversight of public institutions and improving the coverage and quality of health and education services.

30. **Pillar 1 of the DPO series supports second generation business environment reforms as a way to stimulate private sector-led growth.** Georgia has introduced extensive business environment reforms over the past decade, achieving a remarkable turnaround in its investment climate. These measures resulted in increased FDI flows and GDP growth. Both in merchandise and in services, Georgia has been gaining global market shares. Reforms supported will make the business environment more predictable to increase investor trust, and more inclusive, both in terms of the consultations around major economic reforms, as well as deploying new tools to increase productivity growth and export potential of SMEs. Pillar 1 will support measures in the following key areas: enhancing PPD to generate consensus for reforms; eliminating market barriers for entrepreneurship and SME growth; and strengthening the public procurement system.

31. **Pillar 2 supports to establish enabling conditions for financial sector deepening and diversification.** Georgia needs to further deepen and diversify its financial sector to mobilize additional investments, and promote financial access, especially for SMEs.[5] Pillar 2 supports the introduction of a deposit insurance system geared towards small depositors; enhancing financial reporting and disclosure framework; reforms aimed at increasing the soundness and growth of insurance market, which are crucial for development of new insurance services (including life, vehicle and medical insurance) and longer term savings products. A comprehensive pension reform that incentivizes savings in pension funds will complement the existing social safety net and underpin growth of the domestic capital market.

32. **Pillar 3 supports measures that will help domestic companies to be better equipped to innovate and export.** The low productivity of many domestic companies inhibits job creation and limits their integration into global value chains that could open new growth opportunities. To tackle this, the reforms supported by Pillar 3 include: changes in the legal and regulatory framework for the telecommunications sector to enable faster roll out of high-speed broadband internet services in Georgia and improve competition in the upstream wholesale broadband market; the establishment of a more effective innovation support system; fiscal measures to encourage car users to adopt more fuel efficient vehicles; and improvements in the national quality infrastructure that bring about international recognition and facilitate access to EU markets by Georgian firms. Together, these policies can accelerate the country's transition to a knowledge-based economy which takes advantage of the tradition of scientific excellence and can generate a wider range of employment opportunities.

4.2 PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

33. **As a result of the truncation of the DPO series, the second and third operations have been combined. Table 5 indicates the original DPO2 policy triggers, the revised prior actions, the rationale for each change, and the respective adjustments in the results indicators and targets.** This has involved changes in the prior actions as the authorities made faster than expected progress in the completion of some DPO2 and DPO3 triggers, and these were upgraded to reflect the most recent developments, at the same time some triggers that were included in DPO3 have not yet been completed. The coherence of the overall

[5] These reforms will also promote access to finance, which will contribute to faster growth and shared prosperity, particularly by increasing the horizon and performance of investments and allowing households and firms to address life-cycle challenges, as discussed in the 2015 *Global Financial Development Report*.

package has been maintained, and in the majority of cases, the prior actions represent upgrades relative to the respective triggers endorsed in 2015.

Table 5: Changes to the Policy and Results Matrix for DPO2[6]

Original Prior Action No.	Original DPO2 actions	Revised	Reason
	DPO2		
Prior Action #1	The Borrower established the Investors Council.	The Borrower has established and operationalized the Investors Council by conducting regular meetings chaired by the Prime Minister.	The operationalization of the Investors Council was expedited and four meetings have been chaired by the Prime Minister since the Secretariat was created to obtain feedback from private sector and development partners on major economic reforms in 2015-2017.
Prior Action #2	The Borrower has introduced the practice of making major draft economic laws that are approved by the Government available for public review and comments.	N/A	The action was completed on January 18, 2016 through a government resolution that introduced the practice of having certain period for comments before many draft laws are submitted to Parliament. This was completed over one year ago, and based on WBG policies, the action is excluded from the policy matrix.
Prior Action #3	The Borrower adopted a Small and Medium Sized Enterprise (SME) Development Strategy and action plan.	The Borrower, through EDA, has implemented the SME Development Strategy by delivering access to finance programs, and micro and small business support programs.	More progress was made than originally envisaged given the change in the Board date for the DPO2.
Prior Action #4	The Borrower, through SPA, has amended the bylaws regulating procurement practices to mitigate possible bid rigging and unlawful practices in public tenders.	The Borrower, through its Parliament, has adopted amendments to the Law on Public Procurement to bring about conformity with the basic standards regulating the award of contracts as defined by Article 144 of the Association Agreement with EU.	More progress was made than originally anticipated given the change in the Board date for the DPO2. The original DPO2 action was replaced with the trigger for DPO3.

[6] The wording of the Program Development Objective (PDO) was modified to clarify that the supported financial sector and pension reforms are putting in place the "enabling conditions" for financial sector deepening and diversification. These revisions are explained by the truncation of the DPO series, as the timeline for reform to deliver outcomes is shorter than envisioned, and the actual impact of DPO supported reforms on financial deepening and diversification will be felt beyond the life of the series, after 2018.

Prior Action #5	The Borrower (i) approved the DIS reform strategy with a time-bound action plan; and (ii) submitted the draft Law on DIS to Parliament for approval	The Borrower, through its Parliament, has adopted the Law on Deposit Insurance System.	More progress was made than originally envisaged given the change in the Board date for the DPO2.
Prior Action #6	The Borrower: (i) approved the strategy and roadmap for comprehensive pension reform; and (ii) through the Pension Reform Working Group, submitted the respective draft pension reform legislation to the Economic Council.	The Borrower, through its Cabinet, has approved the draft Law on Private Pensions to initiate a public consultation.	The Economic Council was dissolved after the 2016 change in government. Endorsement by the government would have been the next step in the approval process and has now been completed. Opening the draft Law for public consultation (ahead of preparing a final draft, including stakeholder input, for submission to parliament) is an additional step, responding to stakeholder requests for more consultation on legislative reforms.
Prior Action #7	The Borrower designated the government authority that will be responsible for coordinating accounting and auditing reforms.	The Borrower has: (i) through its Parliament, adopted the Law on Accounting, Reporting and Auditing (A&A); (ii) through its Ministry of Finance, established the Service for Accounting, Reporting and Auditing Supervision (SARAS).	The Accounting and Auditing law that was approved in 2016 was more comprehensive than envisaged, addressing many of the A&A ROSC recommendations, and its implementation is already underway.
Prior Action #8	The Borrower has approved a capital markets reform strategy with a time-bound action plan.	N/A	The government completed the action in May 2016. This was over one year ago, and based on WBG policies, the action is excluded from the policy matrix. Follow-up legislative actions are underway but require more time to be completed.
Prior Action #9	The Borrower: (i) submitted to Parliament draft legislation to approximate Georgia's legal framework with EU Solvency I margins and to strengthen the regulatory powers, funding, and capacity of the insurance regulator; and (ii) through the insurance regulator, adopted relevant by-laws.	The Borrower has: (i) through its Parliament, adopted amendments to the Law on Insurance; and (ii) through the ISSSG, adopted relevant by-laws to make Solvency I requirements fully binding by 2018.	The timeline for legislation was expedited and hence more progress was made than originally envisaged.
Prior Action #10	The Borrower, through GNCC, has permits the provision of high-speed	The Borrower, through GNCC, has: (i) issued new licenses for wireless	More progress was made than originally anticipated given

	wireless broadband services by: (i) completing the modification of frequency licenses under technology neutral terms to; and (ii) issuing new licenses for wireless broadband services in the 800 MHz band.	broadband services in the 800 MHz band; and (ii) initiated a public consultation on draft secondary legislation on electronic communications market analysis aligned with EU practices.	the change in the Board date for the DPO2.
Prior Action #11	The Borrower submitted to Parliament for approval the draft Law on Innovation to strengthen commercialization of innovation.	The Borrower, through its Parliament, has adopted the new Law on Innovations.	The timeline for this law was expedited and hence more progress was made than originally envisaged.
NA	NA	The Borrower, through its Parliament, has adopted amendments to its Tax Code to increase the excise taxes on imported cars, with larger increases for cars with conventional engines older than 7 years, and reduce the excise taxes on hybrid cars newer than 7 years, while maintaining the tax exemption on electric cars.	The action that helps reduce climate change vulnerability was introduced, as this strong policy improves the energy efficiency across all sectors of the economy and strengthens Georgian firms' capability and resilience to climate change shocks.
Prior Action #12	GeoSTM has adopted an Institutional Reform Plan (IRP) that defines the medium term priorities, including development of new services, budget sources and results to be achieved for international recognition of the priority laboratories according to the needs of enterprises.	The Borrower, through GAC, has become a full member of the EA, by signing a Bilateral Agreement with the European cooperation for Accreditation.	The original action was completed on November 20, 2015 through the GeoSTM's Order. The improvements in the national quality infrastructure were acknowledged by the EA, and the action was upgraded to recognize that Georgia has now become a full member of the EA.
	Results		
Pillar 1: Second generation business environment reforms to strengthen public-private dialogue, support entrepreneurship and SMEs, and enhance public procurement			
	Major draft economic laws that are made available for public review: Baseline: 0 (2013) Interim: 4 (Q2 2016); 10 (May 2017) Target: 16	Major economic reforms, including respective draft laws reviewed by the Investor Council: Baseline: 0 Target: Pension reform, CIT reform, Judiciary reform, Insolvency Reform	The result indicator was modified to directly link it to the revised Prior Action #1.
	Number of SMEs benefiting from Entrepreneurship Development Agency (EDA) services:	Number of SMEs and entrepreneurs using EDA services: Baseline: 0 (2013) Interim: 7,032 (2016)	The target number of beneficiaries was revised upwards from 100 to 8,000 SMEs, and a quantitative target was introduced for the

	Baseline: 0 (2013) Target: 100 (Disaggregated by gender of owner)	(35% are women entrepreneurs) Target: 8,000 (of which 37% are women entrepreneurs)	gender of beneficiaries. The target beneficiaries of EDA services was set at 100 because the agency was newly-established and at that time, was only in charge of the industrial component of the Produce in Georgia program. During 2015, EDA launched several other initiatives, the largest one being a micro-grants component which supported micro and small enterprises in various regions of Georgia.
	Number of registered users in the e-Procurement system: Baseline: 19,666 Interim: 33,023 (Q2 2016) Target: 30,000	Number of registered users in the e-Procurement system: Baseline: 19,666 Interim: 33,023 (Q2 2016) Target: 36,400	The target number of users registered in the e-Procurement system was revised upwards from 30,000 to 36,400 users, to take account that a larger number of users registered than originally expected.
Pillar 2: Establishing enabling conditions for financial sector deepening and diversification through deposit insurance system, comprehensive pension reforms, and development of insurance markets.			
	The asset management system for the new contributory pensions was established and the personified accounts were ready to receive contributions.	The Pension Agency was established, an Investment Board has been selected, and the information technology systems were set up to accept contributions	Modified the results indicator for Prior Action #6 to take into account the latest design decisions made on the rollout of the pension reform. These three steps are the main elements for implementation of the Pension law.
	Baseline: Only commercial banks and insurance companies are required to publish audited financial statements.	All Public Interest Entities (estimated at 300) file financial statements based on IFRS from 2018; large and medium companies will start the process in 2018 (IFRS for SMEs in the case of medium companies); The financial statements are published in an e-portal; 10 audit quality reviews conducted by SARAS	New indicators linked to Prior Action #7. These indicators are in line with the new A&A law.
	Baseline: No deposit insurance system (DIS) Target: the Deposit Insurance Agency obtained initial capital and launched its operations.	The Deposit insurance coverage for household deposits in effect from 2018 The Deposit Insurance Agency is operational (Charter approved by government, Director appointed by Board, Banks make initial contributions and monthly premiums	Upgraded the results indicator, taking into account the decision to introduce the coverage for depositors in 2018, several years earlier than had been stipulated in the AA with EU.

	Vehicles with Motor Third Party Liability Insurance (MTPL): Baseline: Foreign (transit) vehicles: N/A Target: Foreign (transit) 25 percent	Dropped	Dropped this results indicator, as the new MTPL insurance requirements will only take effect in 2018.
Pillar 3: Increasing the capacity of firms to innovate and to export by enacting reforms to upgrade the ICT sector and strengthen Georgia's national innovation system and quality infrastructure			
	Number of firms/individuals that obtained innovation finance from the Georgian Innovation and Technology Agency GITA: Baseline: 0 (2013) Target: 50 (Disaggregated by gender of owner/individual)	Number of firms/individuals that obtained innovation finance from the Georgian Innovation and Technology Agency GITA: Baseline: 0 (2013) Interim: 167 (23 percent are female entrepreneurs) (Q4 2016) Target: 300 (25 percent are female entrepreneurs) (end 2018)	The target was revised upwards from 50 beneficiaries to 300, and a quantitative target was introduced for the gender of beneficiaries. This takes into account that GITA has launched more innovation finance programs than originally envisioned. As of end 2016, 167 beneficiaries (out of which 23 percent were women) received innovation finance from GITA, including 17 under mini grants program, 20 under start-up venture financing program and 130 under micro grants program. GITA's innovation finance programs will be further scaled up with the support of the World Bank lending operation.
	Number of certificates issued by GeoSTM: Baseline: 842 (2014) Interim: 1,692 (Q4 2016) Target: 10 percent increase Number of certificates issued by calibration/verification entities that received traceability from GeoSTM: Baseline: 1,800 Interim: 6,677 (Q4 2016) Target: 20 percent increase	Number of certificates issued by GeoSTM: Baseline: 842 (2014) Interim: 1,692 (Q4 2016) Target: 2,105 Number of certificates issued by calibration/verification entities that received traceability from GeoSTM: Baseline: 1,800 Interim: 6,677 (Q4 2016) Target: 7,200	Targets were increased as the upgrading of laboratories and services by GeoSTM, together with the improved international recognition, increased the demand for certificates issued by GeoSTM and by calibration/ verification entities that received traceability from GeoSTM. The target number of certificates issued by GeoSTM was revised upwards from a 10 percent increase to a 150 percent increase. The target number of certificates issued by calibration/ verification entities that received traceability from GeoSTM was increased from 20 to 400 percent.

34. **DPO3 triggers that are already completed have been recognized as prior actions for this operation. The treatment of these triggers and changes in result indicators are presented in Table 6.** Four DPO3 triggers have been completed at this date and are duly recognized in the Policy matrix. In regards of the DPO3 triggers that are still underway, it is important to note that the IMF Extended Arrangement EFF program has included most of these as structural benchmarks, which will mitigate the implementation risks.

Table 6: Treatment of DPO3 triggers

Erstwhile DPO3 Triggers	**Treatment**
Pillar 1: Second generation business environment reforms to strengthen public-private dialogue, support entrepreneurship and SMEs, and enhance public procurement	
Trigger 1: The Borrower established a system of Regulatory Impact Assessments (RIA) for priority economic legislation.	**Underway.** The introduction of the RIA was actively discussed at the Parliament. The reform is expected to be supported by other donors, including the EU and the United States Agency for International Development (USAID).
Trigger 2: EDA launched programs for start-ups and SMEs to meet the requirements of the Deep and Comprehensive Free Trade Area (DCFTA) with the European Union (EU).	**Achieved.** Included as a part of the prior action for DPO2.
Trigger 3: The Borrower, through SPA: (i) adopted a comprehensive roadmap for harmonization of public procurement rules with relevant EU directives; and (ii) submitted legal amendments to Parliament for approximation to the basic standards regulating the award of contracts as defined by Article 144 of the Association Agreement with the EU.	**Achieved.** (i) Completed in March 2016 (ii) Included as a prior action for DPO2.
Pillar 2: Establishing enabling conditions for financial sector deepening and diversification through deposit insurance system, comprehensive pension reforms, and development of insurance markets.	
Trigger 4: The Borrower established the DIS Agency and approved its governance structure.	**Underway.** It is expected that the DIS Agency will be established in July 2017, DIS Board approved and its director selected in August 2017. The DIS reform is supported through World Bank Technical Assistance (TA).
Trigger 5: The Borrower launched a public communication and awareness campaign on pension reform.	**Underway.** It is expected that a public communication and awareness campaign on pension reform will be launched in summer 2017. The reform is supported through World Bank and other donors' Technical Assistance.
Trigger 6: The Borrower submitted draft pension reform legislation to Parliament, in line with the respective strategy, for approval.	**Underway.** It is expected that draft pension reform legislation will be submitted to Parliament during the Fall 2017 session**.** The reform is supported through World Bank and other donors' Technical Assistance.
Trigger 7: The Borrower submitted to Parliament for approval a draft law to spur the development of capital markets in line with the respective strategy.	**Underway.** The capital markets reform is supported through World Bank and other donors' Technical Assistance projects.

Trigger 8: The Borrower: (i) enacted the EU Solvency I and regulatory requirements for insurance companies in line with the agreed phased-in market capitalization timetable established in the respective by-laws; and (ii) prepared draft legal amendments for the phased introduction of motor-vehicle third party liability insurance (MTPL),), and submitted these to Parliament.	(i) **Achieved. Included as a DPO2 prior action.** (ii) **Underway.** Compulsory border MTPL Insurance Law has been submitted to Parliament, to be followed by the overall MTPL Insurance Law (to be submitted to Parliament during the spring 2018 session), which will integrate the provisions of both border and domestic MTPL insurance and further pave the way for the country's participation in the Motor Green Card System. The reform is supported through World Bank Technical Assistance.
Pillar 3: Increasing firms' capacity to innovate and to export through reforms to upgrade the ICT sector and strengthen Georgia's national innovation system and quality infrastructure	
Trigger 9: The Borrower improved nationwide access to ICT services by: (i) launching a "Broadband for All" program that is competitively-neutral and aligned with EU practices and the AA; and (ii) adopting an infrastructure-sharing framework focused on broadband development.	(i) **Underway.** This reform is in progress. (ii) **Underway.** GNCC prepared and submitted the amendments to the relevant law to the Ministry of Economic and Sustainable Development (MoESD)
Trigger 10: GNCC adopted a revised framework for market analysis and for wholesale tariff regulation aligned with EU practices.	**Modified.** GNCC prepared a draft secondary legislation on electronic communications market analysis aiming to secure efficient competition aligned with EU practices. GNCC launched a public consultation on the proposed draft in May 2017, which is included as a prior action for DPO2.
Trigger 11: GAC addressed the recommendations of the European Accreditation (EA) peer evaluation in order to become internationally recognized.	**Achieved.** Included as a prior action for DPO2. GAC has become internationally recognized by fulfilling all the recommendations made by EA peer evaluation.

Pillar 1: Second generation business environment reforms to strengthen public-private dialogue, support entrepreneurship and SMEs, and enhance public procurement

Enhancing public-private dialogue mechanisms

35. **More participatory processes are being introduced in policymaking.** With the exception of regulated sectors such as energy and telecommunications, there was no clear legal framework to apply public consultations for proposed legal amendments. Establishing a closer dialogue between the private and public sector and communicating the expected results of the reform agenda will build trust in new economic reforms. Such a dialogue is especially important in light of the introduction of the new reforms stemming from the commitments undertaken by the government's Four-Point Reform Plan.

36. **The Bank has supported the government's efforts to make the policymaking process more inclusive and to better assess the impact of policy reforms.** One of the actions taken was to ensure systematic disclosure of draft major economic laws in the Legislative Herald immediately after they are approved by the government, which makes it easier for the public to review and provide comments.[7] The government passed resolution No.37 on January 18, 2016, and this requires public consultation of amendments of the laws and regulations in twenty areas, including Entrepreneurship, Tax Code, Securities Market, Insurance, Regulation Fee, Competition, and so forth. As of May 2017, amendments to 10 laws

[7] The Legislative Herald of Georgia, which was established in 1998, is a legal entity of public law within the Ministry of Justice of Georgia that functions as the official gazette in Georgia. All normative acts are published online after approval by the Parliament or other state institution; however, draft economic laws were not made available for comments.

and regulations were published for public review and comments. Building on this step, the Bank has provided advice to the government on different options to enhance the public consultation process, including enlarging the policy areas covered by the public review process, and systematizing the practice of consulting stakeholders at the policy design stage.

37. **The DPO2 supports the government's efforts to promote effective public-private dialogue as a result of the establishment and operationalization of the Investors Council.** The Council commenced operations in 2015, and is chaired by the Prime Minister and composed of 15 members, including the business ombudsman, government ministers, and representatives from business associations and international financial institutions, including the European Bank for Reconstruction and Development (EBRD), the Asian Development Bank (ADB), and the International Finance Corporation (IFC). The Investors Council facilitates dialogue with the business community at the highest level to improve the business environment and to stimulate domestic and foreign investments.

38. **The agreed policy actions for DPO2 are:**

Prior Action #1: The Borrower has established and operationalized the Investors Council by conducting regular meetings chaired by the Prime Minister.

39. **Results.** More accountable and transparent rulemaking, together with other aspects of good governance, such as policy consistency, are associated with stronger economic growth, higher investment rates, and faster productivity growth. Several meetings of the Investors Council were held and substantive topics (i.e., tax reform, labor code, inclusive policymaking process, deposit insurance, pension reform, corporate income tax reform, judiciary reform, insolvency reform, and so forth) were discussed among the Prime Minister, Ministers of Finance, Economy, and Agriculture, and heads of various business associations and development partners. By the end of the DPO series, the impact of these reforms will result in a visible increase in the use of PPD in the formulation of policy reforms, enhanced design taking into account private sector views, and more trust in policymaking.

Developing an institutional framework for entrepreneurship and SME support

40. **An institutional framework that actively supports entrepreneurship and SMEs will enable young firms and smaller firms to grow faster and increase private sector employment**. The SME sector has already shown remarkable growth with turnover increasing by 300 percent during 2006-2015, from 2.4 billion to 9.7 billion Lari, according to the National Statistics Office of Georgia (GeoStat). During this period, employment by SMEs increased by 60 percent, to reach 270,190 employees. SMEs now account for 94 percent of registered firms and 43 percent of private sector employment (2015, excluding self-employed). The economic upside of enabling SME growth could be substantial, since SMEs account for 20 percent of GDP, whereas in Organization for Economic Co-operation and Development (OECD) countries, SMEs account for 40-50 percent of GDP. The government is putting in place a framework to remove barriers to firm growth, including provision of skills training and technological advice so that SMEs can expand in domestic and international markets.

41. **DPO1 supported the establishment of the Entrepreneurship Development Agency (EDA) under MOESD.** Since its establishment in 2014, through its "Produce in Georgia" program, the agency has supported 177 businesses (75 startups) with an estimated investment value of GEL 391.15 million and total anticipated job commitments of 7,767. Under the export support program, about 500 export-oriented companies used the agency's export advisory services, and more than 250 of them participated in international trade fairs. Additionally, EDA launched a Micro and Small Support Program under "Produce in Georgia" that provides financial assistance and training to enterprises in the regions. Over 8,800 entrepreneurs have gone through the training, and about 4,900 entrepreneurs (out of which 40 percent were

women entrepreneurs) received financial support by June, 2017.

42. **The government created and adopted a medium-term SME development strategy and action plan that strengthens the SME sector in Georgia and increases its competitiveness in domestic and international markets.** The strategy prioritizes five strategies directions: (i) further improvement of the legislative and institutional framework and operational environment for SMEs; (ii) improvement of access to finance; (iii) SME skills-development promotion of entrepreneurial culture; (iv) export promotion and SME internationalization; and (v) facilitation of innovation and research and development (R&D) in SMEs. The OECD provided technical support to identify the priorities and programs to be included in the SME development strategy, and the strategy also includes policies to promote women entrepreneurship. The government adopted the strategy through Resolution No. 100, dated February 26, 2016.

43. **DPO2 also supports implementation of the SME Development Strategy by EDA.** Serving as the first state agency mandated to facilitate private sector development in the country, EDA has led implementation of several reforms envisioned in the SME Development Strategy. Financial support and technical assistance for micro and SMEs have been main tools employed by the agency to support private sector across the country. Beside daily consultations provided by the agency's qualified service center staff, several activities within the frames of the technical assistance included: improved business practices, access to information on export markets, consultation on DCFTA, etc. EDA's capacity is currently being strengthened so that it can take on a bigger role, and consolidate the information about the different programs run by the Agriculture Ministry's Projects Management Agency, the Georgian Partnership Fund and Georgia's Innovation and Technology Agency.

44. **The agreed policy action for DPO2 is:**

Prior Action #2: The Borrower, through EDA, has implemented the SME Development Strategy by delivering access to finance programs, and micro and small business support programs.

45. **Results.** The DPO series is expected to enhance the competitiveness of SMEs in domestic and international markets through improvements in the legislative and institutional framework, and through advisory and support services for SMEs to expand and enhance their operations, become more market oriented, and turn new ideas into profitable businesses. In 2016, EDA has financed more than 4,500 beneficiaries and provided consulting services to more than 8,500 beneficiaries through its access to finance programs, and micro and small business support programs. By the end of the DPO series, a critical mass of firms will receive these services, improving their access to finance and market knowledge. In the medium- to long-term, this should have a significant impact on the productivity and export-orientation of SMEs.

Strengthening public procurement

46. **Increasing the participation of companies, including local SMEs, in Georgia's three billion Lari procurement market is an important factor in developing high-quality, globally competitive products and services.** As a result of continuous upgrading, Georgia's State Procurement Agency (SPA) is already a regional leader in integrating modern procurement practices, including electronic tendering, maintaining an electronic bidding platform, and executing reverse auctions. The e-procurement system commenced operations in October 2010, and SPA data indicate that the system included nearly 36,400 registered users (including about 31,900 suppliers and 4,500 procuring entities) by March 2017. Georgia's e-procurement system is being used under the Bank financed projects for the procurement of civil works with an estimated contract price below US$10 million, as well as for the procurement of goods below an

estimated contract price of US$1 million.[8]

47. **DPO1 supported the establishment of a training center by the SPA which is providing procuring entities with guidance and training in use of the e-procurement system.** As of March 2017, 1,800 representatives of contracting authorities and 55 suppliers had been trained at the center. Specialized training for SMEs improved their knowledge about procurement criteria and capacity requirements, and their ability to develop an effective bidding strategy. This training aims to increase the rate of successful completion of announced tenders by SMEs.

48. **The government improved procurement practices to mitigate possible bid rigging and unlawful practices.** In December 2015, the government amended the bylaws on the "Approval of the Methodology for the Detection of Artificial Splitting of State Procurement" and the "Approval of the Methodology for the Detection of Misconduct and Establishing of a Working Group Studying the Existence of Possible Corruption Risks in the Field of State Procurement and Development of Proper Preventive Suggestions." All these new changes in the regulations are designed to ensure further improvement in monitoring processes and to reduce possible bid rigging risks. As of end 2016, an additional 10,700 SPA tenders were monitored for unlawful practices.

49. **DPO2 supported legal amendments to procurement rules and standards.** SPA in March 2016 adopted a comprehensive roadmap for harmonization of public procurement rules with relevant EU directives. Parliament adopted the amendments to the Law on Public Procurement in April 2017. These amendments are designed to harmonize the public procurement rules to relevant EU directives and bring the standards regulating the award of contracts closer to those stipulated in the EU Association Agreement.

50. **The agreed policy action for DPO2 is:**

Prior action #3: The Borrower, through its Parliament, has adopted amendments to the Law on Public Procurement to bring about conformity with the basic standards regulating the award of contracts as defined by Article 144 of the Association Agreement with EU.

51. **Results.** By the end of the DPO series, the measures to increase capacity of potential suppliers – including but not limited to SMEs – would result in an increase in the number of users of the e-Procurement system and a higher number of tenders that are successfully completed. The SPA will also strengthen its monitoring of tenders and contracts to prevent unlawful practices.

Pillar 2: Establishing enabling conditions for financial sector deepening and diversification through deposit insurance system, comprehensive pension reforms, and development of insurance markets

Strengthening of the financial safety net[9]

52. **The introduction of a Deposit Insurance System (DIS) is a cornerstone of financial stability and a comprehensive financial safety nets which increase public confidence in the banking system and protect small depositors in the case of bank failures.** Following WB-IMF FSAP recommendation of 2014, and given the need to encourage higher savings in economy, the Georgian authorities have committed to establishing a DIS under the Socio-Economic Development Strategy of Georgia "Georgia 2020". The negative experiences of the 1990s, vulnerabilities and shocks in neighboring countries, and the

---

[8] Nozadze, Sandro (2015). "The story behind Georgia's E-procurement Success,"",http://blogs.worldbank.org/governance/story-behind-georgias-e-procurement-success

[9] These reforms will also promote access to finance, which will contribute to faster growth and shared prosperity, particularly by increasing the horizon and performance of investments and allowing households and firms to address life-cycle challenges, as discussed in the 2015 *Global Financial Development Report*.

need to safeguard the interests of the smaller depositors, including beneficiaries of social transfers and pensions through bank accounts, have prompted the authorities to develop legislation on DIS in 2015-2016 and launch it in early 2018, several years earlier than had been stipulated in the AA with EU. Following the international good practices, this will establish a pay-box deposit insurance system and mobilize minimum ex-ante funding to build up target fund size and provide coverage to the maximum number of depositors within the coverage level.

53. **DPO2 supports Parliament approval of the Deposit Insurance Law.** Building on DPO1, which supported the establishment of the DIS high-level working group, DPO2 supports the next steps in the DIS implementation. The WBG provided technical support to the inter-agency working group chaired by the Ministry of Finance, sharing international experiences, assisting with the development of a DIS concept and commenting on the draft DIS law to ensure that DIS design corresponds with key provisions of EU directives and International Association of Deposit Insurance (IADI) principles. The features of DIS reform were actively and widely consulted with the commercial banks and other stakeholders. The government approved the Strategy and Action Plan on Introduction of Deposit Insurance System in Georgia on March 2, 2017 and the Parliament adopted the Law on DIS on May 17, 2017. The action implements one of the key recommendations of the FSAP 2014, and will help Georgia to meet the EU AA commitments on the DIS, as this needs to be aligned with EU directives by 2020.

54. **The DIS law and DIS strategy provide for a creation of a simple, pay-box DIS with obligatory participation for all the licensed banks, with the coverage for depositors coming into effect in 2018.** GEL 5000 coverage envisions to insure all household deposits for a cumulative amount of funds in their accounts per bank (including transaction, savings, current and payment cards accounts). The proposed coverage level exceeds an average deposit per depositor in the Georgian banking sector, covering 97 per cent of individual depositors' accounts and 15 per cent of the value of household deposits. The law provides for the establishment of a DIS Agency in July 2017 as an independent legal entity, with a supervisory board and executive director to be appointed in August 2017, and banks' initial contributions collected by end 2017. Deposit insurance coverage will become effective on January 1, 2018. It is envisioned that the coverage level can be further revised in 2020 in line with the market dynamics and the growth of deposits in the system. DIS is expected to be financed by the ex-ante payments from banks, with additional contingent financing to be made available on a repayable basis from NGB (under the government guarantee) or the government to minimize DIS liquidity shocks and sustain market confidence.

55. **The agreed policy action for DPO2 is:**

Prior Action #4: The Borrower, through its Parliament, has adopted the Law on Deposit Insurance System.

56. **Results.** Starting from 2018, the deposit insurance coverage for household deposits will be in effect, and the deposit Insurance Agency will be operational with its Charter approved, director appointed, and banks making initial contributions and monthly premiums. The introduction of the DIS will protect individual depositors- account holders in all the licensed commercial banks, therefore securing interests and providing both social and financial protection to households who have funds with banks (including from social transfers and pension payments). Deposit insurance also contributes to financial stability by reducing the risk of run on deposits and thus increasing resilience of the banking sector to shocks originating in failures of non-systemic banks. Furthermore, the introduction of explicit deposit insurance with a clear coverage will allow the authorities to define the scope of potential funding needs and limit fiscal exposure.

Comprehensive pension reform

57. **Pension reform is critical for social protection and fiscal stabilization, and will accelerate financial sector development by promoting longer-term savings and financial inclusion.** Georgia's

pension system consists of a basic universal, non-contributory pension system for the elderly (Pillar 0), which is not indexed, and a voluntary contributory pension system (Pillar 3), which lacks incentives to encourage savings. These pensions fulfill a function of alleviating poverty but do not provide significant income replacement. The comprehensive reform supported under the DPO series will strengthen social protection and open up fiscal space for the government to incentivize private savings.

58. **Building on DPO1, the DPO2 supports the next steps in design, consultation and implementation of the pension reform.** A pension reform unit was created within MOESD in 2014, and in December 2014, the government through its Economic Council endorsed the broad parameters of the pension reform. This policy action was supported by DPO1. The government approved and disclosed the pension reform strategy and roadmap in March 2016.

59. **The reform proposal is to introduce a contributory pension savings pillar on top of the universal basic pension, which will be indexed to keep the basic pension above the minimum subsistence level.** Contributions to the saving pillar of 2 percent each by employers and employees will be turned into a defined contribution individual pension savings account. The government would provide an additional matching 2 percent to make a total contribution of 6 percent. Those under 40 will be enrolled into the system on a mandatory basis, while for those above this age, an automatic enrollment basis will apply with an opt-out option. The scheme will be managed by a central, non-profit Pension Agency in order to maximize economies of scale and to keep costs low. A Supervisory Board made up of Ministers will be responsible for the agency, with an independent, professional Investment Board will make investment decisions regarding the scheme's assets. The basic pension will continue to be universal, at the same time, future increases would be indexed using a rule-based approach so the pension stays above the minimum subsistence level. The pension indexation rules are still under discussion, and will need to balance fiscal considerations with social policy objectives.

60. **The draft Law on Private Pensions was discussed and approved by the government on March 2, 2017, marking the formal start of the public consultation process**. MOESD and the Ministry of Finance (MOF) were instructed to begin public discussions of the draft law and then present a revised version to the government of Georgia. The communications strategy for the pension reform was prepared and a public communication and awareness campaign will be launched in the summer of 2017. It is expected that the draft Law on Private Pensions will be submitted to Parliament in the fall of 2017, to be approved by the end of 2017. The reform is actively supported by a number of donors, including WBG, ADB, and United States Agency for International Development Governance for Growth (USAID G4G). AFD is also planning to provide technical assistance.

61. **To support pension reform and foster financial market deepening and access to finance, the authorities have developed a capital markets reform strategy.** A well-functioning capital market will mobilize additional savings and provide a source of liquidity for financial institutions and a source of alternative funding for medium and large enterprises[10]. Capital market reform will also provide more investment opportunities for future pension funds, and therefore the two reforms – capital markets and pension reform – need to proceed in parallel. The capital market development strategy and action plan were adopted by the government on May 11, 2016. The strategy envisions reform of the legal and regulatory framework to bring it in line with the core EU Directives, as envisioned by the AA, by using EU and International Organization of Securities Commissions (IOSCO) principles, strengthening of capital markets infrastructure, enhancement of regulatory capacity and market conduct supervision, and development of products in support of pension reform and private sector growth. Implementation of the strategy is

10 According to the Global Competitiveness Report 2016 - 2017, Georgia received one of the lowest rankings in terms of financing through the local equity market (130th).

underway with the support of international development partners. Preparation of the roadmap for harmonization of the Georgian securities market legislation with the EU directives is ongoing, an Investment Funds Law is being drafted, and a IOSCO self-assessment will begin in mid- 2017.

62. **The agreed policy action for DPO2 is:**

Prior Action #5: The Borrower, through its Cabinet, has approved the draft Law on Private Pensions to initiate a public consultation.

63. **Results.** By the end of the DPO series, the legal framework and institutions will be in place to implement the comprehensive pension reform. Specifically, the Pension Agency will be organized, with a Director and Investment Board already hired, and the individualized accounts set up and ready to receive contributions by the end of 2018. The actual beginning of the contributory system is likely to take place sometime in 2019, with some flexibility required to make sure that all systems are fully functional.

Enhancing the financial reporting systems

64. **Lack of transparency about firms' financial information and ownership hinders the development of capital markets and access to finance more generally.** As noted in the 2015 Accounting & Auditing Report on the Observance of Standards and Codes (ROSC) Update, financial statements of local companies are of uneven quality and too few of them are audited. International experiences demonstrate that transparent and accurate financial information prepared in accordance with the principles of international standards helps investors make investment decisions efficiently. The interested investors and creditors need to have reliable information about the possible economic return of projects and the long-term viability of enterprises, as well as better information about the sources of equity.

65. **Following substantive consultations with the private sector, the government submitted the law on Accounting, Reporting and Auditing to Parliament and this approved the new law in June 2016**. The law will improve audit quality in Georgia and brings its laws on financial reporting and audit closer to European laws. The law addresses major issues, which includes the entry in force of the IFRS and IFRS for SMEs, definition of Public Interest Entities (PIEs), introduction of the Public Oversight Body (POB), establishment of a new audit registry, and certification of auditors. The Service for Accounting, Reporting and Auditing Supervision (SARAS) was established in September 2016. SARAS became the competent authority in charge of the regulation and oversight of statutory auditors and audit firms as well as of enforcement of corporate reporting requirements. SARAS is subordinated to the Ministry of Finance.

66. **SARAS has taken an active role in implementation of the newly adopted A&A law.** SARAS is preparing a company portal which will be used to collect and publish financial and non-financial reports and information of Georgian companies. The portal will be equipped with an entities categorization tool and a reporting profile calculator making it easier for businesses to understand their specific reporting requirements based on their size and category. SARAS will be launching the portal in the next several months. In parallel, SARAS had first started carrying out audit quality control inspections. The institutionalized quality control audit is a novelty for Georgia, initially introduced as an attempt to approximate the respective EU Directive. The formal quality control review process will be fully operational by Sep 1, 2017, as outlined by the A&A Law.

67. **The agreed policy action for DPO2 is:**

Prior action #6: The Borrower has: (i) through its Parliament, adopted the Law on Accounting, Reporting and Auditing; and (ii) through its Ministry of Finance, established the Service for Accounting, Reporting and Auditing Supervision.

68. **Results.** The changes in the financial reporting framework will provide shareholders, financial institutions, and potential investors with more timely and reliable financial information. All Public Interest Entities (estimated at 300) file financial statements based on IFRS from 2017 and large and medium companies (estimated at 300) will start the process in 2018, whereas small companies (estimated at 1,500) will file from 2019. These financial statements will be published in an e-portal. Audit quality control inspection will be also conducted by SARAS starting from September 2017. This will result in an improved investment climate and better informed managerial and credit decisions.

Insurance market development

69. **The insurance sector is small and has been characterized by weak financial performance, reflecting the lack of compulsory classes of insurance and deficiencies in the regulatory framework.** According to 2016 data, the insurance market is represented by 14 companies with total written premiums of GEL 393 million, or 1 percent of GDP. Currently, insurance penetration and density levels are quite low by regional and global standards, and the majority of the population does not have risk mitigation for property and personal risks. Georgia does not comply with the EU requirements regarding insurance classes and products classification. Underdevelopment of insurance products results in limited insurance options for Georgian citizens and almost universal reliance on self-insurance. Insurance products, such as life and property, are not developed, while mandatory insurance classes such as MTPL are nearly absent.

70. **Amendments to the Insurance Law supported by DPO2 were adopted by Parliament on June 8, 2016, and on September 16, 2016, the Insurance State Supervision Service of Georgia (ISSSG) adopted relevant regulations to phase-in the solvency and minimum capital requirements (MCR) envisaged in the law.** The adoption of the amendments will support the development of a better capitalized and more dynamic insurance market. The ISSSG regulations require that by the beginning of 2017, insurance companies should be 50 percent compliant with the solvency and MCR requirements envisaged in the law. By the middle and end of 2017, the compliance requirement is set at 75 percent and 100 percent, respectively.

71. **Going forward, the insurance market will also see the reintroduction of the compulsory motor vehicle third party liability insurance (MTPL).** MTPL insurance was discontinued in 2004 and needs to be reintroduced to urgently address the problem of mounting medical and social costs associated with road traffic injuries, to encourage safer driving, and to facilitate faster growth of the insurance sector. An inter-agency working group comprising of MOESD, MOF, and the Service Agency and Patrol Police Department of the Ministry of Internal Affairs is actively working on the legal and technical design of the MTPL reform in consultation with private sector stakeholders, including insurance companies. The reform is also being supported through a World Bank FIRST technical assistance project. The compulsory border MTPL Insurance law has been already submitted to Parliament and will be followed by the overall MTPL Insurance Law (to be submitted to Parliament in the spring 2018 session), which will integrate the provisions of both border and domestic MTPL Insurance. This will pave the way for Georgia's participation in the Green Card System (or International Motor Vehicle Insurance System).

72. **The policy action for DPO2 is:**

Prior Action #7: The Borrower has: (i) through its Parliament, adopted amendments to the law on Insurance; and (ii) through the ISSSG, adopted relevant by-laws to make Solvency I requirements fully binding by 2018.

73. **Results.** The actions in this area will lead to development of the insurance industry through better capitalization of companies and the introduction of new products and services. Specifically, the insurance regulator will ensure that the solvency margins of all insurance companies are in compliance with the EU

Solvency I requirements by the end of 2017.

Pillar 3: Increasing the capacities of firms to innovate and to export by enacting reforms to upgrade the ICT sector and strengthen Georgia's national innovation system and quality infrastructure

Improving efficiency, competition, and access in telecommunication and Internet services

74. **Limited broadband connectivity at prices that are affordable to the wider population and business community constrains innovation and competitiveness.** Georgia's telecommunications sector has grown, with private investment totaling US$1.2 billion since 1991, coverage over most of the country, and mobile telephony services that are used actively by most of the population. The various markets (mobile telephony, domestic backbone networks, and international connectivity) are moderately competitive, with at least two major and several smaller private firms operating in each market segment.[11] However, there were delays in upgrading mobile networks to 4G speeds and there is limited adoption of Internet services (42 percent of the population, 4Q 2016). Many rural communities can access 3G mobile networks for Internet connectivity, as these cover 80 percent of the country, but the quality of the connections is often poor and cannot support business needs, and they are expensive for the rural population.[12] Only about 5 percent of the poorest 40 percent of rural households subscribe to Internet services, compared with 50 percent of similar households in Tbilisi. Increased broadband coverage in rural and underserved areas is a key enabler for skills development and the competitiveness of tourism and other service industries.

75. **The government's policies to enhance ICT connectivity, and the timely decisions of the Georgian National Communication Commission, have facilitated the roll out of 4G networks from 2015 onwards, boosting investment in the sector.** DPO1 supported legal and regulatory amendments that encouraged upgrading of technologies, greater competition in the ICT sector, and more affordable broadband Internet services. GNCC adopted the modification of frequency licenses under technology-neutral terms in 2015, which lifted the regulatory restriction on the type of technology used with their license. Since then the three private networks companies - MagtiCom, Mobitel, and GeoCell - rolled out high-speed (fourth generation, 4G) wireless broadband networks. There have been significant improvements in technology and quality of service. The amount of private investment in the telecommunication sector doubled between 2014 and 2015, growing from GEL 193 million in 2014 to GEL 413 million in 2015. In close consultation with the market players, GNCC has also prepared relevant modifications to the Law on Electronic Communications enabling infrastructure sharing in Georgia, which would significantly reduce the costs of broadband infrastructure projects in the country.

76. **DPO2 supports the issuance of wireless broadband licenses through competitive auctions and the development of market analysis procedures.** The actions consist of the issuance of multiple licenses for wireless broadband following market mechanisms and improvement of the legal framework for electronic communications market analysis. Usage of low frequency bands for mobile broadband service delivery should improve availability and quality of service in rural areas of Georgia. Following the multi-spectrum auctions, GNCC issued new licenses for wireless broadband services in the 800 MHz band to two operators in January 2015 and June 2016, and spectrum in the 2100 MHz band to one operator in January 2017. An improved market analysis procedure will allow GNCC to be more effective in regulating the market. GNCC prepared and launched public consultations on draft secondary legislation on electronic communications market analysis. WB technical assistance in this area is being supplemented by Lithuania's telecommunications regulator as part of the EU's Technical Assistance and Information Exchange program (TAIEX) and an EBRD-funded technical assistance project.

[11] The market structure could change with two ongoing merger reviews, leading to consolidation among larger firms.
[12] 1 GB is about 15 Lari per month, or 8 percent of the average per capita income of a rural inhabitant.

77. **The agreed policy action for DPO2 is:**

Prior Action #8: The Borrower, through GNCC, has: (i) issued new licenses for wireless broadband services in the 800 MHz band; and (ii) initiated a public consultation on draft secondary legislation on electronic communications market analysis to secure efficient competition aligned with EU practices.

78. **Results.** These actions will promote improved quality of broadband services, especially in rural areas, as a result of investments by mobile and fixed network operators, more intense competition in relevant segments, and improved efficiency of radio spectrum usage. Based on a review of international experiences, the reform was originally expected to result in increased investment of US$50 million in the telecom sector. The $218 million in incremental investments observed up to 2016 have exceeded this estimate. In addition, fiscal revenues in excess of US$100 million are expected over the next 2-3 years from auctioning and renewal of radio frequency spectrum licenses.

Developing a dynamic innovation and technology transfer system

79. **Low levels of technology absorption and research and development (R&D), reductions in state funding for science, and weak commercialization of innovation have been bottlenecks for bringing about upgrades of technology and growth of high-tech industries.** The country ranks 64th in the Global Innovation Index (GII) (2016); and it ranks 105th and 123rd, respectively, on capacity for innovation and private R&D in the Global Competitiveness Index 2016/17. By 2014, Georgian R&D investment had declined to 0.1 percent of GDP. Georgia's researchers are performing at close to international levels in several fields, including in materials science, nanotechnology, biotechnology, and pharmaceuticals—and these could serve as the foundation for future commercialization of innovative products. However, continuing reductions in state funding for science have resulted in a steep decline in the number of scientists per million inhabitants, and it is rare for researchers to commercialize their intellectual property.[13]

80. **DPO1 supported the government's efforts to develop more effective innovation policies through the establishment and operationalization of the Georgian Innovation and Technology Agency (GITA) and the Research and Innovation Council under the Prime Minister.** GITA, established in February 2014, is in charge of innovation policy implementation. It targets (i) supply-side market failures that limit the quantity and quality of research and innovation in Georgia, including failures in early-stage finance and innovation infrastructure; and (ii) demand-side constraints related to the lack of innovative efforts by domestic firms. Technology Parks and Fabrication Labs were established in 2015-16 and several elements of the innovation infrastructure (i.e., incubator and accelerator programs) have been launched. As of December 2016, 17 projects had been supported by GITA through mini grants and 130 through micro grants, 20 projects were financed under the Startup Georgia program, 1,100 IT specialists were trained, and more than 20,000 persons attended GITA's workshops and seminars. Given the relatively small share of women studying science and engineering, GITA is actively raising awareness of its activities and programs among women. 23 percent of the beneficiaries that received innovation finance from GITA were female. The Research and Innovation Council, comprised of key ministers and stakeholders, has taken the lead in coordinating innovation policymaking to ensure coherence in prioritizing policy actions, allocating resources, and assigning clear responsibilities for detailed design of instruments.

81. **DPO2 is supporting the modernization of the legal framework underpinning Georgia's innovation ecosystem.** The new Law on Innovation was approved by Parliament on June 22, 2016._The adoption of the new law facilitates private sector involvement in innovation and sharpens the incentives for researchers to cooperate with enterprises. The law provides a clear framework for the government to

---

[13] Georgia 2020 Innovation Strategy—Comments and Recommendations, June 2014.

advance the development of Georgia's innovative ecosystem by specifying the functions and responsibilities of GITA and of the Research and Innovation Council. The law specifies that GITA can establish infrastructure, such as science parks, business incubators, and innovation labs; provides clear guidelines on funding activities and sources of innovation projects; and establish guidelines on the commercialization of projects funded by GITA.

82. **The agreed policy action for DPO2 is:**

Prior Action #9: The Borrower, through its Parliament, has adopted the Law on Innovations.

83. **Results.** The establishment of a modern institutional framework for technology transfer and innovation, and for scaled-up financial support for commercial innovation, is expected to enhance the innovation capacity of firms and academic institutions in Georgia. The new law encourages private innovation, R&D, and commercialization as well as enables GITA to provide grants to third parties, including the private sector, in line with EU principles. The impact of these reforms should be a visible increase in the number of firms that have adopted innovative products or processes as a result of the services and financing provided by GITA.

Stimulating the adoption of green technologies

84. **Georgia is abundant with water resources, rich habitats and pristine ecosystems that are of regional and global importance, but it is also among the most vulnerable countries to climate change in the ECA region and has lower adaptive capacity.** These findings were highlighted in the 2015 Georgia Country Environmental Analysis (CEA) carried out by the World Bank in the context of the 2014-17 CPS. On a positive note, Georgia has annual climate-related development finance per capita committed to the country was about two times larger than the average in Eastern Europe, Caucasus, and Central Asia.[14]

85. **The government is taking action at different levels to address the climate change challenge, including by joining the Paris Agreement and committing to reduce Greenhouse Gas emissions by 15 percent by 2030.** On the global level, Georgia submitted its Nationally Determined Contribution (NDC) in 2015. After the Paris Agreement entered into force, the Prime Minister issued a resolution on the approval of Georgia joining this Agreement. This resolution was submitted to the depository of the Paris Agreement on May 8, 2017 and has entered into force on June 7, 2017. The strategy in regard to adaptation is to improve the country's preparedness and adaptive capacity by developing climate-resilient practices that reduce the vulnerability of highly exposed communities. On the mitigation side, Georgia plans to unconditionally reduce its GHG emissions by 15 percent below the Business as usual scenario (BAU) for 2030. This is equal to a reduction in emission intensity per unit of GDP of approximately 34 percent from 2013 to 2030. The 15 percent reduction target will be increased up to 25 percent in a conditional manner, subject to a global agreement on technical cooperation, access to low-cost financial resources and technology transfer.

86. **Increasing energy efficiency (EE) is a central plank of the government's strategy to reduce GHG emissions, focusing on sectors like energy, construction, industry and transportation that account for the bulk of emissions**. A National Energy Efficiency Action Plan (NEEAP) is under development. An inter-governmental Permanent Council has also been set up by the Ministry of Energy to implement a project supported by the Danish government (DANIDA), which with the participation of Ministry of Economy and Sustainable Development, Ministry of Finance and other institutions is developing regulations for energy labeling of household electronic equipment, upgrading engineering standards and norms for energy-efficient buildings, and developing technical guidelines for connecting

[14] 2016 study on Financing Climate Action in Georgia under the OECD Green Action Programme, German Federal Ministry for the Environment, Nature Conservation, Building and Nuclear Safety.

small-scale renewable energy generation facilities to the national grid. In the transport area, government has already started a number of initiatives to curb GHG, including fiscal measures to stimulate adoption of more fuel efficient cars, increases in excise taxes for gasoline and diesel, programs to modernize public transport including investing in buses that run on compressed natural gas (CNG) for all major cities and introducing new trains.

87. **DPO2 supports changes in excises taxes to stimulate adoption of newer, more fuel efficient cars, including hybrid and electric vehicles, and faster retirement of older vehicles.** The government had already exempted electric cars from excise taxes and import duties in 2015, and a project is being rolled out to develop a network of charging stations in the capital. As part of the 2017 budget, the government introduced bold measures to encourage the adoption of hybrid technologies (for which the excise tax was reduced by 60 percent for cars that are less than 7 years old), and discourage the purchase of conventional gasoline-fueled cars, especially older models (cars face higher excise taxes overall, which go up for older cars, particularly those above 10 years).

88. **The agreed policy action for DPO2 is:**

Prior Action #10: The Borrower, through its Parliament, has adopted amendments to its Tax Code to increase the excise taxes on imported cars, with larger increases for cars with conventional engines older than 7 years, and reduce the excise taxes on hybrid cars newer than 7 years, while maintaining the tax exemption on electric cars.

89. **Results.** The fiscal measures for cars are expected to raise the share of electric and hybrid cars, saving about 14,000 tons of GHG emissions by 2020, 44,000 tons by 2025, and 59,000 by 2030. Energy savings are calculated by estimating the percentage of the vehicle fleet represented by regular vehicles, hybrid vehicles, and by electric vehicles over time and multiplying by energy consumed per vehicle in the BAU case versus the EE case. Besides the reduction in GHG, the measure will also reduce air pollution and thereby curb respiratory and other health problems.

International recognition of Georgia's national quality infrastructure

90. **Domestic demand for national quality infrastructure (NQI) services is expected to increase because of new market opportunities opening up in the EU that will make it necessary for Georgia's products and services to be of consistent quality.** In 2013, the Georgian National Agency for Standards and Metrology (GeoSTM) serviced about 2,000 firms in the areas of standards and metrology and issued 925 calibration certifications as of end 2015. The Georgian Accreditation Center (GAC) also carried out 52 different types of accreditations, including of testing laboratories, inspection bodies, and verification bodies. However, the foreign investors and export-oriented domestic firms that use NQI services also need access to internationally recognized certificates, which are not available in Georgia, in order to meet criteria from importing countries or supply networks. Having completed the capacity building of the GeoSTM and GAC, the government is seeking full international recognition of its quality management systems.

91. **DPO1 supported the government's actions to obtain international recognition of critical parts of Georgia's national quality infrastructure.** It supported GeoSTM's efforts to achieve a quality management system that meets the ISO/IEC 17025 international standard. It also supported the GAC's submission of an official application to apply for a bilateral agreement with the European co-operation for Accreditation (EA), because recognition will reduce the accreditation costs for local laboratories.

92. **GeoSTM has continued its efforts to strengthen the institutional capacity to deliver better calibration services to firms in Georgia.** They prepared an Institutional Reform Plan (IRP) in November 2015 that defined their medium-term priorities and provided a comprehensive implementation plan

including: direction of reform; comprehensive list of tasks, activities and responsibilities; timeframe; and budget. The reforms will be carried out by establishing confidence in national measurement standards, including the refurbishment of the premises, development of new services in the priority areas, and development of institutional capacity for GeoSTM.

93. **Building on the DPO1 action, DPO2 supports the GAC's international recognition through a bilateral agreement with the EA.** A team from the EU's EA carried out an on-site evaluation in March 2016 which included evaluation of the management system at the GAC. EA peer reviewers had made a number of recommendations which GAC already addressed and responded to the EA. Then, in October 2016, the GAC received the EA's confirmation that GAC had passed the EA peer review assessment. GAC's accreditation services has been internationally recognized through the EA bilateral agreement in April 2017.

94. **The agreed policy actions for DPO2 is:**

Prior Action #11: The Borrower, through GAC, has become a full member of the EA, by signing a Bilateral Agreement with the European cooperation for Accreditation.

95. **Results.** Given the opportunity related to DCFTA and government's support for export promotion through EDA, more companies are aware of the importance of obtaining quality related services, such as testing, certification, and calibration to meet the requirements imposed by trading partners and regulators. As of December 2016, more than 1,600 calibration certificates were issued by GeoSTM, which increased by more than 100 percent compared to that of 2014, and calibrated and accredited entities more than 6,600 certificates were laboratories/entities calibrated or accredited by GeoSTM and GAC. Access to internationally recognized NQI services within Georgia will further support Georgian firms' access to international markets. By the end of the DPO series, the reforms should result in an increased number of firms that receive the internationally recognized NQI services for goods and services.

96. **The policy actions in the DPO series are supported by substantial analytical work.** The progress in completing each of the DPO2 policy actions and their analytical underpinnings are summarized in Table 7.

Table 7: DPO2 Prior Actions and Analytical Underpinnings

Prior actions	Analytical Underpinnings	Progress
	Pillar 1	
Prior Action #1: The Borrower has established and operationalized the Investors Council by conducting regular meetings chaired by the Prime Minister.	The EBRD Transition Report (2013) highlighted that greater transparency and accountability can be an important complement to business environment reforms.	Completed
Prior Action #2: The Borrower, through EDA, has implemented the SME Development Strategy by delivering access to finance programs, and micro and small business support programs.	The Bank, supported by a Competitive Industries and Innovation Policy (CIIP) grant, extended technical assistance to the government for creation of an EDA and possible financial and non-financial instruments it could roll out to support SME development.	Completed.

Prior Action #3: The Borrower, through its Parliament, has adopted amendments to the Law on Public Procurement to bring about conformity with the basic standards regulating the award of contracts as defined by Article 144 of the Association Agreement with the EU.	The Public Expenditure Review (2014) highlighted the lack of suitably qualified procurement experts, both in the public and private sectors. The issues include the absence of standards for the level of detail required for procurement design, quality of technical specification for tenders, and quality of documents submitted by suppliers.	Completed
Pillar 2		
Prior Action #4: The Borrower, through its Parliament, has adopted the Law on Deposit Insurance System.	The FSAP (2014) and the Georgia Continuing Economic Memorandum (CEM) 2013 emphasized the urgency of enhancing financial safety nets by creating a deposit insurance system and deepening and diversifying the financial sector through the implementation of reforms in pensions, capital markets, and insurance The Bank project extended technical assistance to support introduction of Deposit Insurance System as a key element of financial safety net.	Completed.
Prior Action #5: The Borrower, through its Cabinet, has approved the draft Law on Private Pensions to initiate a public consultation.	The Bank project extended technical assistance to support the government restructuring plans of the overall pension system as a key priority for financial markets development.	Completed
Prior Action #6: The Borrower has: (i) through its Parliament, adopted the Law on Accounting, Reporting and Auditing; and (ii) through its Ministry of Finance, established the Service for Accounting, Reporting and Auditing Supervision (SARAS).	The Accounting & Auditing ROSC 2015 Update recommended that Georgia improve the A&A standards because better financial reporting can improve the investment climate, business environment, and access to finance for enterprises.	Completed
Prior Action #7: The Borrower has: (i) through its Parliament, adopted amendments to the law on Insurance; and (ii) through the ISSSG, adopted relevant by-laws to make Solvency I requirements fully binding by 2018.		Completed
Pillar 3		
Prior Action #8: The Borrower, through GNCC, has: (i) issued new licenses for wireless broadband services in the 800 MHz band; and (ii) initiated a public consultation on draft secondary legislation on electronic communications market analysis to secure efficient competition aligned with EU practices.	The Bank's ICT and Innovation strategy project extended technical assistance to the government and GNCC in the ICT sector development strategy and the amendment of the Electronic Communications Law. A technical note on ICT policy and regulation (Aug 2014) was also prepared to identify and address constraints of ICT sector development.	Completed

Prior Action #9: The Borrower, through its Parliament, has adopted the Law on Innovations.	The Georgia CEM (2014) suggested that while newer firms innovate, they also need support to scale up, survive, and increase jobs. Strengthened access to finance, for example, through innovation grants, could boost R&D while facilitating university-enterprise linkages to build a stronger national system of innovation. The Bank project team supported by the CIIP grant extended technical assistance to the government for creation of GITA, and to GITA for introduction of funding programs. Recommendations for the innovation strategy were shared to support Georgia's innovation ecosystem (July 2014).	Completed
Prior Action #10: The Borrower, through its Parliament, has adopted amendments to its Tax Code to increase the excise taxes on imported cars, with larger increases for cars with conventional engines older than 7 years, and reduce the excise taxes on hybrid cars newer than 7 years, while maintaining the tax exemption on electric cars.	The Bank's report on Country Environmental Analysis and Institutional, Economic and Poverty Aspects of Georgia's Road to Environmental Sustainability. The report released in 2015 highlighted that Georgia is among the most vulnerable countries to climate change in the ECA region and has lower adaptive capacity.	Completed
Prior Action #11: The Borrower, through GAC, has become a full member of the EA, by signing a Bilateral Agreement with the European cooperation for Accreditation.	The Georgia CEM (2014) recommended further development of the national quality infrastructure according to DCFTA requirements to enable firms to adhere to international standards and in order to strengthen institutional and technical capacity. The Bank's report on the Upgrading NQI in Georgia (Apr 2011),), and the EU's report on Regulatory Impact Assessment of adoption of EU directives (2012),), facilitated the policy dialogue with authorities.	Completed

4.3 LINK TO CPS AND OTHER BANK OPERATIONS

97. **The proposed DPO series is central to the WBG's engagement in Georgia, as emphasized in the CPS for 2014-17.** The CPS underlines the importance of faster, inclusive and sustainable growth, while seeking a greater focus on social outcomes and poverty reduction, and is fully consistent with the government's reform program in Basic Data and Directions (2015-18). The CPS is built around two strategic pillars: (a) strengthening public service delivery to promote inclusive growth; and (b) enabling private sector-led job creation through improved competitiveness. This DPO series supports the second pillar of the CPS, whereas the first pillar is supported by the Inclusive Growth DPO, for which the Bank's Board approved the second operation in the series on April 28, 2017.

98. **The proposed DPO builds on previous Bank operations and complements existing operations by supporting improvements in key sectors**. The policy dialogue underlying the proposed operation was greatly facilitated by the previous DPO (FY12-13-14), which supported the strengthening of legislation to promote market access to the EU, among other areas. Areas supported by the last DPO series that are further developed in the proposed DPO series include critical actions related to the implementation of the DCFTA and the AA. Innovations, entrepreneurship, and ICT are supported under the Georgia National Innovation

Ecosystem Investment Project. Financial Sector development agenda is supported through the Financial Sector Deepening and Inclusion in Georgia (FIRST) Initiative and through Financial Sector Advisory Center (FinSAC) trust funds. Accounting and auditing reform is implemented with technical assistance from the Strengthening, Auditing, and Reporting in the Countries of the Eastern Partnership (STAREP) trust fund. International Finance Corporation (IFC) investments are largely in the areas of airport infrastructure, hydro power, real estate, banks, agriculture, and micro-finance. In addition, IFC is also providing advisory services on trade facilitation, agribusiness, and investment climate.

99. **The potential for leveraging WBG's know-how and resources through various analytical and advisory services was an important consideration in the design of this DPO program.** The specific activities that fed into the design of the program include:

Pillar 1:(i) TA to improve the investment climate in Georgia in three key areas: tax, trade logistics, and investment policy (Georgia Investment Climate Project, 2013-16); (ii) Assessment of value chains for female entrepreneurs (South Caucasus Gender Programmatic task P160432) (ii) Improving Efficiency and Transparency in Public Procurement (P160448).

Pillar 2: (i) Country Economic Memorandum 2013 "Georgia Rising: Sustaining Rapid Economic Growth" (P127774); (ii) Financial Sector Assessment Program (FSAP) 2014; (iii) Report on the Observance of Standards and Codes on Accounting and Auditing, 2015 (P132977); (iv) Strengthening Auditing and Reporting in the Countries of Eastern Partnership (P146154, P146158); (v) South Caucasus Financial Sector Advisory TA (P148214); (vi) Georgia Financial Advisory TA (P155869); (vii) Georgia Financial Sector Deepening and Inclusion TA (P159890); and (viii) Georgia Deposit Insurance TA (P143745).

Pillar 3: (i) TA to support the preparation of Trade Competitiveness Diagnostics (P144844); (ii) TA to support innovation-led growth of key sectors in Georgia (Competitive Industries and Innovation Program TA, P146270); (iii) TA to support the national ICT strategy (P147316); (iv) Country Economic Memorandum 2014, "Georgia: Seizing the Opportunity to Prosper" (P147344); and (v) Georgia National Innovation Ecosystem IPF (P155241);

4.4 CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

100. **The government undertook broad-based consultations with relevant stakeholders on the prior actions supported by the proposed DPO operation.** Several rounds of consultation were held with the business community and stakeholders, including relevant ministries, donors, academic institutions, and non-governmental organizations (NGO). The Investors Council reviewed several of the reforms supported by the DPO, including the mechanisms for public disclosure of draft legislation, the deposit insurance system and pension reforms. The pension reform was discussed at two of the Investors Council meetings chaired by the Prime Minister, first when the proposed reform was at the concept stage and second once the draft law on Private Pensions was endorsed by the government for the public consultation (June 14, 2017). The strategy and draft law for the DIS was actively consulted with the commercial banks, and the World Bank team participated in two round table discussions to facilitate the process and share international experience. The ROSC 2015 update and subsequent preparation of the new A&A law, was undertaken following intense consultations with various stakeholders including parliament, the National Bank of Georgia as well as business community and auditors. GITA prepared the Law on Innovations in close coordination with the Ministry of Education and Science and held multiple consultations with stakeholders from the innovation ecosystem, such as universities, research institutes, etc. These public consultations allowed the government to receive comments and proposals to be considered for effective policy making.

101. **The WBG collaborated closely with the IMF, AFD, ADB, and other development partners.** WBG also collaborated closely with IMF, with exchanges of views on financial sector reforms, including

the FSAP 2014. AFD is also providing budget support to the government based on the policy reform matrix supported by the current operation and is launching a technical assistance project in support of pension reform. WBG is also closely collaborating with: (i) EBRD on improving the PPD in economic policy making, (ii) ADB and USAID G4G on pension and capital markets reform, and (iii) the Physikalisch-Technische Bundesanstalt (PTB) – the National Metrology Institute of Germany - on NQI services. The EU has provided financing and TA on trade facilitation and private sector development to support the implementation of the DCFTA. In addition, the ADB has provided budget lending to the government of Georgia to facilitate structural reforms that are also supported by the proposed DPO.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1 POVERTY AND SOCIAL IMPACT

102. **The policies supported by the DPO series are expected to improve the living conditions of Georgian households by enhancing the country's growth and job creation potential.** The actions of the DPO are organized around three pillars that will jointly support the creation of a more fertile environment for firms' expansion, especially SMEs. Georgia has been struggling to create more employment, and consequently employment creation has played only a minor role in poverty reduction in the 2010-2014 period (Georgia 2015 Poverty Assessment). In this context, any actions that can boost the potential for creation of employment in the country will ultimately have a positive impact on the living conditions of households in the country. Some specific actions, however, may have a direct impact on the households at the bottom of the distribution, and hence it is critical to analyze them in order to make sure that potential negative effects are identified and that adequate mitigation policies are proposed (See Appendix 4).

103. **The actions supporting the comprehensive pension reform are a welcome move towards strengthening the social protection system and improving its fiscal sustainability and predictability. However, it will be important to monitor whether all workers can benefit from the incentives under consideration as part of the reform.** Analyses of the impact of pensions on households' budgets carried out as part of the 2015 Public Expenditure Review indicate that, overall, the increases in the basic pension are responsible for two thirds of the poverty reduction that can be attributed to redistributive direct social policies (including targeted social assistance (TSA), old-age pensions, disability pensions, internally displaced population (IDP) benefits, and other direct transfers) and can considerably reduce income inequality. In this context, the government is considering what indexation rule to introduce for basic pension increases so that the basic pension is kept above the minimum subsistence level. This rule-based approach to pension increases would have positive distributional impacts by protecting the purchasing power of the pensioners and help preserve the poverty-reduction and inequality-reduction features of the current system. The proposed public informational campaign will play a key role to communicate the benefits of the reform to all quintiles of the population.

104. **The introduction of DIS will benefit the bottom of the distribution by strengthening the financial institutions that distribute the most important direct social transfer (pensions and TSA).** The deposit insurance coverage scale of GEL 5000 is designed to protect the smallest depositors in the banks (estimated at 97 percent by number of accounts). Amounts above the established coverage level will not be covered by the deposit insurance, avoiding a regressive scheme. As the deposit insurance coverage scope includes also current/transaction accounts (to which social transfers, pensions, salaries are paid to), the benefit will extent to a large share of households in the bottom 40 who benefit from these transfers. Thus, although it will not increase directly the welfare of the bottom of the distribution, the deposit insurance system reinforces social safety net and provides additional protection to the vulnerable, in contrast to the current situation when a failure of a bank may ultimately lead to loss of all the funds people may have in banks, including the poor.

105. **The changes introduced in the excise taxes for cars are expected to have very limited distributional impact.** While close to 25 percent of the households in the bottom 40 owns a car (2015 IHS), a very limited number in this group reported car purchases in the last year (less than one percent). This indicates that although some households in the bottom 40 could be affected with the proposed increases in excise taxes to fuel-based cars, especially if they trade used cars with certain vintage, where the increases in excise taxes are heavier, they represent a very small share. The reduction in excise taxes for hybrid cars, on the contrary, may help to increase demand for hybrid cars across the entire distribution, which can potentially have positive environmental effects in the medium term. Current retail prices in developed countries suggest that sales of hybrid cars are most likely concentrated among the upper deciles of the distribution. However, even in this scenario, the bottom 40 is not affected negatively by the proposed change in taxation on hybrid cars.

106. **All the other proposed PA have a neutral impact on the welfare distribution and in two instances could have a positive impact in the mid-term.** The actions included in the Pillar 1 are not expected to affect the welfare distribution in the short term. However, the actions included in the SME development strategy (PA 2) can potentially have a positive impact by increasing employment creation in the mid-term. Prior Actions 6 and 7 in the Pillar 2 will in general contribute to develop an adequate environment for investment but are not expected to affect the welfare distribution in the short term. Actions part of the Pillar 3 will contribute to improve the business development environment, but are not expect to impact the income distribution in the short term. Increased accessibility to internet in rural areas (PA 8) have the potential to boost employment creation in rural areas in the mid-term.

107. **The actions oriented to support entrepreneurship started under DPO1 and continued under DPO2 have the potential to positively affect women's economic activity and income generation that can benefit their households and the country economy.** As noted in the country gender assessment 2016[15], estimates have shown that the country is foregoing about 11 percent of GDP per capita due to gender inequalities in the labor market, and two thirds of that loss derives from a misallocation of entrepreneurial talent between men and women. In Georgia, only 32 percent of firms with five or more employees have a woman top manager, and only 34 percent have female participation in ownership, and an expansion. Efforts to promote savings and financial access will also benefit women. Although there is no sex gap in account holdings in Georgia, account penetration is lower than elsewhere in Eastern Europe and Central Asia, where 47.0 percent of women and 55.7 percent of men hold bank accounts (FINDEX 2016). Greater inclusion in the formal financial system would likely increase asset ownership and trigger greater economic empowerment among women, particularly among the self-employed, who are largely women working in agriculture and related sectors. To this end, the actions supporting entrepreneurship and innovation under this DPO program are expected to lead to increased percentages of female entrepreneurs using entrepreneurship (EDA) services (37% by end 2018) and benefitting from innovation finance (25% by end 2018).

5.2 ENVIRONMENTAL ASPECTS

108. **The policy action to promote the adoption of fuel efficient cars is expected to have a positive impact on the natural environment, whereas the other actions supported by the DPO series are not expected to have direct impacts on the environment.** The changes in the excise taxes for cars are expected to raise the share of electric and hybrid cars, reducing GHG emissions over the medium-long term, and reducing air pollution. The policy measures focus on legal, regulatory, and supervisory reforms to strengthen and further develop the private and financial sector, that do not carry environmental risks. The Pillar 1 actions promote more active stakeholder engagement in the policymaking processes, which creates

[15] "World Bank. 2016. Georgia Country Gender Assessment. World Bank, Washington, DC. © World Bank. https://openknowledge.worldbank.org/handle/10986/26091 License: CC BY 3.0 IGO.

additional opportunities for professionals of relevant fields and civil society to provide comments on environmental considerations.

5.3 PFM, DISBURSEMENT AND AUDITING ASPECTS

109. **The public financial management (PFM) system is adequate to support the operation.** The public financial management risks in Georgia are low. The 2012 Public Expenditure and Financial Accountability (PEFA) assessment showed significant improvements in the country's budgetary and financial management systems compared with the 2008 PEFA. Since then, a basic set of systems for strategic budget planning, budget formulation, and execution was put in place. Government budgets are published on the MOF website. The integrated public financial management system was fully implemented. Significant progress was made in the area of program budgeting with assistance from the EU. All state financial transactions were unified under a single treasury account. The previous DPO series supported the government's efforts at moving to modified cash basis IPSAS and increasing coverage and transparency of the budget with an emphasis on the e-budget. Since 2012, the Treasury has prepared consolidated financial statements in line with modified cash basis international public sector accounting standards (IPSAS) and published them on the Treasury's website. The transition to full IPSAS is expected by 2020. Moreover, under the AA with the EU and the DPO2, Georgia had committed to adapt and align its legislation with the EU norms in different fields including accounting and auditing. As a result, a new law on Accounting, Reporting and Auditing aimed at raising the standard in financial reporting, audit quality and regulation, and business accountability, was passed in June 2016.

110. **The State Procurement Agency continues to improve transparency in public procurement processes by adopting international standards.** The Law on State Procurement was enacted in 2009 and provides a good legal framework for second generation reforms, including introduction of e-procurement. The unified e-procurement system was launched in 2010 and a user manual was developed to ensure effective functioning. All documents needed in the process of public procurement are uploaded into the system electronically which makes them accessible to all interested parties. The current system has reduced the volume of paperwork and has increased transparency. In addition, the state procurement agency recently modified the e-procurement system to meet the procurement needs of multilateral development banks. As a result, the government's e-procurement system is being used for Bank projects using the national competitive bidding process for contracts estimated to cost less than US$10 million for civil works, US$1 million for goods, and US$100,000 for simple goods following shopping procedures.

111. **The August 2014 IMF staff report for a SBA reported that the NBG's foreign exchange management system and system of safeguards were adequate.** The September 2014 safeguard assessment showed that NBG's overall governance framework was broadly appropriate. Since 2009, the majority of the NBG's systems have been upgraded, and many key operations are now largely automated. Controls have been strengthened in key areas relevant to safeguards, in particular, foreign reserves management, government banking, and currency and vault operations. The *de facto* and *de jure* exchange rate arrangement in Georgia is floating. Although the NBG intervenes in the foreign exchange market, it does not make a commitment on the exchange rate target. The March 2013 amendment to the 2010 agreement between the NBG and the Treasury Service of the Ministry of Finance ensures that foreign exchange transactions between the government and the NBG are priced at the market exchange rate of the day when the foreign exchange order is submitted to the NBG.

112. **Borrower and loan amount:** The Borrower for this DPO series will be Georgia. Upon the Loan Agreement becoming effective, which is subject to ratification by Parliament, the proposed IBRD loan of EUR 44.6 million (US$50 million equivalent) will be made to Georgia, represented by MOF.

113. **Disbursement:** The proposed DPO will be disbursed in Euros into the State Treasury's foreign

currency account maintained at the NBG. The disbursed proceeds of this DPO will form part of the country's official foreign reserves. The recipient, the government of Georgia, shall ensure that upon deposit of the loan proceeds into the currency account, an equivalent amount in Georgian Lari (GEL) at the official exchange rate will be deposited within 30 days of disbursement into the Treasury Single Account in the NBG and accounted for in the Recipient's budget management system. The proceeds of the operation deposited into the Treasury Single Account with NBG will be available to finance budget expenditures. The Ministry of Finance will be responsible for administration of the operations for preparing the withdrawal application, and for maintaining the Treasury Foreign Currency Account at the NBG. The Ministry, with the assistance of the NBG, will maintain records of all budget transactions under DPO2 in accordance with sound accounting practices. The proceeds under DPO1 in the amount of US$50 million were fully disbursed in June 2015.

114. **Confirmation and eligible expenditure:** The MOF will provide to the Bank a confirmation that the amount of the operation has been credited to an account that is available to finance budget expenditures (the format of the confirmation letter should be acceptable to the Bank). This confirmation letter is required within 30 days of receipt of the amount. If, after the proceeds are deposited in the NBG account, the proceeds of the operation are used for ineligible purposes as defined in the Loan Agreement, the Bank will require the government of Georgia to promptly, upon notice from the Bank, refund an amount equal to the amount of said payment to the Bank. Amounts refunded to the Bank upon such request shall be cancelled.

115. **Reporting, auditing and closing date:** Given the improvements in Georgia's public financial management system, the IMF's positive assessment of the NBG, and unmodified audit opinions in the NBG's financial statements for 2013, 2014 and 2015 (the 2016 audited financial statements are not available yet), no additional fiduciary arrangements, including audit, will be required for the proposed DPO. There also were no audit requirements under the previous DPO series. The closing date of the proposed loan will be July 31, 2018. The Bank reserves the right to request an audit of the treasury foreign currency account, if necessary.

5.4 MONITORING AND EVALUATION

116. **The MOF and MOESD are the main counterparts for this operation and coordinate implementation with all line ministries and agencies involved in the DPO series.** The line ministries and agencies submit progress reports on the prior actions and result indicators to the MOF and MOESD as and when requested. Given the long history of budget lending operations in Georgia, institutional capacity to conduct proper monitoring and evaluation for the progress of the policy actions has been built up. Though there are variations between line ministries and agencies, in general these institutions have the capacity to provide good and timely data as needed.

117. **Regular reviews will be carried out by the WBG team to monitor progress on the reforms during supervisory missions.** Data for monitoring is generally available through special requests made to the respective ministries and is considered reliable. Macroeconomic data is available through the GeoStat. Georgia subscribed to the IMF's Special Data Dissemination Standards (SDSS) in 2010 and is a compliant country. As a result, timely data is readily available through the NBG, MOESD, MOF, and GeoStat.

118. **Grievance Redress**. Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a DPO may submit complaints to the responsible country authorities, appropriate local or national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit complaints to the WB's independent Inspection Panel, which determines whether harm occurred or could occur as a result of WB non-compliance with its policies and procedures. Complaints may be

submitted at any time after concerns have been brought directly to the WB's attention and Bank management has been given an opportunity to respond.

6. SUMMARY OF RISKS AND MITIGATION MEASURES

119. The main risks to the operation, and mitigating measures, are summarized below in Table 8.

***Macroeconomic risk is rated substantial*. Low growth, limited fiscal consolidation, a large current account deficit, and high external debt are the main risks to the economy.** With subdued growth prospects in the economies of key trading partners, output expansion in Georgia could be negatively affected. Most of the impact on Georgia will be through lower export demand and reduced remittances, which impacts consumption growth. The impact of geo-political shocks on the EU and on global growth also adds to the risk of slower growth. This risk is mitigated, to an extent, by the structural reforms being undertaken by the government to improve competitiveness and the investment climate in the country. Fiscal risks could emanate from pressures to increase social spending or to reverse the ongoing consolidation of expenditures. With accelerated public infrastructure expenditures, the deficit is likely to decrease only gradually over the medium-term. The government's commitment to fiscal consolidation as evidenced by the 2017 budget and 2017-2020 year fiscal plans, committed within the IMF program, ensured that the macroeconomic framework was adequate for the budget support programs supported by different donors. On the external front, the country continues to be vulnerable as a result of its high current account deficit (because of low savings) coupled with low export demand and remittances, high level of dollarization, large external debt, and low level of reserves, which heightens foreign exchange risks. With low export earnings, a further depreciation of the Lari, and a slow adjustment in imports, the current account deficit has widened. As a result, the external debt has climbed up to 111.8 percent of GDP in 2016. While FDI inflows have so far been maintained (largely because of the British Petroleum-financed investment in the gas pipeline from Azerbaijan), there are downside risks given adverse economic prospects for Azerbaijan and Turkey, the two biggest FDI source countries in 2016. The cost of servicing foreign currency-denominated debt has increased, and the loan dollarization is 65 percent, creating vulnerabilities for the economy. Ensuring continued financial stability requires measures to reduce dollarization. In addition, continued disturbances in some of Georgia's key export markets and longer-term stagnation in the EU could further impact external performance. The main channels of transmission of external disturbances are through lower FDI, exports, remittances, and other capital inflows, and this could impact overall macroeconomic stability, a pre-condition for program performance. Mitigating factors include a flexible exchange rate policy, the proposed new program with the IMF, and increased access of Georgian firms to global markets.

***Others: Geopolitical risk is also assessed as substantial.* The tensions in the broader region add to geopolitical risks.** Any further escalation in the broader region could lead to further tensions and have a significant impact on the Georgian economy.

Table 8: Systematic Operations Risk Rating (SORT)

Category	Risk	Rating (High, Substantial, Moderate, Low)
1	Political and governance risk	Moderate
2	Macroeconomic	Substantial
3	Sector strategies and policies	Moderate
4	Technical design of project or program	Moderate
5	Institutional capacity for implementation and sustainability	Moderate
6	Fiduciary	Low
7	Environment and social	Low

8	Stakeholders	Moderate
9	Others: Geopolitical risk	Substantial
	Overall	Moderate

APPENDIX 1: POLICY AND RESULTS MATRIX

Prior actions for DPO1	Prior actions for DPO2	Results Baseline (2013 end) Target (2018 end)
Pillar 1: Second generation business environment reforms to strengthen public-private dialogue, support entrepreneurship and SMEs, and enhance public procurement		
	Prior Action #1 The Borrower has established and operationalized the Investors Council by conducting regular meetings chaired by the Prime Minister, as evidenced by the Borrower's Cabinet Decree No. 829 dated April 20, 2015 and No. 2160 dated October 7, 2015, and minutes of meetings dated October 29, 2015, February 17, 2016, May 20, 2016, and January 24, 2017.	At least four (4) major economic reforms, including respective draft laws are reviewed by the Investors Council: Baseline: 0 Target: 4 (e.g. Pension reform, CIT reform, Judiciary reform, Insolvency Reform)
Prior Action #1 The Borrower established the Entrepreneurship Development Agency (EDA) to promote the creation and growth of start-up companies and SMEs, as evidenced by the Borrower's Resolution No. 173, dated February 19, 2014.	*Prior Action #2* The Borrower, through EDA, has implemented the SME Development Strategy by delivering access to finance programs, and micro and small business support programs, as evidenced by its 2016 Annual Report.	Number of SMEs and entrepreneurs using EDA services: Baseline: 0 (2013) Interim: 7,032 (2016) (35% are women entrepreneurs) Target: 8,000 (of which 37% are women entrepreneurs)
Prior Action #2 The Borrower, through its State Procurement Agency (SPA), established a training center to improve the knowledge of contracting authorities and suppliers with respect to procurement procedures, as evidenced by the Borrower's Resolution No. 306, dated April 23, 2014; and the SPA's Chairman Order No. 1 dated May 7, 2014.	*Prior Action #3* The Borrower, through its Parliament, has adopted amendments to the Law on Public Procurement to bring about conformity with the basic standards regulating the award of contracts as defined by Article 144 of the Association Agreement with EU, as evidenced by the Law of Georgia on "Amendments to the Law of Georgia on State Procurement" dated April 6, 2017.	Number of registered users in the e-Procurement system: Baseline: 19,666 Interim: 33,023 (Q2 2016) Target: 36,400 Number of SPA tenders monitored for unlawful practices: Baseline: 13,000 Interim: 20,082 (Q2 2016) Target: 45,000

Prior actions for DPO1	Prior actions for DPO2	Results Baseline (2013 end) Target (2018 end)
Pillar 2: Establishing enabling conditions for financial sector deepening and diversification through deposit insurance system, comprehensive pension reforms, and development of insurance markets		
Prior Action #3 The Borrower established the inter-agency Deposit Insurance System (DIS) Working Group to design the DIS and coordinate its implementation, and approved its corresponding work plan, as evidenced by the Borrower's Decree No. 33, dated January 16, 2015.	*Prior Action #4* The Borrower, through its Parliament, has adopted the Law on DIS, as evidenced by the Law of Georgia on DIS dated May 17, 2017.	Baseline: No DIS Target: Deposit insurance coverage for household deposits in effect from 2018; the Deposit Insurance Agency is operational (Charter approved by Government, Director appointed by Board, Banks make initial contributions and monthly premium).
Prior Action #4 The Borrower, through MOESD, submitted to the Economic Council the proposed comprehensive pension reform, as evidenced by: (i) the minutes of the Economic Council meeting dated December 30, 2014, and (ii) the letter from the Minister of MOESD to the Bank, dated March 4, 2015	*Prior Action #5* The Borrower, through its Cabinet, has approved the draft Law on Private Pensions to initiate a public consultation, as evidenced by the Extract from the Protocol No. 6 of the government of Georgia meeting held on March 2, 2017	Baseline: N/A Target: The Pension Agency is established, an Investment Board is selected, and information technology systems are set up to accept contributions following the enactment of the Pension Law.
	Prior Action #6 The Borrower has: (i) through its Parliament, adopted the Law on Accounting, Reporting and Auditing, as evidenced by the Law of Georgia on Accounting and Auditing dated June 8, 2016, and (ii) through its Ministry of Finance, established the Service for Accounting, Reporting and Auditing Supervision (SARAS), as evidenced by the Minister of Finance Decree No. 223 dated September 14, 2016.	Baseline: Only commercial banks and insurance companies are required to publish audited financial statements. Target: All Public Interest Entities (estimated at 300) are obliged to start filing financial statements based on IFRS from 2017, large and medium companies start the process in 2018, and the financial statements are published in an e-portal; and 10 audit quality reviews conducted by SARAS
	Prior Action #7 The Borrower has: (i) through its Parliament, adopted amendments to the Law on Insurance, as evidenced by Law of Georgia on Amendments to the Law of Georgia on Insurance dated June 8, 2016.; and (ii) through the ISSSG, adopted relevant by-laws to make	Insurance companies that are in compliance with EU solvency I margin requirements: Baseline: 0% Target: 100%

Prior actions for DPO1	Prior actions for DPO2	Results Baseline (2013 end) Target (2018 end)
	Solvency I requirements fully binding by 2018, as evidenced by Orders No. 15 and No. 16 of the Head of State Insurance Supervision Service dated September 16, 2016.	
Pillar 3: Increasing firms' capacity to innovate and to export through reforms to upgrade the ICT sector and strengthen Georgia's national innovation system and quality infrastructure		
Prior Action #5 The Borrower: (i) amended the "Law of Georgia on Electronic Communications"; and (ii) through GNCC, approved amendments to GNCC's previous resolutions N6 and N13 related to radio frequency spectrum allocation, all with the purpose of promoting growth and competition of wireless broadband services, as evidenced by the "Amendments to the Law of Georgia on Electronic Communications" dated August 1, 2014, and the GNCC's Resolutions No. 7 and No. 8 dated November 7, 2014. *Prior Action #6* The Borrower, through GNCC, adopted a revised methodology for spectrum pricing for terrestrial services of electronic communications. The methodology covers, among other things, reserve prices for auctions, and fees for license renewal for telecommunication operators; as evidenced by the GNCC's Resolution No. 7 dated November 7, 2014, and the GNCC's Resolution No. 9 dated December 4, 2014.	*Prior Action #8* The Borrower, through GNCC, has: (i) issued new licenses for wireless broadband services in the 800 MHz band, as evidenced by the GNCC's Decision No. 56/1 dated January 29, 2015, and No 349 /1 dated June 2, 2016; and (ii) initiated a public consultation on draft secondary legislation on electronic communications market analysis aligned with EU practices, as evidenced by the publication of the draft "Regulation on Methodological Rules for the Definition of Relevant Markets and Market Analysis for the Purpose of ex ante Regulation and the Assessment of Concentration in the Sector of Electronic Communications" on the GNCC's website.	Incremental private investment in the telecommunications sector (US$): Baseline: -- (2013) Interim: US$170 million (2015) Interim: US$ 218 million (Q2 2016) Target: US$50 million Broadband Internet subscriptions: Baseline: 33% Interim: 42% (Q4 2016) Target: 45%
Prior Action #7 The Borrower established: (i) the Georgian Innovation and Technology Agency (GITA) with the corresponding mandate and budget to carry out its programs, as evidenced by the Borrower's Resolution No. 172, dated February 19, 2014; and (ii) the Research and Innovation Council, as evidenced by the	*Prior Action #9* The Borrower, through its Parliament, has adopted the Law on Innovations, as evidenced by the Law of Georgia on Innovation dated June 22, 2016.	Number of entrepreneurs and startups that obtain innovation finance from GITA: Baseline: 0 (2013) Interim: 167 (23 percent are female entrepreneurs) (Q4 2016)

Prior actions for DPO1	Prior actions for DPO2	Results Baseline (2013 end) Target (2018 end)
Borrower's Resolution No. 32, dated February 3, 2015.	*Prior Action #10* The Borrower, through its Parliament, has adopted amendments to its Tax Code to increase the excise taxes on imported cars, with larger increases for cars with conventional engines older than 7 years, and reduce the excise taxes on hybrid cars newer than 7 years, while maintaining the tax exemption on electric cars.	Target: 300 (25 percent are female entrepreneurs) (end 2018) Baseline: N/A Interim: 2 technology parks and 3 fabrication laboratories are functioning Target: 2 technology parks (1 in Tbilisi and 1 in the region) and 8 fabrication laboratories are functioning (Equipped, team appointed, and open to the public)
Prior Action #8 The Borrower: (i) achieved international recognition of the Georgian National Agency for Standards and Metrology (GeoSTM)'s quality management system in accordance with ISO/IEC 17025, as evidenced by the certificate issued by the Euro-Asian Cooperation of National Metrological Institutions (COOMET) dated February 11, 2014; and (ii) through the Georgian Accreditation Center (GAC) applied to the European Cooperation for Accreditation (EA) to obtain international recognition of GAC, as evidenced by the official application to EA dated September 19, 2014.	*Prior Action #11* The Borrower, through GAC, has become a full member of the EA, by signing a Bilateral Agreement with the European cooperation for Accreditation, as evidenced by (i) the signed EA Bilateral Agreement; and (ii) a decision of EA Multilateral Agreement Council dated April 27, 2017.	Number of certificates issued by GeoSTM: Baseline: 842 (2014) Interim: 1,692 (Q4 2016) Target: 2,105 Number of certificates issued by calibration/verification entities that received traceability from GeoSTM: Baseline: 1,800 Interim: 6,677 (Q4 2016) Target: 7,200

APPENDIX 2: LETTER OF DEVELOPMENT POLICY

PRIME MINISTER
OF GEORGIA

16 June 2017

Dear President Kim,

Allow me to begin by thanking the World Bank Group for strong support to Georgia's economic reform strategy. We highly appreciate our partnership within the scope of the Second Development Policy Operations contributing to the inclusiveness of growth and increased competitiveness of the private sector.

One of the main objectives of the Government of Georgia, as stated in our National Socio-Economic Development Strategy 2020 (Georgia 2020), is to identify key constraints to inclusive growth and define priority directions of their elimination. To achieve this goal, we have been focusing on ensuring private sector competitiveness, fostering human capital development and facilitating access to finance. In order to share the benefits of economic growth in the society, the Government has initiated a Four-Point Reforms Plan aiming at implementing structural reforms and achieving economic efficiency. We are fully committed to continue pursuing economic policies consistent with macroeconomic fundamentals.

Since the last quarter of 2014, we faced an economic slowdown caused by deteriorating external environment. Despite this, Georgian economy showed resilience to external shocks. Our macroeconomic policies are guided by our commitment to gearing our fiscal, monetary and exchange rate policies towards supporting macroeconomic stability and growth. We are committed to fiscal consolidation while ensuring that funding for all public social obligations are sustained and growth supportive public investments are in place. We are committed to a flexible exchange rate to safeguard external sustainability, export competitiveness, and high growth prospects.

Our aim is to integrate with the European and international markets. We stand ready to design and implement reforms in compliance with the Association Agreement (AA), including the Agreement on Deep and Comprehensive Free Trade Area (DCFTA), which was signed in June, 2014. The AA envisages gradual approximation of Georgian legislation and systems with respective European legislation and practice. The Government of Georgia developed the DCFTA action plan for 2014-2017, which includes all actions and measures to be implemented during this period. Moreover, Georgia already has free trade agreements with Turkey, Russia and other CIS countries. In June 2016, Georgia signed a Free Trade Agreement with European Free Trade Association (EFTA). In May, 2016, Georgia signed a FTA with China. Moreover, negotiations on FTA with Hong-Kong were finalized in April 2017.

Furthermore, as a result of implemented reforms in the areas of rule of law and the Justice system, also relevant economic areas, and our firm commitment to become a member of the European family, Georgia was recently granted visa-free regime by the European Union, which allows our citizens to enter Europe without visa. This will enhance Georgia's ties with Europe, encourage economic, business as well as people-to-people contacts.

The policy of the Government is to deliver sustainable and private sector driven growth. Dynamic and vibrant private sector needs to have a leading role with the state maintaining a facilitating function. We are also committed to persevering with our medium-term structural reform agenda consistent with the National Socio-Economic Development Strategy (Georgia 2020) and the four-point reform plan initiated by the Government, which covers the following strategic directions:

- Education reform; supporting skills development through education reform targeted at bridging the gap between skills demand and supply.
- Infrastructure development to increase regional connectivity and utilize Georgia's potential as a transit country and a tourism country; In particular, development of the core road infrastructure that consists of the East-West highway, two South-North corridors crossing the highway in Tbilisi and Kutaisi; and the road connecting the biggest sea port cities (Poti and Batumi).
- Governance reform; including having the general public more actively participating in decision making and improving the provision of government's services on the basis of the one-stop shop principle.
- Economic reforms to promote job creation by improving, among others, the business and investment environment.

Collaboration between the Government of Georgia and the International Monetary Fund (IMF) is essential for Georgia. The IMF shares and supports the Government's economic policy. In April 2017, the IMF's Executive Board approved a three-year Extended Fund Facility (EFF) program in the amount of SDR 201.4 million or 100 percent of Georgia's quota. This program echoes the Government's four-point reform plan. Approval of the program is a support for Government's strong commitment to maintain sound macroeconomic policy, as a basis for important structural reforms aiming at boosting private sector development and economic growth.

Support from the World Bank is critical for the success of our ambitious reform agenda. The proposed Georgia Second Private Sector Competitiveness Development Policy Operation is designed to back-up key elements of our policies and build upon the recent gains.

The reforms launched during the recent years were focused on market liberalization and resulted in economic growth, but a number of challenges remain to be addressed to increase private sector competitiveness. Our Government is paying particular attention to improving the business environment, promoting savings, diversification of the financial sector as well as upgrading innovation, ICT sector, and core infrastructure in the country. These policies will help to achieve the goals of creating more and better jobs and promoting inclusive growth.

During the recent years, we have successfully implemented several reforms aimed at increasing competitiveness of the Georgian economy. We plan to roll out further reforms in coming years to improve the business environment, strengthen the financial sector and increase Georgian companies' capacity to innovate and export. We are committed to fight climate change, as illustrated by the recent entrance into force of Georgia's approval of the Paris agreement as well as joining the OECD Declaration on Green Growth, among other actions underway. Along these lines, we have implemented a number of important reform measures in the Private Sector Competitiveness Development Policy Operation, which targets our most urgent developmental needs.

We have taken significant steps to foster second-generation business environment reforms and to establish a closer public-private dialogue and communicate the expected results of the reforms to the public and stakeholders to build trust in reforms and make policymaking more inclusive. The Investors Council established in 2015 serves as a platform for dialogue between the Government, international organizations and business community and aims at improving business environment and investment climate. Another important measure taken by the Government of Georgia in the area of establishment of Regulatory Impact Assessment (RIA) is an elaboration of the framework for institutionalization of RIA system, including relevant guidebook. Training of relevant public servants and preparing pilot RIA with donors' assistance is currently underway. In addition, in January 2016 the Government of Georgia adopted a decree which introduces the practice of making major draft economic laws to be approved by the Government, available for public review and comments.

Moreover, in order to further enhance government-to-business cooperation, within the framework of the Governance reform (as a part of the four-point plan), the concept of the "Business House" has been elaborated. This concept implies not only simplification of government-to-business relations, but bringing this cooperation on a qualitatively new level. The Business House will provide over 600 services to businesses under one centralized location (both physical and digital) currently delivered by more than 60 public institutions. This will save time and resources of business needed for dealing with bureaucracy. This reform can be considered as an intermediate step before Georgia moves to a fully-fledged e-governance system.

We have prioritized a SME development as we expect this to be the main source of private sector growth, jobs creation and innovation. In February 2014, the Government of Georgia established the Entrepreneurship Development Agency under the Ministry of Economy and Sustainable Development, which aims at increasing the competitiveness of the SMEs and facilitating their export activities. The Agency plays a crucial role in creating a favorable business environment for the SMEs through the provision of non-financial supports such as business planning development and marketing advisory services, and financial instruments such as matching grants and subsidized loans for entrepreneurship support and export promotion. The Agency's program includes technical assistance to upgrade technical equipment and production processes of the SMEs in order, among others, to comply with EU standards and regulations. To enhance achieved results, the Government evaluated the effectiveness of existing state-support programs and elaborated a new vision and approach in this direction. As a result, the Agency was reorganized, enhanced and empowered with more diversified services and capacities transforming it into a new LEPL "Produce in Georgia". This new agency will support local businesses, foreign investors and Georgian exporters in all business directions to increase their competitiveness.

In parallel, in February, 2016, a SME Development Strategy of Georgia 2016-2020 and a respective Action Plan were adopted by the Government of Georgia. The strategy was elaborated in close cooperation with the OECD and GIZ. The Strategy covers the five strategic directions that are crucial to be addressed to ensure development of the small and medium businesses, facilitate growth and competitiveness, which is vital for employment generation and positioning Georgian SMEs on local and international markets. The SME Strategy is based on 10 principles of the Small Business Act for Europe and is in full compliance with the EU and international best practice. Annual implementation reports of the SME Strategy and relevant Action Plan for 2016 were discussed at the high level Steering Group meetings established for the strategy implementation monitoring purposes and were presented to the Government of Georgia.

The Government has achieved significant progress in the field of state procurement during the previous years. Owing to continuous upgrading, Georgia's State Procurement Agency (SPA) is already a regional leader in integrating modern procurement practices. A transparent electronic procurement system makes public tenders largely available for everyone to submit bids and considerably simplifies the procurement procedures. Herewith, the State Procurement Agency of Georgia has elaborated comprehensive Road Map for approximation of public procurement legislation to the EU *acquis*. In March, 2016 the Government of Georgia adopted a "Roadmap and Action Plan for the implementation of the Public Procurement Chapter of the EU-Georgia Association Agreement". According to the Road Map, the State Procurement Agency prepared amendments to the Law on State Procurement. New amendments fully comply with the Article 144 of the Association Agreement on basic standards of contract award. The Parliament of Georgia adopted amendments to the Law on State Procurement in April 2017.

As long as financial sector development is concerned, the Government is taking important steps to deepen and diversify the financial services available to the population and businesses and strengthen financial safety nets. Government's efforts will help to develop financial markets, accumulate long-term savings, and ensure social protection. The Government approved a Deposit Insurance Strategy and an Action Plan and submitted draft law on the Deposit Insurance System (DIS) to the Parliament in early March, 2017. The Parliament adopted the law on DIS, as well as accompanying legislative amendments, in May 2017. According to the law, the deposit insurance coverage will become effective from January 1, 2018.

Pension reform is a critical element of the economic reform agenda, as it will improve the social safety nets and support fiscal stabilization. The government approved pension reform strategy and an action plan in 2016. The draft law on Private Pensions was discussed and approved by the Government in March, 2017. By the decision of the Government, the Ministry of Economy and Sustainable Development and the Ministry of Finance were instructed to start public communication campaign of the pension reform and re-submit updated draft to the Government based on the outcomes of the public outreach. The draft legislation will be submitted to the Parliament for approval by the end of 2017. The pension reform introduces a savings system, mandatory for younger workers and voluntary for older workers and the self-employed, which will increase the resources available to workers during retirement. The system will require employees, employers, and the Government to each contribute 2 percent of gross wage, which will be invested and available to workers at retirement.

The pension reform will create a demand for long-term financial instruments. The Government has taken measures to stimulate the supply of such instruments. The Government of Georgia has approved a Capital Market Strategy with a time-bound action plan in May 2016. In the framework of this strategy, relevant institutions are working on elaboration of draft legislation, as well as improvement of the system and relevant financial infrastructure. Currently, with participation of IFIs, the Government is working on elaboration of the Investment Funds legislation. Overall, the Government is strongly committed to prepare a package of legislation to promote the development of a more vibrant capital market that can improve access to new financial instruments.

We are also enhancing the financial reporting system. A new law on Accounting, Reporting and Auditing came into force in June, 2016. According to this law, a new public oversight authority (SARAS) was established under the Ministry of Finance in August 2016. Public Interest Entities will start filing financial statements based on IFRS from 2017, while large and medium companies will start the process in 2018 (IFRS for SMEs in the case of medium companies). These financial statements will be published on an e-portal. SARAS will also start formal audit quality control review process by September 1, 2017, as outlined by the law.

We are also planning to further approximate insurance legislation with EU directives to strengthen the powers, funding and capacity of the insurance regulator and facilitate sector development. With respect to the Solvency I standards, relevant amendments to the law of Georgia on Insurance were adopted by the Parliament of Georgia. Based on these amendments, the Insurance State Supervision Service of Georgia (ISSSG) has adopted and published by-laws "On approval of the Rule of determining the required Solvency Margin by the insurers in the course of insurance operations" and "The Rule on determining the regulatory capital of insurer and calculation thereof". From the end of 2016, the first phase of increase of the minimum capital was implemented at all stages of insurance activities. The ISSSG is currently working on minimum capital determination (increase) by forms and classes of insurance and respective changes will enter into force within the deadlines established by the law "on Insurance" (January 1, 2018).

Moreover, the introduction of law on Motor Third Party Liability (MTPL) insurance was divided into two phases. As a first phase, draft MTPL law for foreign vehicles was prepared and will be submitted to the Government in the nearest future. The law is expected to be adopted by the Parliament by the end of 2017. This Law will be followed by the overall MTPL Insurance Law, which will integrate the provisions of both border and domestic MTPL Insurance.

The Government of Georgia has prioritized development of knowledge-based and innovation-driven economy. We believe that one of the most important issues for Georgia's economic development is further enhancement of innovations and absorption of technology. Wide-ranging efforts to spur investment and raise productivity are accompanied by longer-term measures that will increase the firms' capacity to innovate and export. For this purpose, the Georgian Innovations and Technology Agency (GITA) has been established under the Ministry of Economy and Sustainable Development in 2014. The GITA's main mandates are: a) contributing in developing regulatory framework for innovation, with the aim to simplify innovation, science and startup activities in the country; b) provision of infrastructure for innovation (Tech parks, Fabrication Laboratories, Community Innovation Centers); c) developing skills and capacity for entrepreneurial activities, ICT specialists and provision of technical assistance through business incubation and acceleration programs; and d) enhancing access to finance for innovative projects, startups and R&D commercialization (venture financing, matching grants, etc.) One of the most important results in this area is the development of new innovative startups with global scalable potential, as well as faster knowledge transfer and technology absorption by Georgian firms, establishment of connections between scientific and business circles, orienting Georgian exports towards high-tech products. In 2016, the Parliament adopted the law on Innovations, which will support strengthening commercialization of innovations. Government is continuing reviewing existing laws to simplify innovation and startup activities in Georgia. The Government of Georgia has secured 40 million USD from the World Bank for the National Innovation Ecosystem (GENIE) Project in 2016. The main objective of the project is to increase innovative activities of the enterprises and individuals in Georgia and their participation in the digital economy. The implementing entity of the project is GITA.

We are also increasing the public investments and fiscal measures that can stimulate the introduction of energy efficient technologies, as this is one of the cornerstones of the Government's agenda to develop a green economy. In the transport sector, new investment to increase the number of "green" buses running on compressed natural gas and introduce modern trains have been implemented and are improving the quality of public transportation. In parallel, we introduced changes in excise taxes to promote the purchase of newer, more energy efficient cars and encourage switching to public transportation. These changes in the Tax Code include a significant increase of the excise taxes on cars other than hybrid and electric ones with larger increases for cars older than 10 years. Increases in excises on gasoline, diesel and other fossil fuels will also incentivize a more rational use and switch to more energy efficient alternatives, which will reduce Georgia's climate change vulnerability and improve overall energy efficiency.

We are putting significant efforts in improving the efficiency, affordability and regional access of telecommunications services. In order to improve nationwide access to ICT services, the Government of Georgia approved a State Program on "broadband infrastructure development in Georgia" in July 2016. In January 2015, the GNCC completed modification process of frequency licenses under technology neutral terms and two new licenses in the 800 MHz band were issued. Furthermore, the GNCC prepared and launched public communications on draft secondary legislation on electronic communications market analysis to secure efficient competition aligned with EU practices. We believe that widespread availability of high-quality broadband internet connectivity can underpin Georgia's transformation into a knowledge-based economy.

Significant reforms have been undertaken to modernize Georgia's National Quality Infrastructure. Through the investments in the Georgian National Agency for Standards and Metrology (GeoSTM), which have led to international recognition of its calibration and measurement capabilities in several fields, companies in Georgia will reduce their costs of entering new export markets. In parallel, the Georgian Accreditation Center (GAC) is modernizing its regulatory framework in line with European practices, which will further increase the quality of services for exporters. These actions will help companies in Georgia to benefit from the steps taken towards European integration, and reduce the barriers to trade and investment. GeoSTM has adopted an Institutional Reform Plan (IRP) that defines the medium term priorities, including development of new services, budget sources and results to be achieved for international recognition of the priority laboratories according to the needs of enterprises. In 2016 in the framework of CIB (Comprehensive Institutional Building Program) the national measurement standards base of GeoSTM was significantly modernized, new advanced measurement standards and instruments were purchased, installed and put into operation, that allows GeoSTM to offer wider range of services to customers in Georgia as well as on regional level.

In order to become internationally recognized, the Georgian Accreditation Center has addressed the recommendations of the European Accreditation (EA) peer evaluation. European Accreditation (EA) peer evaluation team has accepted corrective actions made by GAC and in April 2017 EA MAC committee (Multilateral Agreement Committee) took decision that GAC becomes a Bilateral Agreement (BLA) signatory in the fields of testing (excluding medical examination according to 15189), calibration, inspection, persons and products certification. The official signing of the BLA was held in May 2017 in Slovenia, during a general assembly of EA. We are strongly committed to take relevant steps to further develop Georgia's National Quality Infrastructure.

Let me reiterate, that we strongly appreciate the support of the World Bank in the implementation of the strategic actions outlined above. We look forward to our continued successful partnership, including cooperation in the context of the proposed Development Policy Operation.

Allow me, Mr. President, to take this opportunity and extend my sincere regards and esteem.

Sincerely,

Giorgi Kvirikashvili

Re: Letter of Development Policy - Georgia Second Private Sector Competitiveness Development Policy Operation

Dr. Jim Yong Kim

President of the World Bank Group and Chairman of the Board of Executive Directors

Washington, DC

APPENDIX 3: IMF RELATIONS

IMF Executive Board Approves US$285.3 million Extended Arrangement under the Extended Fund Facility for Georgia[16]

April 12, 2017

On April 12, 2017, the Executive Board of the International Monetary Fund (IMF) approved a three-year extended arrangement under the Extended Fund Facility (EFF) for Georgia for an amount of SDR 210.4 million (about US$285.3 million or 100 percent of quota) to support the authorities' economic reform program.

The EFF-supported program will help Georgia reduce economic vulnerabilities, pursue well-coordinated policies, and promote economic growth. The program includes ambitious structural reforms to generate higher and more inclusive growth, focusing on: improving education; investing in infrastructure; making the public administration more efficient; and improving further the business environment to boost the private sector as a growth engine. The Executive Board's approval allows for an immediate disbursement of SDR30 million (or about US$40.7 million). The remaining amount will be phased over the duration of the program, subject to six semi-annual reviews.

[16] IMF Press Release No. 17/130

APPENDIX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior actions	Significant positive or negative environment effects (yes/no/to be determined)	Significant poverty, social or distributional effects positive or negative (yes/no/to be determined)
Pillar 1: Second generation business environment reforms to strengthen public-private dialogue, support entrepreneurship and SMEs, and enhance public procurement		
Prior Action #1: The Borrower has established and operationalized the Investors Council by conducting regular meetings chaired by the Prime Minister.	No.	No.
Prior Action #2: The Borrower, through EDA, has implemented the SME Development Strategy by delivering access to finance programs, and micro and small business support programs.	No.	No. Potential indirect positive impact by promoting employment creation. Potential positive impact on female-led firms to grow and increase sustainability.
Prior Action #3: The Borrower, through its Parliament, has adopted amendments to the Law on Public Procurement to bring about conformity with the basic standards regulating the award of contracts as defined by Article 144 of the Association Agreement with the EU.	No.	No.
Pillar 2: Establishing enabling conditions for financial sector deepening and diversification through deposit insurance system, comprehensive pension reforms, and development of insurance markets		
Prior Action #4: The Borrower, through its Parliament, has adopted the Law on Deposit Insurance System.	No.	Yes, positive effects through the strengthening of financial institutions that distribute social transfers.
Prior Action #5: The Borrower, through its Cabinet, has approved the draft Law on Private Pensions to initiate a public consultation.	No.	Yes, positive effects in the medium-long term.
Prior Action #6: The Borrower has: (i) through its Parliament, adopted the Law on Accounting, Reporting and Auditing; and (ii) through its Ministry of Finance, established the Service for Accounting, Reporting and Auditing Supervision (SARAS).	No.	No.

Prior Action #7: The Borrower has: (i) through its Parliament, adopted amendments to the law on Insurance; and (ii) through the ISSSG, adopted relevant by-laws to make Solvency I requirements fully binding by 2018.	No.	No
Pillar 3: Increasing the capacities of firms to innovate and to export by enacting reforms to upgrade the ICT sector and strengthen Georgia's national innovation system and quality infrastructure		
Prior Action #8: The Borrower, through GNCC, has: (i) issued new licenses for wireless broadband services in the 800 MHz band; and (ii) initiated a public consultation on draft secondary legislation on electronic communications market analysis to secure efficient competition aligned with EU practices.	No.	No. Potential indirect positive impact by promoting employment creation.
Prior Action #9: The Borrower, through its Parliament, has adopted the Law on Innovations.	No.	No.
Prior Action #10: The Borrower, through its Parliament, has adopted amendments to its Tax Code to increase the excise taxes on imported cars, with larger increases for cars with conventional engines older than 7 years, and reduce the excise taxes on hybrid cars newer than 7 years, while maintaining the tax exemption	Yes, positive effects through the contribution to the reduction of greenhouse gas emissions.	No.
Prior Action #11: The Borrower, through GAC, has become a full member of the EA, by signing a Bilateral Agreement with the European cooperation for Accreditation.	No.	No.