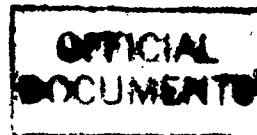




PRIME MINISTER
OF GEORGIA



W 8503-C

LETTER OF DEVELOPMENT POLICY

Georgia First Inclusive Growth and Private Sector Competitiveness Development Policy Operations

Tbilisi, March 3, 2015

Dear President Kim,

Allow me to begin by thanking the World Bank Group for strong support of Georgia's successful development efforts that have been underway in all the recent years. One of the main objectives of the government of Georgia as stated in our Socio-economic Development Strategy Georgia 2020 (Georgia 2020) is to identify key constraints to inclusive growth and define priority directions to eliminate them. To achieve this goal we have been focusing on ensuring private sector competitiveness, fostering human capital development and facilitating access to finance.

Our aim is to integrate with the European and international markets. We stand ready to design and implement reforms in compliance with the EU-Georgia Association Agreement (AA), including Agreement on Deep and Comprehensive Free Trade Area (DCFTA), which was signed in June 2014. AA envisages gradual approximation of Georgian legislation and systems with the European norms and best practices. DCFTA, which is in force since September 2014, opens new trade and investment opportunities and easier access to the EU market. The Government of Georgia adopted DCFTA Action Plan for 2014-2017, which includes all actions and measures to be implemented during this period. At the same time with the help of the donor community the government is taking steps to support the private sectors' adaptation to the DCFTA requirements. We recognize that a dynamic and vibrant private sector needs to be in the driver's seat with the state playing a facilitating role.

The reforms launched in 2004 were focused on market liberalization and resulted in economic growth but a number of challenges remain for achieving inclusive growth. As far as strong and competitive private sector plays a vital role in achieving sustainable economic development and inclusive growth, enhancement of private sector competitiveness is among the priorities of the Government of Georgia. Our Government is paying particular attention to improving the business environment, promoting savings mobilization, diversification of the financial sector as well as upgrading innovation, ICT sector and national quality infrastructure. These policies will help to achieve the goals of creating more and better jobs and promoting inclusive growth.

We have achieved several milestones in transforming Georgia into a modern democracy with increased accountability and transparency. The parliamentary elections in 2012, the Presidential elections in 2013, followed by local elections in 2014, marked the country's first democratic transfer of power. We are continuing the reforms on anti-corruption measures, aiming at further

strengthening governance mechanisms. As a result of past reforms, Georgia has made a substantial improvement in Corruption Perception Index ranking 50th in 2014 as opposed to 133rd ten years ago.

Yet, global economic outlook remains uncertain. We thus need to continue building safety buffers to make sure that macroeconomic stability, which is one of the key preconditions of our strategy, is preserved. To this end, we are on the right track with our policy of fiscal consolidation and we continue to manage our public debt in a conservative manner. With these policies we will maintain adequate fiscal space to react if needed on exogenous shocks. We undertook significant reforms to reinforce public financial management, improve business environment and social services. Public expenditures were reprioritized since 2013. Expenditures on education, health and social protection were scaled-up with the fiscal space for these increases coming from the reduction of non-recurrent expenditures. At the same time revenue collections improved. The resulting lower fiscal deficits allowed us to sustain favorable public debt situation. According to rapid estimation, in 2014 real GDP growth is 4.7 percent despite challenging external environment, with solid performance across the board.

Since 2012 we have successfully implemented several reforms aimed at increasing competitiveness of the Georgian economy, and we will roll out further reforms in coming years to further improve the business environment, strengthen the financial sector and increase private sector capacity to innovate and export. Along these lines, we have suggested including a number of important reform measures in the Private Sector Competitiveness Development Policy Operation, which targets our most urgent development needs.

We are taking significant steps to foster second-generation business environment reforms and to establish a closer public-private dialogue and communicating the expected results of the reform to the public and stakeholders to build trust in reforms and make policymaking more inclusive. The Economic Council under the Prime Minister was created in 2013 and plays a crucial role in providing a forum to discuss economic policies with stakeholders before these are considered by the Government and Parliament and strengthen intra-governmental coordination during the design and implementation of critical reforms. We are establishing Investors Council, which will serve as a platform for dialogue between government and business community and aims at improving the business environment and investment climate. Another important initiative in this area is our plan of introducing Regulatory Impact Assessments (RIA) for priority economic legislation.

We have prioritized SME development as we expect this to be the main source of private sector growth, jobs creation and innovation. In February 2014, the Entrepreneurship Development Agency (EDA), the first public entity solely dedicated to supporting the development of private sector, increasing competitiveness of SMEs and facilitating export activities was established. EDA will play a crucial role in creating a favorable business environment for SMEs through the provision of various non-financial support schemes and financial instruments aimed at business development, enhancement of its competitiveness and export promotion. For facilitation of economic activities in the regions, new program, which considers provision of matching grants together with consultancy services for micro and small businesses in the regions was launched. To enhance results, EDA is planning to regularly evaluate the effectiveness of its programs. To further strengthen SME development, Government of Georgia, in close cooperation with OECD is preparing a medium-term SME development strategy and action plan.

The Government has achieved significant progress in the field of state procurement during 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. SPA is currently putting its efforts to raise awareness of contracting authorities and suppliers, especially SMEs, as well as improve procurement practices and review the tendering techniques and legal framework to bring them in compliance with the EU legislation and best practices according to DCFTA.

The Government is committed to creating an effective competition policy and an institutional framework that promotes competition in key product markets. Developing an effective competition policy is one of the priorities of Georgia 2020 and a commitment under the DCFTA. The Georgian Competition Agency (GCA), as an independent institution was established in early 2014 following the adoption of amendments to the Law on Free Trade and Competition, which had been supported by the World Bank under the previous Development Policy Operations. The GCA is working on further approximation of competition policy framework with the European best practices.

In the financial sector, the Government is taking important steps to deepen and diversify the financial services available to the population and companies, and strengthen financial safety nets. Government efforts will help to develop financial markets, accumulate longer-term savings, and social protection. Under the AA, we are committed to creating a Deposit Insurance System (DIS) to increase the confidence of depositors and investors and deepen the savings market. We are also planning to further approximate insurance legislation with the EU directives according to AA to facilitate sector development and strengthen institutional capacity of the insurance regulator.

Pension reform is a critical element of the economic reform agenda, as it will improve the social safety nets and support fiscal stabilization. In March 2013, an interagency working group on comprehensive pension reform was established by Government of Georgia's decision. Working Group is chaired by the Vice Prime Minister, Minister of Economy and Sustainable Development of Georgia (MoESD). A pension reform unit created at the MoESD started operation in 2014. It will design the changes in the pension system and build consensus among stakeholders. Capital markets development is a complementary reform area as it will support the pension reform and improve access to capital for Georgian enterprises. Once the strategy for capital market development is ready, the Government will 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 systems and collateral registries to make it easier for firms, and especially SMEs, to access credit. The Accounting and Auditing Law that was adopted in 2012 significantly strengthens the statutory framework for accounting and auditing. The Georgian law governing secured transactions incorporates many modern features, and scores well in the World Bank's Doing Business Report 2015. In addition, Georgia has an efficient immovable collateral registration regime. National Agency of Public Registry under the Ministry of Justice of Georgia is working on strengthening secured transactions on movable property regime, in accordance with international best practices.

Wide-ranging efforts to spur investment and raise productivity are accompanied by longer-term measures that will increase firms' capacity to innovate and to export. In February 2014, the Georgian Innovation and Technology Agency (GITA) was established with the aim of implementing the Government's innovation policy reforms and providing services and programs to intensify the innovation process in Georgian companies and academia. To achieve this goal, GITA will be providing financial support (matching grants) and non-financial support (Technology Park, venture accelerator, innovation and fabrication laboratories, education programs) to the most promising entrepreneurs and companies. One of the most important results in this area will be faster knowledge transfer and technological absorption by Georgian firms, establishment of connections between scientific and business circles, orienting Georgian exports towards high-tech products.

We are putting significant efforts in improving the efficiency, affordability and regional access of telecommunication services. Parliament approved amendments to the Electronic Communications Law in 2014 to enable upgrading of mobile broadband from 3G to 4G and promote competition in the telecommunications market. We believe that widespread availability of high-quality broadband Internet connectivity can underpin Georgia's transformation into a knowledge-based economy.

Significant reforms have taken place to modernize the Georgia's National Quality Infrastructure. Through the investments in the Georgian National Agency for Standards and Metrology and institutional strengthening, 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, which is an associate member of the EA, is modernizing its regulatory framework in line with European best 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 technical barriers to trade.

In addition, through the Inclusive Growth Development Policy Operation, we are undertaking several measures to strengthen macroeconomic management and Georgia's human capital.

The Government is adopting measures to further strengthen public financial management through improved accountability, broader coverage and greater transparency of the government's fiscal accounts. In particular, we amended the budget code to integrate Legal entities of Public Law (LEPLs), non-entrepreneurial (non-commercial) legal entities (NELEs) and local municipalities into the system of Single Treasury Account (STA). Our in-house IT system and relevant modules were fully upgraded to handle budgets of over 600 newly defined budgetary entities at the budget planning and execution phase. This reform will support the strategic allocation of available public resources to finance state's priorities and create long-term stable funding package to finance those priorities. To manage existing resources better, we will also adopt improved capital budgeting guidelines.

In order to improve fiscal management we will continue strengthening our macro-fiscal analysis and forecasting capacity. We introduced the information annex on macroeconomic risks to the Budget Law 2015 for the first time and estimated upsides and downsides that would affect key macro variables that are statistically significant for fiscal management. Going forward we plan to enhance the analysis of the fiscal risks by assessing contingent liabilities stemming from the State Owned Enterprises (SOEs) and attaching an SOE risk assessment report to each year's

budget as an annex. Over the last decade, the Government has successfully transformed a loss-making, heavily indebted large state-owned enterprises sector into a profitable, growing segment of the economy. Building on these successful reforms our government will streamline the accounting and monitoring mechanisms to aggregate the financial and non-financial information of the whole SOEs sector contributing to the quality fiscal risk assessments.

Creation of the effective and comprehensive civil service system is an integral part of our public sector reform agenda as it echoes to our commitment to integrate into the European and Euro Atlantic structure. Georgia took a firm commitment to create a civil service model that would ensure more transparency and effectiveness of public sector. The new law that is under development will be adopted soon and will be based on international best practices. The support of international partners was critical for us in developing and approving the conceptual framework for civil service reform. As a result we already made good progress in strengthening the mandate of the civil service bureau, its capacity and infrastructure. A number of regulations were issued to support initial steps for these changes. We will continue our efforts to establish an efficient regulatory and institutional framework for the efficient civil service system by adopting and implementing the amended Civil Service Law.

Georgia has developed strong and well-targeted social safety nets including both the targeted social assistance program (TSA) and the Universal Health Care system (UHC). While advancing on fiscal consolidation front we have been able to maintain and even expand spending levels on health, social assistance programs and education to ensure that our objectives of protecting vulnerable groups of population are not compromised. As part of these efforts we are increasing coverage and improving targeting of the TSA program through the introduction of a new methodology that is based on differential benefit packages, reduced subjective judgment and improved social information management system. We therefore expect to reduce the poverty gap considerably and improve the coverage of the bottom decile from 60 to 75 percent over the next 2 years. In addition, work disincentives, if any, will be discouraged through the adoption of specific measures. We are also improving further the Universal health care (UHC) program that was introduced by the government in February 2013 by including certain drugs in the package, initially for TSA beneficiaries. This will help to address, among others, the problem of high out-of-pocket medical spending by households. In addition, the Ministry of Labor Health and Social Affairs has also introduced the requirement to have a doctor's prescription for the purchase of certain drugs to promote the rational use of medicines. We expect this measure to considerably reduce self-medication practice in Georgia. We plan to improve the quality of healthcare services before, during and after childbirth through establishing effective functional links between different levels of perinatal services and ensuring adequate management of obstetric and neonatal diseases, complications and emergencies.

We are committed to boost employment generation and support the formation of innovation-based economy. Our Strategy of Georgia 2020 identifies a number of main priorities for further development of education and research. These broad objectives include improving the quality and accessibility of education, increasing motivation and qualification of teachers, increasing participation in preschool and vocational education and training sector, improving learning outcomes for students, and supporting internationalization of higher education. In particular, we have developed a new teacher policy framework aimed at attracting high-caliber teachers into the profession and supporting professional development of the existing teaching force. We will implement the new Teacher Recruitment, Evaluation and Professional Development scheme to

ensure that Georgian students will benefit from better teaching and learning environment. The Government is committed to both improving equity in access to quality of preschool education and therefore, the future reform efforts will focus on adoption of national preschool education curriculum and introduction of instruments to monitor preschool curriculum implementation across the country.

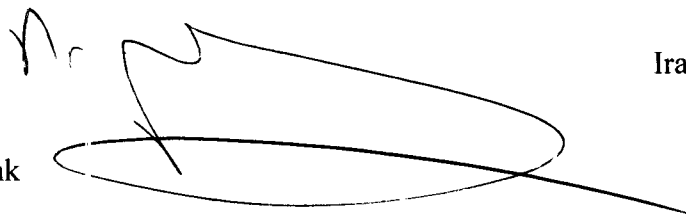
Georgia's 2014 census took place after a gap of 12 years and it has immense implications for policy making and the accuracy of indicators that we set to monitor and evaluate outcomes of the reforms under Georgia 2020. A review of the sampling frame for the household survey and respective analysis is underway to develop a new common survey framework for Georgia. As part of this new framework we plan to conduct two separate surveys, the household survey and the labor force survey, and adopt a revised framework for both of them. The objective is to increase the sample size, improve the sampling design and publish data with higher frequency. Meanwhile we are mindful of the UN recommendation to conduct census at ten year intervals. Therefore going forward we plan to make the census timely, implementing it at least every ten years, and to specify a minimum pre-census preparation time, which is required for the preparation of detailed digital maps, developing and extensive field testing of questionnaires, a comprehensive publicity and public relations program, the recruitment and training of enumerators, supervisors and other field staff and the development and testing of procedures and programs for data processing and analysis. Going forward, we will conduct two separate surveys – the household survey and the labor force survey – and will also adopt a revised framework for both the survey to strengthen evidence-based policy making.

We deeply appreciate the support of the World Bank in the implementation of the strategic actions outlined above. We are looking forward to our continued successful partnership with the World Bank, including cooperation in the context of the proposed two development policy operations.

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

Sincerely,

Mr. Jim Yong Kim
President of the World Bank
Washington, DC

A large, stylized handwritten signature in black ink, likely belonging to Irakli Garibashvili. The signature is fluid and cursive, with a prominent loop at the end.

Irakli Garibashvili