

**PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE**

November 12, 2014
Report No.: AB7662

Operation Name	First Inclusive Growth DPO (DPO1)
Region	Europe and Central Asia
Country	Georgia
Sector	Health (17%); Other social services (16%); General public administration sector (34%); Sub-national government administration (16%); Gender (17%)
Operation ID	P149991
Lending Instrument	Development Policy Lending
Borrower	Ministry of Finance, Georgia
Implementing Agency	Ministry of Finance
Date PID Prepared	November 6, 2014
Estimated Date of Appraisal	February 11, 2015
Estimated Date of Board Approval	March 31, 2015
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Key Development Issues and Rationale for Bank Involvement

The Georgian growth run over the past decade was fueled by large foreign capital inflows and significant policy reforms during the pre-crisis years and by high public capital spending during the post-crisis recovery period. Overall, growth during 2004-13 was largely powered by services, construction and non-tradables in general. However, a decade of strong economic growth in Georgia has not succeeded in making a significant dent on the unemployment rate. The government has been successful in attracting foreign investors to the country and the economy has experienced sustained growth with the exception of 2008-09. Net job creation, however, remained weak and by 2013 the overall unemployment rate remained close to 15 percent, one of the highest in the ECA region. The majority of the work force – more than 55 percent – is employed in agriculture (mostly self-employed in family subsistence farming), but the sector contributes to only 8.2 percent of GDP. Low productivity levels in agriculture have contributed significantly to high rural poverty. Limited employment opportunities have left various sections of the population vulnerable.

There has, however, been significant progress in poverty reduction and shared prosperity in recent years, but it has been driven by factors other than net job creation. The poverty rate, according to the national poverty line, fell from 21 percent in 2010 to 14.8 percent in 2012 and the mean consumption of the bottom 40 grew at 5.3 percent annually, exceeding the growth

enjoyed by the population overall.^{1,2} This was mainly attributable to government transfers, food disinflation and increased earnings. Inequality in Georgia is higher than in the ECA region on average with a Gini coefficient of 40.7 in 2011. Making growth more inclusive will, therefore, require investments in human capital as well as reforms to support competitiveness.

The objectives of this operation are consistent with the new development strategy of the government and the CPS which focuses on areas in which the Bank has a comparative advantage. These include convening power, rigorous analytical work, and the ability to leverage assistance from development partners. The policy actions supported by this DPO targets the government's most urgent development challenges and builds on previous development policy operations. The previous series of DPOs concentrated on structural reforms to build competitiveness for sustained growth.

The reforms supported by the previous DPO series were anchored in public finances (modified cash basis IPSAS and coverage of LEPLs in the e-budget), social sectors (universal health coverage, upgraded standards for hospitals and primary health care, increased efficiency of pensions), and improvements in competitiveness (adoption and implementation of framework laws on competition, food safety and free movement of products, improved customs efficiency, power sector reliability, and general education). The current DPO series lays the foundation for inclusive growth by furthering reforms in the areas of public financial management, social sectors and infrastructure and environmental sustainability. Specific actions already taken by the government in these areas include the following: the government has already set up a treasury single account at the central government level, universal health care has been introduced, and the social information management system has been set up to improve targeting efficiency of social assistance programs.

II. Proposed Objectives

The objectives of this operation are to: (i) strengthen monitoring of SOEs and municipalities and enhance the government's capacity for capital budgeting; (ii) improve coverage and targeting of social expenditures, quality of education and healthcare services, and monitoring of outcomes; and (iii) support competitiveness by improving infrastructure and environmental sustainability and enhancing gender equality.

The first pillar in this operation supports rationalization in the number of SOEs and measures to include municipal expenditures under the treasury single account. This will help improve the monitoring of SOEs and municipal expenditures. The second pillar supports the adoption of a new methodology to calculate TSA such that it helps in reducing inclusion and exclusion errors and provides TSA assistance to more number of poor. Pillar 2 also supports amendments to the law on statistics in an effort to improve the quality of data and improvements in obstetrics and neonatal care. Pillar 3 supports measures to improve gender equality which will help support competitiveness in the long run.

¹ Poverty at the Europe and Central Asia (ECA) regional poverty line of US\$2.50 per person per day was 45 percent in Georgia in 2011 and has not changed much over the past decade.

² Consumption growth among the bottom 40 percent was 5.4 percent during 2010-12 compared with 3.6 percent for the population as a whole.

The DPO objectives under the three pillars are anchored in the government's development strategy. The three DPO pillars map to two of the three priority areas outlined in Georgia 2020 as well as the necessary pre-conditions laid out by the government. Pillar 1 of the operation will support the pre-conditions of enabling macroeconomic stability and more effective public administration. Pillar 2 will support the government's efforts on human capital development while Pillar 3 will support improvements in the competitiveness of the private sector. The first generation reforms which started a decade back have helped Georgia improve its business environment, achieve sustained growth rates and maintain low inflation. However, the country has not yet recovered to its 1990 level of real per capita income and socio-economic vulnerabilities persist. Further improvements in the living standards of Georgians will therefore need to come from other areas. These include investment in human capital, enhanced private sector competitiveness, and fiscal, social and environmental sustainability. A supportive macro-fiscal environment will remain a necessary condition. This operation supports government reforms in some of these areas.

III. Preliminary Description

The prior actions of the operation along with intended results are presented below.

Pillar I:

State-Owned Enterprises

Prior Action 1: Adopt the SOE rationalization strategy and action plan that provides enterprise-based actions (privatization, closure, merger or keeping the existing structure) for all central government SOEs under the Ministry of Economy and Sustainable Development (MOESD). The expected result is to reduce the number of SOEs under the MOESD from 440 in 2013 to 220 in 2017. This will help in better fiscal monitoring and support macroeconomic stability.

Municipal Governments

Prior Action 2: Amend the budget code to include municipal expenditures in the Treasury Single Account. The expected result is that budget execution data and available balances of municipalities will be available on a real time basis as against the annual data that is currently available. This will help in better fiscal monitoring and support macroeconomic stability.

Pillar II:

Social Assistance

Prior Action 3: Adopt the new methodology to calculate TSA so as to reduce inclusion and exclusion errors along with explicit measures to avoid work disincentives. The expected result is to increase the share of the bottom decile receiving TSA from 50 percent in 2013 to 60 percent by 2017. This will help the poorest segment of the population and support those who do not benefit from the economic opportunities created in the country.

Health

Prior Action 4: Adopt the state program for expanding the list of outpatient medicines for TSA beneficiaries under the UHC package. The expected result is to reduce out-of-pocket spending of TSA beneficiaries on healthcare from 72 percent in 2013 to 10 percent by 2017. This will help support the government's efforts to build human capital and protect the vulnerable from impoverishing health expenditures.

Monitoring and Evaluation

Prior Action 5: Amend the law on statistics to make the census timely and to specify a minimum census preparation time. The expected result is to conduct a high quality census every 10 years. This will help improve monitoring and evaluation of government expenditures and contribute to better fiscal outcomes.

Pillar 3:

Gender

Prior Action 6: Adopt the action plan to improve gender equality. The expected result is to increase the number of women employed by the central government by 10 percent by 2017. This will support overall competitiveness in the long run.

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

The overall poverty, social, and gender impact of most policy actions supported by this operation are expected to be positive. In particular, the SOEs rationalization plan, the change in the TSA calculation formula, and the adoption of the plan for enhancing obstetric and neonatal care will have a distributional impact. The distributional impact of the SOE rationalization strategy can take place through various interrelated channels like labor market outcomes, changes in access to services and adjustments in prices and quality of services, and through the state budget. This PSIA will however focus on distributional impact only through labor market outcomes. The impact of the change in the methodology to calculate the TSA will most likely be positive as the coverage of the TSA will increase to include individuals who do not currently benefit but should, and by increasing labor income in those families for which the current structure of the benefit creates work disincentives. However, there will also be households which will no longer receive TSA and an assessment of their welfare will also be weighed in. The adoption of the regional plan for obstetric and neonatal care will most likely have a positive distributional impact as it will improve the standards for the provision of obstetric and neonatal care, which can impact positively on the incidence of maternal and infant mortality and on the incidence of other complications related to childbirth, especially for low-income households. Identifying the regions with the highest incidence of these cases will allow focusing efforts on those regions, in order to maximize the possible impact of the plan. The regional plan for obstetric and neonatal care as well as the implementation of the action plan on gender equality will also have a positive gender impact through improved health outcomes and increased employment opportunities for women.

Environment Aspects

The policy reforms supported by the first operation under the DPO series are neutral to the environment. However, the second and third operation under the series includes some policy actions which are directly or indirectly aimed at enhancing environmental sustainability while others that are neutral. The triggers on the environmental impact assessment and the forest code will have direct positive benefits for the environment. In addition, the indicative triggers on irrigation and roads are expected to have an indirect positive long-term environmental impact. The development and adoption of the National Irrigation and Drainage Strategy will strengthen the management and efficiency of service delivery through rehabilitation of infrastructure, improvement of pricing policy and maintenance system, establishment of monitoring schemes, and increased resilience to the likely impacts of climate change. While systemic repair and modernization of infrastructure will allow cutting down water loss due to infiltration and leakages, the optimal pricing will discourage excessive water use, stimulate adoption of more efficient irrigation technologies, and provide incentives for infrastructure maintenance. Proper monitoring arrangements should include water quality and other key environmental indicators so as to produce information required for environmentally sustainable management of the irrigation and drainage sector. The adoption of the Road Sector Financing Strategy and an action plan for its implementation is likely to bring about a positive long-term impact on the environment because it will result in a better condition of road surfaces and storm water drainage systems, lower erosion of roadside slopes, and decreased incidence of traffic accidents. These improvements translate into lesser emissions from vehicles, lesser turbidity and pollution of surface water bodies close to the roads, and decreased risk of environmental pollution from hazardous substances that may be released during vehicle accidents.

V. Tentative Financing

Source:	(\$m.)
Borrower	0
International Bank for Reconstruction and Development	50
Total	50

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