PROJECT INFORMATION DOCUMENT (PID) CONCEPT STAGE

Report No.: PIDC9327

Project Name	Third Regional Development Project (P150696)
Region	EUROPE AND CENTRAL ASIA
Country	Georgia
Sector(s)	General water, sanitation and flood protection sector (35%), Sub-national government administration (20%), Rural and Inter-Urban Roa ds and Highways (35%), SME Finance (10%)
Theme(s)	City-wide Infrastructure and Service Delivery (35%), Cultural Heritage (20%), Urban Economic Development (25%), Infrastructure servi ces for private sector development (10%), Micro, Small and Medium Enterprise support (10%)
Lending Instrument	Investment Project Financing
Project ID	P150696
Borrower(s)	Georgia
Implementing Agency	Georgia Municipal Development Fund
Environmental Category	B-Partial Assessment
Date PID Prepared/ Updated	25-Nov-2014
Date PID Approved/ Disclosed	28-Nov-2014
Estimated Date of Appraisal Completion	09-Feb-2015
Estimated Date of Board Approval	24-Mar-2015
Concept Review Decision	Track II - The review did authorize the preparation to continue

I. Introduction and Context

Country Context

With a population of 4.5 million people growth in Georgia averaged nearly 6 percent p.a. during 2004-2013. While Georgia remains one of the very few countries in Europe and Central Asia (ECA) that have not yet caught up to their 1990 real GDP level, it has benefited from a noteworthy push on structural reforms and liberalization starting in 2004. Improvements in the business environment, infrastructure quality, public finance, and reduced trade barriers stimulated investments. GDP per capita increased from $920 in 2003 to US$3,597 in 2013 although it is still among the lowest in ECA.

Georgia did not experience the structural transformation associated with pushing resources and productivity growth towards the export sectors. While it achieved global recognition as a top performer on the Doing Business rankings (and ranked 8th out of 183 countries in the 2013 Doing Business Report), productivity gains were concentrated mainly in non-tradables, which is where FDI flowed largely to.

Growth stemmed mainly from capital inflows before the twin crises of 2008 and from high public capital spending after. Growth was fueled by high foreign direct investment before the global economic crisis of 2008, a period of easy finance world-wide. This led to booming consumption, imports, and investment and allowed Georgia to incur a large current account deficit – reaching 20 percent in 2007 before moderating to a still high 11-12 percent range over 2011-2012. The twin shocks in 2008 of the global economic crisis and the conflict with Russia interrupted capital inflows and private investment and growth plummeted – in 2009 GDP contracted by 3.8 percent. The Government was quick to implement a fiscal stimulus to support recovery, including a large public investment package and increased social transfers. These efforts paid off and growth quickly rebounded, averaging more than 5 percent during 2010-2013.

Despite growth, unemployment stayed high and it remains the most significant public policy challenge. Georgia's robust growth performance was accompanied by high unemployment, which remained in the 12-13 percent range even during the pre-crisis boom. Unemployment peaked to 17 percent in 2010 and then fell to 15 percent in 2012. Georgia was able to create significant new employment but this has been insufficient to bring about overall net job creation.

Reducing poverty and promoting shared prosperity remain a challenge in Georgia. Poverty and extreme poverty, measured using absolute poverty lines anchored on the national relative poverty and extreme poverty lines, are high in Georgia compared to other countries in the region. In 2012, 14.8 percent and 3.7 percent of the population lived in poverty and extreme poverty respectively. Consumption growth among the bottom 40 percent of the population, the World Bank’s indicator of shared prosperity, was also lower than for the population as a whole for the period 2006-2010. This was reversed in 2010-2012 mainly due to the benefits of the fiscal stimulus rolled out in the period after the global economic crisis that increased social transfers and finally brought about an improved shared prosperity of the bottom 40 percent.

At the aggregate level, the Government aims to address two priorities—increasing employment and narrowing the current account deficit. These are to be achieved by promoting private investments in sectors such as tourism, energy and logistics, and by continuing public investment in infrastructure, regional development, agriculture and education. These efforts are seen as key catalysts for accelerating job creation. Consequently, Georgian authorities continue to support private sector to lead economic growth and job creation efforts.

Sectoral and Institutional Context

Inequality in Georgia is spatially reflected in regional and urban/rural disparities. Unemployment in 2012 was largely urban at 26.2 percent, while rural unemployment was at 7 percent. However, 64 percent of the poor live in rural areas, despite the fact that rural areas comprise less than 50 percent of Georgia's total population. Regional disparities in service delivery are also very visible in water and sanitation. Today, only Tbilisi provides piped water to almost all households while in most of the remaining regions, piped water is available to no more than 30 percent of households. In Tbilisi, over 90 percent of households have bathrooms, while in economically weak rural regions, the number drops to only 3 to 4 households out of 10.

Consequently, the Government identified addressing regional disparity, poverty and unemployment as key priorities for intervention in its new national development strategy "Socioeconomic Development Strategy of Georgia: 2020". The financing of regional development programs, decentralization and investment in municipal infrastructure and services, are emerging as key tools in this regard as articulated in the Strategy on Regional Development. The objective of this strategy is to address regional disparities, focusing on developing the potential sources of economic growth in each region.

The development of the tourism sector (often focused on cultural heritage and nature) emerges as a source of economic growth both nationally and also in key regions and cities. International tourist arrivals have grown rapidly (more than 5 million visitors in 2013, representing a 66 percent increase since 2011). Tourism and travel sector is becoming a key generator of jobs, accounting for 14.2 percent of total employment in 2013 and 16 percent of GDP (directly and indirectly), with a forecast to continue growing by 4.8 percent per annum. The sector currently also provides nearly 20 percent of export earnings.

In line with this strategic direction, the Government invested about US$400 million between 2005-2013 for revitalization of municipal infrastructure and restoration of old buildings (most of which have a cultural heritage value) in the cities of Tbilisi, Signagi, Mtskheta, Batumi and Kutaisi. Nonetheless, the Government recognized that restoring buildings and municipal infrastructure was not sufficient to trigger and sustain local economic transformation. Thus, an integrated and demand-driven approach to regional development was seen as critical to spurring growth in targeted cities and regions.

The Government has, therefore, launched a Regional Development Program with support of the World Bank, to attract private investors, especially in tourism and agribusiness in targeted regions. The Regional Development Project (RDP - P126033, US$ 60 million), focusing on Kakheti region, was approved by the Board on March 20, 2012. The RDP was followed in November 2012 by the Second Regional Development Project (RDPII - P130421, US$ 30 million), which focused on Imereti. Both projects are under implementation, and achieving remarkable results.

These include, in Kakheti, an increase in the number of hotel beds in the targeted areas from 1,610 to 2,511 (exceeding the project's targets of 1,932); an increase in the number of SME points of sales (tickets, souvenirs shops, restaurants, hotels, guest-houses and family houses) from 248 at baseline to 282 (expected to exceed the 323 target by end of 2014); an increase in the hours of water supply from 8h per day to 24h, and at least 80 new business start-ups. House owners have already transformed part of their properties into a productive or service asset (hand-crafts workshop, souvenir shop, café, restaurant or a guest-house).

The Government requested the Bank to support a Third Regional Development Project (RDPIII) with US$60 million. The proposed Project will focus on Samtskhe-Javakheti, a lagging region in the south, and Mtskheta-Mtianeti, a growing region economically close to the capital.

Relationship to CAS

The proposed Project is aligned with the Country Partnership Strategy (CPS) for FY14-FY17 (Report Number: 85251-GE). The Project supports Focus Area 1: Strengthening Public Service

Delivery to Promote Inclusion and Equity, as it promotes Effective Public Administration and Decentralization. It also supports Focus Area 2: Enabling job creation by the private sector through improving competitiveness, as it improves Georgia's investment and business environment, including in the regions; supports innovations and development of technologies, including in the regions; and develops infrastructure and maximum realization of Georgia's transit potential.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From PCN)

The Project Development Objective is to improve infrastructure services and institutional capacity to support increased contribution of tourism in the local economy of the Samtskhe-Javakheti and Mtskheta-Mtianeti regions.

Key Results (From PCN)

Infrastructure Services:

- Increased hours per day of piped water delivery in project areas.
- Improved access roads to selected tourism attraction sites.

Tourism Economy:

- Increased volume of private sector investments in targeted areas.
- Increased hotel beds in circuit areas.

Institutional Capacity:

- Increased number of tourism related enterprises (e.g., souvenir and handcraft shops, family and guest houses, restaurants, museums, etc.).
- Establishment of two regional destination management offices for sustainability.

III. Preliminary Description

Concept Description

The Project will finance investment priorities identified under a Tourism Development Strategy of each region. The strategies are currently under final stages of preparation, supported with technical assistance from the World Bank. Proposed investments will also be aligned with the regional development strategies; prepared with technical assistance from EU (Mtskheta-Mtianeti) and GiZ (Samtskhe-Javakheti). The design of the Project – a proposed blend of institutions, infrastructure, and targeted interventions – will be informed by both a comprehensive diagnostic and relevant international experience. The Project will aim at supporting the local economy in the regions by carrying out an integrated approach to tourism development, focusing on infrastructure, urban regeneration, cultural heritage restoration, skills development and enabling the environment to attract private sector investments. The Project is expected to support better anchoring of the regions to the Georgia-wide tourism circuits, to tap the hitherto untapped yet potentially significant tourism and hospitality industry potentials. The Project is important in the general context of Georgia regional development and spatial planning vision.

The Samtskhe-Javakheti region stretches over 6413 km2 and a population of 208,000. The region includes 6 large municipalities and its administrative center is Akhaltsikhe. Main urban areas are Akhalkalaki, Akhaltsikhe, Borjomi, Vale, and Ninotsminda. In 2013, the region was visited by 180,273 international tourists. There are 160 accommodation units, including 55% family houses, 36% hotels, and 4% guest houses. The total number of beds is 6,137. A SWOT analysis concerning

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the tourism sector highlighted a number of strengths comprising increasing tourism trends; ski infrastructure in Bakuriani; Borjomi-Kharagauli National Park and its tourism trails; uniqueness of cultural heritage; varied landscape, flora, fauna, and folk craft traditions. However, a number of weaknesses prevent tourism from growing further, including lack of high standard hotels; weak tourism and municipal infrastructure; low level of tourism services and skills; inadequate condition of natural and cultural heritage sites and poor access; lack of high quality food services, souvenirs and craft shops in the regions; and poor marketing, promotion and destination management.

The Mtskheta-Mtianeti region has an extension of 6.785 km2 and a population of 125,000. The region includes 4 large municipalities and its administrative center is Mtskheta. The main urban areas are Mtskheta and Dusheti. In 2013, the region was visited by 715,155 international tourists. There are 83 accommodation units, including 57% family houses, 39% hotels, and 2% guest houses. The total number of beds is 2,754. From a tourism standpoint, the region offers a variety of products, with potential to offer high-quality tourism, through preserving and enhancing wildlife, ecosystems, and cultural heritage. Harnessing tourism potential of this region might help provide job opportunities and therefore support rural population, balancing migrations to lower plains.

Building on the design and lessons learned under the RDP and RDP II, the Project will have two components:

Component 1: Infrastructure Investment (US$55 million)

Component 1.1: Urban Regeneration and Circuit Development (US$45 million). This component will finance: urban regeneration of old towns and villages, including restoration of building facades, public spaces, museums, roads and water, and enhancement of cultural and natural heritage sites, including access and presentation.

Based on product development and marketing potential, infrastructure needs, and employment levels, the Project will focus on sites along the circuit connecting the selected heritage, nature and ski sites. The proposed sites/subprojects discussed with the Government for financing under the Project will supplement what the Government has already invested in. These can be grouped into two categories:

• Three cities suggested for urban regeneration building on its comparative advantage as cultural heritage and vernacular architecture destinations: Dusheti, Kazbegi and Abastumani. The Project will build on previous investments made by the Government, and may finance small-scale incremental investments needs, in Mtskheta, Gudauri, Bakuriani, Borjomi and Akhalsekhi. Additional investment needs in Akhalkalaki, Ninosminda and Khevsureti will be subject to a great scrutiny during preparation, under the planned Tourism Development Strategy for each region.

• Nine cultural heritage sites are suggested for improved site management and construction of tourism facility and access road: Saphara Monastery, Saro Church and Darbazi houses, Zarzma Monastery, Vani Caves, Khertvisi Fortress, Akhalkalaki Castle, Ananuri Fortress, Gergeti Trinity Church and Shatili.

Component 1.2: Provision of Public Infrastructure to Attract Private Investments (US$10 million). To encourage private sector investments in the region, this component will support a selected number of private sector entities in project areas that demonstrate interest and capacity to invest in tourism or agribusiness through investing in complementary public infrastructure that is necessary

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to ensure the viability of their investments e (e.g. public facilities within vicinity of the investments, road/sidewalk, water/sanitation, communications, connection to main trucks, etc.). The investment proposals would be subject to screening by a selection committee and there will be appropriate conditions tied to that.

Component 2: Institutional Development (US$5 million).

The component will support institutional capacity and performance of the Georgia National Tourism Administration (GNTA), Agency for Culture Heritage Preservation of Georgia (ACHP), National Museum, Project Implementing Entity (Municipal Development Fund of Georgia, MDF), and other local and regional entities in order for them to carry out the following activities: destination management and promotion, including local outreach campaigns; marketing and promotion; skilled workforce development and capacity building; feasibility studies, design, construction supervision and sustainable site management of cultural heritage; and performance monitoring & evaluation activities.

In order to stimulate rapidly increased travel to the regions and develop institutional capacity and performance of tourism related local and regional entities establishment of Regional Destination Management Organizations (DMO) should be given a priority. There is not a single institutional unit existing that could work with the government, donors, the international travel trade, and help to define a product development strategy, implement it, and market the destination. In frames of the proposed project the role and importance of DMO experience have been highly addressed.

Business development for tourism and agribusiness SMEs is a key alongside improved business access to markets and finance. The Ministry of Economy and Sustainable Development (MESD) intends to promote micro businesses in all regions of Georgia. In this regard, TA will be provided under this Component in order to support prospective SMEs with business startup/expansion advisory services so that they can easily access micro finance programs offered by MESD.

IV. Safeguard Policies that might apply

Safeguard Policies Triggered by the Project	**Yes**	**No**	**TBD**
Environmental Assessment OP/BP 4.01	✖		
Natural Habitats OP/BP 4.04	✖		
Forests OP/BP 4.36		✖	
Pest Management OP 4.09		✖	
Physical Cultural Resources OP/BP 4.11	✖		
Indigenous Peoples OP/BP 4.10		✖	
Involuntary Resettlement OP/BP 4.12	✖		
Safety of Dams OP/BP 4.37		✖	
Projects on International Waterways OP/BP 7.50		✖	
Projects in Disputed Areas OP/BP 7.60		✖	

V. Financing (in USD Million)

Total Project Cost:	75.00	Total Bank Financing:	60.00
Financing Gap:	0.00		

Financing Source	Amount
Borrower	15.00
International Bank for Reconstruction and Development	60.00
Total	75.00

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