

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

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Operation Name	Private Sector Competitiveness DPO1
Region	Europe and Central Asia
Country	Georgia
Sector	General industry and trade sector (50%); General finance sector (25%); Other industry (25%)
Operation ID	P149998
Lending Instrument	Development Policy Lending
Borrower(s)	Government of Georgia
Implementing Agency	Ministry of Economy and Sustainable Development
Date PID Prepared	September 30, 2014
Estimated Date of Appraisal	December 10, 2014
Estimated Date of Board Approval	March 25, 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

Georgia has a consistent track record with regard to macroeconomic stability and improving the business environment. Macroeconomic and financial stability have been preserved in the face of negative shocks, and public sector debt has remained at manageable levels. The business deregulation, anticorruption, legal, tax and trade reforms that Georgia put in place in 2004-12 made the country a more attractive destination for foreign direct investment (FDI) and brought it global recognition as a top reformer. Georgia ranked 9th in the *2013 Doing Business* report, compared with the already high ranking of 15th in 2009, and its position on the *Global Competitiveness* ranking improved from 90th place in 2008-2009 to 69th in 2014-15. The Government is committed to addressing remaining business environment constraints.

The challenge facing Georgia is to facilitate sustainable and inclusive economic growth. Above mentioned reforms contributed to robust economic growth during the last decade; however, unemployment remains a significant public policy concern. Although significant new employment was created during the last ten years, especially in the service sector, the combination of labor shedding in the public sector and economic transformation in some of the older sectors meant there was little in the way of net job creation. Consequently, unemployment has stayed stubbornly high, never falling below the 12-13 percent range. Also, in 2012, 14.8 percent and 3.7 percent of the population still lived in poverty and extreme poverty respectively.

The Government's inclusive growth agenda foresees policy reforms to strengthen the private sector's competitiveness and productivity, thereby reducing the economy's

reliance on public investment as the main source of growth. Long-term growth prospects will also depend on Georgia's ability to leverage the benefits of membership in the Deep and Comprehensive Free Trade Area (DCFTA) and the Association Agreement (AA) with the European Union (EU), both of which will improve market access and encourage trade and FDI. Harnessing the gains from deeper integration with the EU will require promoting the reallocation of capital and labor to more productive industries, building the capacity in domestic firms so they can cope with compliance costs associated with the harmonization of the legal and regulatory frameworks, and upgrading state institutions to improve trade facilitation, reduce technical barriers to trade, protect intellectual property rights, and develop the country's human capital.

II. Proposed Objective(s)

The DPO series supports the Government's policy reforms that aim to spur inclusive economic growth through improvements in the business environment, deeper access to finance, and improved capacity to export and innovate.

The operation is consistent with the Socio-economic Development Strategy "Georgia 2020" (SDS), which sets out the government's vision for inclusive development. The proposed DPO1 supports crucial initial reforms which are the first step towards broader and deeper policy changes in the second and third operation. The DPO reform measures are organized around three pillars:

Pillar 1 - Enhancing the Business Environment supports:

- (i) Greater private sector involvement in the economic-policy making process
- (ii) More effective competition policy; and
- (iii) Improved access to SMEs to public procurement.

Pillar 2 - Deepening Access to Finance supports:

- (i) Financial deepening and capital market development, including pension reforms to incentivize savings in new instruments;
- (ii) Increased financial sector transparency and investment attractiveness; and
- (iii) Improved access to collateralized finance.

Pillar 3 - Increasing the Capacity to Innovate and Export supports:

- (i) Developing the innovation ecosystem;
- (ii) ICT sector development; and
- (iii) Lowering the transaction costs of exporting firms.

III. Preliminary Description

Pillar 1 of the DPO series will support measures to enhance the business environment, as a way to stimulate private sector growth and the reallocation of resources from low-productivity to high-productivity firms and industries. The "second-generation" business environment reforms under this pillar will incentivize private investment and make it easier for small and medium sized enterprises (SMEs) to grow.

Pillar 2 will support measures to increase access to finance by removing legal and regulatory obstacles that deter savings and slow financial market development. Availability of short and long-term financing is crucial to respond to investment and production needs of Georgian firms, especially SMEs. The reform measures include development of financial markets and instruments through strengthening legislation, regulations and supervision.

Pillar 3 will support measures to stimulate innovation and exports by Georgian firms. The reform measures include: legal reforms and the establishment of institutions to promote commercial innovation such as the Georgian Innovation and Technology Agency; changes in the legal and regulatory framework regulating the telecommunications sector to accelerate access to broadband Internet services; and upgrade in the national quality infrastructure in line with AA commitments.

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

While the overall set of policies supported by the DPO program is expected improve the living conditions of Georgian households by enhancing growth potential, a number of the supported actions may have a direct distributional impact, affecting especially households in the lower tail of the income distribution. A detailed assessment of potential impacts will require further analysis using available microdata. Data will be needed both at firm and household levels. The actions with direct distributional impacts are three and correspond to each of the pillars of intervention, as follows: (i) For Pillar 1: (Prior Action #3) Strengthen SME participation in public tenders by establishing a training center to improve knowledge and capacity about procurement procedures; (ii) For Pillar 2: (Prior Action #5) Incentivize private savings through the approval of a roadmap for comprehensive pension reform in Georgia, and (iii) For Pillar 3: (Prior Action #12) Accelerate the provision of wireless broadband services by issuing (more than one/three) licenses for wireless broadband services in the 800 MHz band.

Strengthening SME participation in public procurement can benefit the bottom 40 by increasing the opportunities of employment for this group. Providing better opportunities to SME to compete for public purchases can translate into more opportunities for SME growing, leading to more job creation. With certain caveats, information from the Integrated Household Survey (HIS) and the Business Environment and Enterprise Performance Survey (BEEPS) can be used to identify characteristics of SME workers and obtain a better estimate of the potential beneficiaries of the additional employment opportunities.

Incentivizing private savings as part of an overall pension system reform can also have a positive impact on the bottom 40 as long as it can actually translate into increases in future pensions. As discussed in the 2012 Public Expenditure Review, in addition to being more fiscally sustainable, a scheme that incentives private retirement savings can help to raise the level of future pensions by complementing a minimum universal pension, especially for middle and high income individuals. More analysis based on the

IHS is necessary to identify the magnitude of the effect on the income of the bottom 40 and the poverty rates, especially after considering potential behavioral changes the savings-incentivizing scheme can produce.

Finally, accelerating the provision of wireless broadband services, especially in the rural side, will have a positive impact on poverty and shared prosperity by facilitating the creation of enterprises that can create employment opportunities. Information from the IHS shows that the number of internet connections is quite small in the rural side, a region that concentrates two thirds of the poor (Georgia 2014 Poverty Assessment). Increasing the availability of internet connections can make viable businesses that seek reliable and affordable connectivity, and hence making more dynamic the rural economy and increasing the job opportunities in this region.

Environment Aspects

The specific policy actions supported by this DPO series are not expected to have direct impacts on the natural environment. The policy measures focus on legal, regulatory, and supervisory reforms to strengthen and further develop the financial sector, that do not carry environmental risks.

V. Tentative financing

Source:		(\$m.)
Borrower		0
International Bank for Reconstruction and Development		50.0
	Total	50.0

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