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INTERNATIONAL FINANCE CORPORATION

COUNTRY PARTNERSHIP STRATEGY

FOR GEORGIA

FY2014 – FY2017

April 9, 2014

South Caucasus Country Department
Europe and Central Asia Region

International Finance Corporation
Europe and Central Asia Department

GOVERNMENT FISCAL YEAR
January 1 – December 31

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of February 18, 2014

Currency Unit	Georgia Lari
US$1.00	GEL 1.76

WEIGHTS AND MEASURES
Metric System

ABBREVIATIONS AND ACRONYMS

AAA	Analytical and Advisory Activities
ADB	Asian Development Bank
CIS	Commonwealth of Independent States
CPRR	Country Program Results Review
CPS	Country Partnership Strategy
CPSPR	Country Partnership Strategy Progress Report
DCFTA	Deep and Comprehensive Free Trade Area
DPL	Development Policy Lending
EBRD	European Bank for Reconstruction and Development
ESW	Economic and Sector Work
EU	European Union
FDI	Foreign Direct Investment
FSAP	Financial Sector Advisory Program
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
GEF	Global Environment Facility
GEL	Georgia Lari
IBRD	International Bank for Reconstruction and Development
ICT	Information and Communications Technology
IDA	International Development Association
IDF	Institutional Development Fund
IFC	International Finance Corporation
IMF	International Monetary Fund
ILCS	Integrated Living Conditions Survey
JICA	Japan International Development Agency
KfW	Kreditanstalt für Wiederaufbau
MDG	Millennium Development Goal
MTEF	Medium-Term Expenditure Framework
MOF	Ministry of Finance
PER	Public Expenditure Review
PFM	Public Finance Management
PPP	Public Private Partnership
SME	Small and Medium-sized Enterprise
TF	Trust Fund
UNDP	Targeted Social Assistance
UNDP	United Nations Development Program
USAID	United States Agency for International Development

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GEORGIA
COUNTRY PARTNERSHIP STRATEGY (2014-2017)

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Map of Georgia (IBRD33410R)

This Country Partnership Strategy (CPS) was prepared by a joint WBG team led by Eavan O'Halloran and Rashmi Shankar under the guidance of Henry Kerali and Thomas Lubeck, with significant contribution from Carla Pittalis, Iullia Mironova and Luis Alvaro Sanchez.

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EXECUTIVE SUMMARY

1. **The objectives of this Country Partnership Strategy (CPS FY2014-FY2017) are to help end extreme poverty and boost shared prosperity in Georgia in a sustainable manner.** The CPS comes at a propitious time for Georgia. The Government has outlined its vision in the Socio-Economic Development Strategy (SDS) that has the over-arching objective to achieve faster, inclusive and sustainable growth, while seeking a greater focus on social outcomes and poverty reduction. The objectives of this CPS are thus fully aligned with the Government's SDS. The design of the CPS is based on available analytical work on the drivers of growth and inclusion and identifies two areas of focus that will support achievement of the objectives:

a. ***Strengthening public service delivery to promote inclusive growth:*** the goal is to accompany the Government in its commitment to increasing budgetary resources for social sector programs in a fiscally sustainable way. This area of focus supports improving the effectiveness and efficiency in the delivery of public services where there is a known link to reducing extreme poverty and boosting shared prosperity;

b. ***Enabling private sector-led job creation through improved competitiveness:*** the goal is to support a sustainable pattern of growth that generates employment and provides income opportunities for the bottom 40 percent of the population. The private sector will be the driver of employment creation. The CPS contribution focuses on removing important constraints in finance, infrastructure, technology and skills that prevent the private sector from thriving.

2. **The CPS program is geared to empower Georgia to take advantage of the opportunities available for growth, employment and inclusion.** Georgia is located along a strategic corridor connecting Europe and Asia, has significant renewable hydropower energy resources, diverse climates and sceneries that augur well for tourism, and good potential for higher value-added agricultural production. Georgia initialed the Association Agreement with the European Union (EU) and its integral part – the Deep and Comprehensive Free Trade Area (DCFTA) - in November 2013, thereby opening up significant opportunities for trade and investment. In parallel, the Government is committed to a more inclusive growth model that is fiscally sustainable by strengthening the efficiency of public service delivery and increasing social expenditures to levels more comparable to other ECA countries.

3. **The WBG's strong engagement in Georgia to date and the Government's SDS set a good foundation**. The current WBG program is selective and coordinated with the other development partners' programs. Performance on support to reforms, project implementation and the quality of knowledge has been strong. The program has maintained balance between stimulating growth through business environment reforms and enhanced infrastructure while, in parallel, supporting poverty reduction through improved public expenditure management, a more effective social protection system, and reforms in the health and education systems.

4. **The CPS maximizes the financial and knowledge resources of the WBG for Georgia**. The lending program includes the remaining IDA allocation (Georgia is expected to graduate from IDA at the end of FY14), the full volume of IBRD available, a broad package of IFC investments and the

full menu of MIGA products where demanded. Selectivity in the delivery of analytical and advisory services (AAA) is driven by alignment to the twin goals and complementarity with the CPS objectives. The CPS pro-actively commits to monitoring progress towards results, introducing corrective measures and fine-tuning as new knowledge is gained. Finally, the program will generate knowledge on gender issues and support the collection and analysis of gender disaggregated data.

5. **Strict selectivity criteria were applied to the choice of engagement areas in the CPS.** The CPS reflects ownership as the program focuses on areas are where the Government has specifically asked for WBG support taking into account the WBG's value-added and other partners' programs. The engagement areas rank high as potential drivers of poverty reduction and shared prosperity, as identified in the analysis. The CPS program builds on the successful elements of the existing program and a good track record of implementation. The program allows for the WBG's global knowledge to play a critical role and, finally, targets areas where the WBG can achieve measurable results.

6. **The CPS outlines mitigating measures to contain the risks to the program.** The risk to delivery of the ambitious program from the domestic political context is mitigated by ensuring close alignment with the Government's SDS and anchoring the program in evidence based decision making. Public sector capacity poses risks which are mitigated through a broad package of support, coordinated with other development partners, and through focus on capacity building, results-based planning and "delivering for impact". The risk that employment generation may continue to lag is mitigated through a comprehensive focus on economic competitiveness, while recognizing that expectations for radical transformation should be modest within the CPS time frame. Macroeconomic risks are mitigated by the Government's commitment to a sound fiscal policy framework, anchored in fiscal consolidation and efficient public financial management, with broad support from the WBG, the IMF and other partners. Should these risks materialize; the program will be adapted at the mid-way point as the two-fold focus of the CPS on enabling job creation by the private sector and effective public service delivery allows for a balanced approach that can be fine-tuned during implementation.

I. COUNTRY CONTEXT AND DEVELOPMENT AGENDA

A. Political Developments

1. **The parliamentary elections of October 2012 and the presidential elections one year later ushered in a new government led by the Georgia Dream coalition.** The one year period between the two elections was marked by policy uncertainty and slow implementation of public programs that resulted in diminished consumer and investor confidence and significantly lower growth. After the presidential elections, Irakli Gharibashvili was appointed the new Prime Minister and head of Government, and under the new constitution has full executive authority over domestic and foreign policy. The new government subsequently embarked on the preparation of a medium-term development vision articulated in the draft Socioeconomic Development Strategy (SDS) 2020, in which this Country Partnership Strategy (CPS, for the period FY14-17) is anchored. The overarching objective of the SDS is to achieve faster, and more inclusive and sustainable growth.

2. **Georgia has taken steps to strengthen significantly market access and establish closer economic ties with the European Union (EU).** It initialed the Association Agreement with the EU at the Vilnius summit in November 2013, which paves the way for a Deep and Comprehensive Free Trade Area (DCFTA). This represents an important opportunity for Georgia to strengthen its cooperation with Europe on political, economic, social and security issues, and to benefit from bilateral free trade. Relations with Russia are showing signs of improvement, as witnessed by the formal lifting of a ban on the import of wine and mineral waters from Georgia, which has already led to an increase in trade between the two countries.

B. Growth, Poverty and Shared Prosperity, and Gender

Sources of Growth

3. **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 $3,597 in 2013 although it is still among the lowest in ECA.

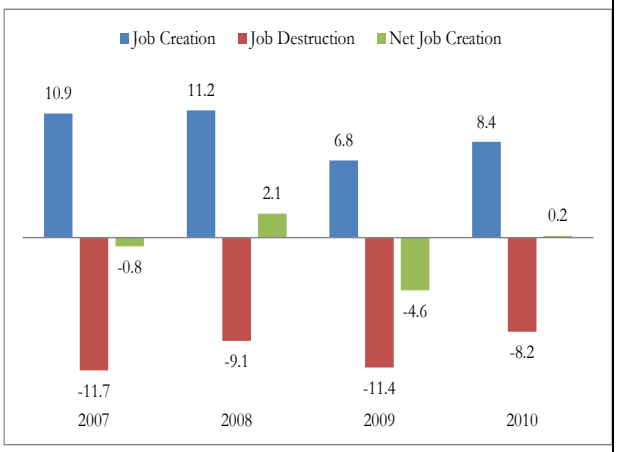
4. **Georgia did not experience the structural transformation associated with pushing resources and productivity growth towards the export sectors.** While it achieved global recognition as a top performer on the Doing Business rankings, productivity gains were concentrated mainly in non-tradables, which is where FDI flowed largely to. At the same time, agriculture was not a public policy priority until 2012, in spite of absorbing a significant proportion of the labor force. As a result, while growth rates have been impressive on average, there was no strong revival of labor-intensive manufacturing or productive transformation of agriculture or agri-business.

5. **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.

6. **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. As shown in Figure 1, Georgia was able to create significant new employment but this has been insufficient to bring about overall net job creation. Labor shedding in the public sector and as an outcome of economic transformation in some of the older sectors meant that there was significant labor churning and little net job creation. New growth sectors, especially in tourism and other service sectors, have not been able to generate formal employment as effectively as a robust agri-business or manufacturing sector would have. The majority of the work force – more than 55 percent – is employed in agriculture (mostly self-employed), which contributes only 8.2 percent of GDP and is characterized by largely family-based subsistence farming with a relatively small agri-business sector. Low productivity levels in agriculture have contributed significantly to high rural poverty.

Figure 1: Job Creation in Georgia: Pre-crisis and crisis



Source: Staff calculations with GeoStat data

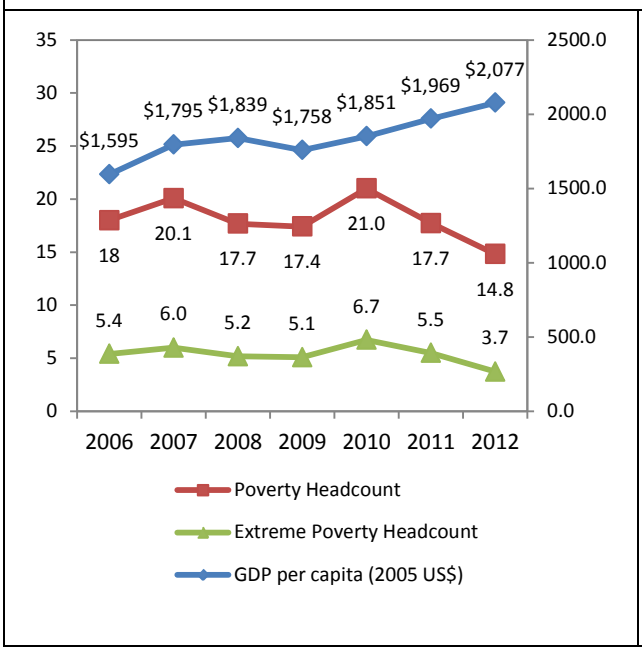
Poverty and Shared Prosperity: Trends and Drivers

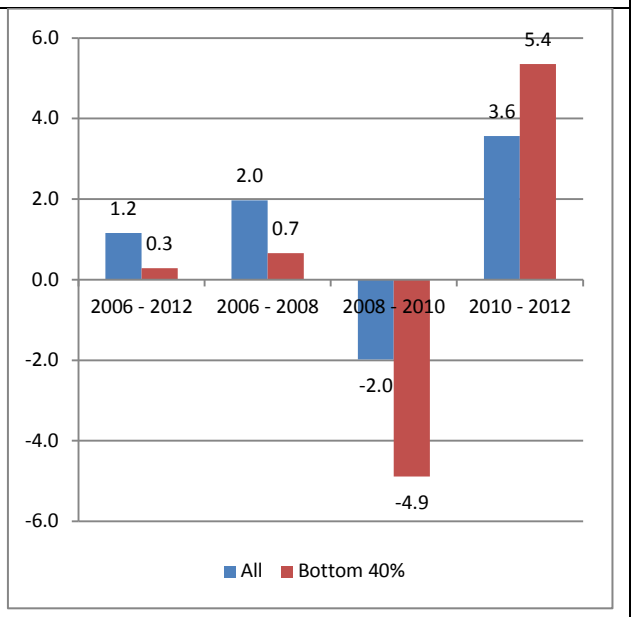
7. **Reducing poverty and promoting shared prosperity remain a challenge in Georgia.** Poverty and extreme poverty, measured using absolute poverty lines anchored on the national relative poverty and extreme poverty lines,[1] are high in Georgia compared to other countries in the region. In 2012, 14.8 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 (Figure 2). 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.

[1] An absolute poverty line is used to facilitate comparisons of poverty performance over time in Georgia. The 2012 values were GEL 91.2 per adult equivalent per month and GEL 52.9 per adult equivalent per month (extreme or food poverty line).

Figure 2 Poverty and Shared Prosperity in Georgia

(World Bank Staff calculations using Integrated Household Survey data)





8. **High unemployment contributes to the weak link between growth and poverty reduction.** Strong economic growth in 2006-2008 was accompanied by stubbornly high unemployment in the 12 to 13 percent range and very limited wage growth, while the crisis resulted in significant employment losses. Labor income, the main source of income for most households, declined causing poverty to rise from 18 percent in 2006 to 21 percent in 2010, while consumption growth among the bottom 40 percent was just 0.7 percent in 2006-2008 and minus 4.9 percent in 2008-2010 (Figure 2).

9. **In recent years, the social protection system has played an important part in reducing poverty.** The Government's response post-crisis was to increase social transfers (both pensions and the Targeted Social Assistance - TSA) and public investment. Both measures had a direct impact on household income, as noted in the improvement in the shared prosperity indicator for 2010-2012 and the significant drop in poverty from 21 percent in 2010 to 14.8 percent in 2012. In 2011, an estimated 56 percent of the population and 60 percent of the bottom 20 percent of the population lived in a household that received old-age pensions,[2] which accounted for nearly 60 percent of the bottom quintiles' and 13 percent of top quintiles' average consumption expenditure. The increases in pension and TSA benefits had a large impact on the welfare of these groups. Similarly, higher employment and wages in the construction and related sectors due to high public investment supported an increase in labor income. Declining food and energy prices reduced the cost of the basic basket consumed by the less well off—simulations suggest that poverty levels would have been more than 2 percentage points higher in 2012 had inflation rates followed past trends. In 2013, TSA and pensions were increased by 100 and 50 percent respectively which is expected to have a positive impact on decreasing poverty rates.

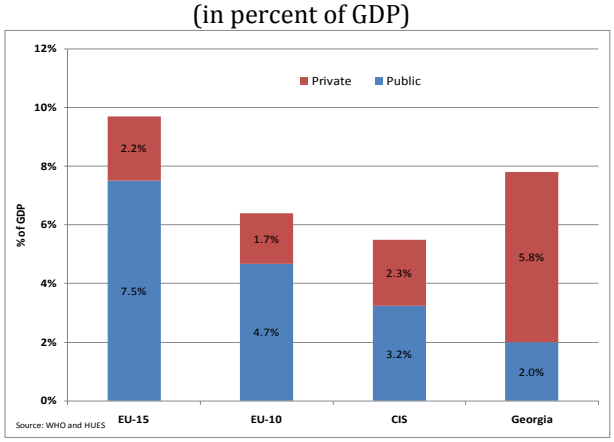
[2] UNICEF's Welfare Monitoring Survey, 2011 round.

10. **The probability of being poor or among the bottom 40 percent is strongly associated with labor market status, gender and limited access to economic opportunities.** The poor and those in the bottom 40 percent are more likely to live: (i) in larger households with greater number of dependents, and headed by someone with less than secondary education and/or a woman; (ii) in households suffering larger unemployment and inactivity rates, and headed by a self-employed individual; and (iii) in rural areas. Furthermore, Georgia has one of the highest incidences of Internally Displaced People (IDPs) in the world (estimated at 5.6 percent of the population). IDPs are dependent on subsistence agriculture and on social assistance, with limited recourse to adequate housing, sustainable livelihoods and jobs. Rates of employment and economic self-reliance are low among IDPs and they account for a disproportionate amount of the poor.[3] Over 17 percent of IDPs are unable to afford nutrition or suffering from systematic starvation while only 48 percent claim average or above average nutrition levels.

11. **Historically low public spending on health and education has contributed to poor social outcomes.** Spending on education as a share of GDP has oscillated between just 2 and 3 percent since the late 1990s including for pre-school (about 0.2 percent of GDP in 2011.)[4] (Figure 3). This has contributed to weak labor mobility across sectors and to inadequate skills development among poor households, leading to high unemployment among the bottom 40 percent, even during periods of high GDP growth. Georgia took part in the PISA 2009 education evaluation and its scores were far lower than expected: just 38 percent of students are estimated to have a proficiency in reading literacy, 31 percent in mathematics and 34 percent proficient in science.[5] Health emergencies are impoverishing for vulnerable groups: out of pocket spending has been amongst the highest in the ECA region at over 70 percent of total health spending (Figure 4). In parallel, drug spending is high at 3-4 percent of GDP and pharmaceutical expenditures accounted for up to 43 percent of total health expenditures and up to 60 percent of household health expenditures in 2012.

Figure 3: Public and Private Health Spending, Europe and Georgia

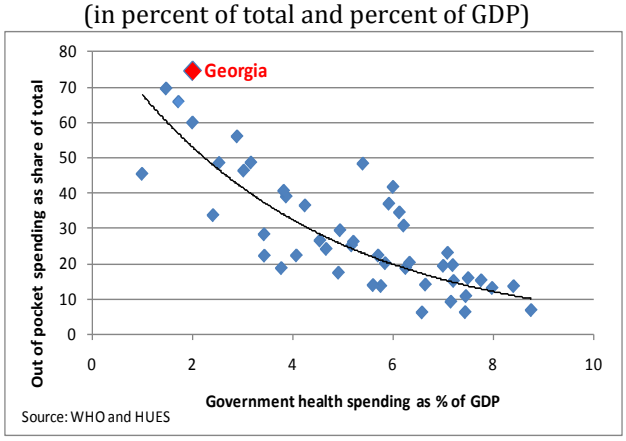
(in percent of GDP)



Source: WHO and HUES

Figure 4: Government and Out-Of-Pocket Spending on Health in Europe and Georgia (2010)

(in percent of total and percent of GDP)



Source: WHO and HUES

[3] World Bank, 2013 'Supporting the Livelihoods of Displaced Persons in Georgia'

[4] Source: MoF; Survey of Municipalities; ISET Policy Institute (2012).

[5] There was no significant difference in the performance of boys and girls in math or reading, although there was a statistically significant gender difference of 19 score points in scientific literacy favoring girls.

12. **While Georgia is on track to achieving several of the Millennium Development Goals (MDGs) by 2015, important challenges remain, which can undermine the social sustainability of the observed trends.** There has been significant progress in recent years with declining infant and maternal mortality; full enrolment in primary education, with higher ratio of girls to boys in primary and secondary education; and increased proportion of the population with access to safe water sources. However, significant inequalities remain in terms of access to basic services and economic opportunities between the poor, the less well-off and marginalized population groups and the rest of the population.

Table 1: Status of Achievement of Selected MDGs

Key Social Indicators/MDGs	Current Status	2015 Targets	Attainment by 2015
1. **Eradicate extreme poverty and hunger** Poverty headcount (below national poverty line) Prevalence of malnutrition (% of children under 5)	 14.8% (2012) 1.1% (2009)	 Halve the ratios between 1990 and 2015	 Progress made Achieved
2. **Achieve universal primary education** Primary school enrolment (gross, %) Primary completion rate (% of relevant age group)	 106.1 (2012) 108.1 (2012)	 100% 100%	 Achieved
3. **Eliminate education gender disparity & empower women** Share of women in wage employment in non-ag. sector (%) Ratio of girls to boys in primary & secondary education (%)	 42% (2012) 101.2 (2012, primary only)	 50% 100	 Progress, but unlikely to be achieved Achieved
4. **Reduce child mortality by two-thirds** Under five mortality rate (per 1,000 live births)	 20 (2012)	 reduce by 2/3 between 1990-2015	 Possible to achieve. Indicator was 47 in 1990 so a 2/3rd reduction is 16
5. **Reduce maternal mortality by three-fourths** Maternal mortality ratio (per 100,000 live births)	 22.8 – National estimate 2012; (2010, WDI estimate is 67)	 reduce	 Possible to achieve. Georgia is close to achieving the high income rate of 14.
6. **Halt/reverse HIV/AIDS and other diseases** HIV prevalence (% of population ages 15-49) Tuberculosis incidence (per 100,000 people)	 0.3% (2012, WDI) 116 (2012, WDI); 84.1 – national estimate 2012	 reduced incidence	 Not likely to be achieved. HIV/AIDS went from 0.2% to 0.3% from 2010-2012, Achieved. TB has been reduced from 128 in 2010

Source: World Development Indicators (WDI)

Gender

13. **Gender inequalities remain constraints to more robust and inclusive growth.** Georgia ranks low in the World Gender Inequality Index (81 out of 195 countries in 2012).[6] Work undertaken for the Gender Assessment (forth coming) reveals the following dimensions:

- **Human capital:** Sex ratios at birth are significantly skewed, indicating a strong preference for boys: estimates show that 109.4 boys were born for every 100 girls in 2012, and the trend has remained steady since the mid-1990s. This phenomenon is symptomatic of gender inequalities, as well as an increased availability of scanning technologies to determine the sex of the child in utero. While the primary school enrollment gap closed in 2010 and tertiary enrollment is slightly higher among women, selection of disciplines in higher education

[6] A Country Gender Assessment is underway in Georgia to further this knowledge, as per the requirements of OP/BP 4.20

institutions suggest a persistent gender divide, with far more males self-selecting into math, sciences, medicine and engineering, while girls self-select into lower-paying disciplines such as education. Maternal mortality rates are low (22.8 per 100,000 live births) compared to the average for lower middle income countries, with universal access to prenatal care (84 percent of pregnant women received prenatal care in 2012). Fertility levels are low: WDI data indicate a fall from the already low rate of 1.62 children per woman in 2000 to 1.55 in 2010. The gender gap in life expectancy is high, and men live on average 9 years less than women.

- **Economic sphere:** Only 60 percent of women, compared to 78 percent of men, are either employed or looking for a job, and two-thirds of employed women are self-employed (mainly in agriculture). Given cultural norms, and the constraints posed by their roles as care-givers to children and elderly relatives, women are more likely to aim for part-time work, particularly teaching and secure public sector jobs. While legislation does not permit discrimination, the wage gap is one of the highest in ECA, with women earning on average 45 percent less than men in 2011. Female entrepreneurship is low, especially in the formal sector. Only 41 percent of firms with more than 5 employees are at least partly owned by women and only 20 percent of firms are female-managed. Women increasingly represent about half of the total labor migrants, and are generally more skilled, sending on average higher remittances than men.
- **Legal framework and political sphere:** The legal framework for women's rights provides for equal access to labor market, inheritance and protection of property rights. In practice, women have fewer protections due to weak enforcement mechanisms and lower levels of literacy. The Law on Gender Equality (2010) prohibits discrimination and harassment based on sex, and several legal provisions are in place to allow women to combine their dual role of mothers and workers; the new government has made public kindergartens free of charge, potentially providing more opportunities for women to pursue employment. However, women are underrepresented in political institutions, an indication of their lesser public role and traditional gender norms, which limit their voice and agency in the public sphere.
- **Strengthening gender statistics:** The commitment to collecting and using gender disaggregated statistics is enshrined in the 2010 Law and its Action Plan. In addition to regular Household Surveys, the 2014 Census offers further opportunities for sex-disaggregated data to promote evidence-based policymaking and more equal outcomes for men and women in Georgia.

C. Medium-Term Prospects for the Georgian Economy

14. **Economic growth is projected at an average of 5.5 percent a year over the medium-term based on greater policy certainty, improved market access, and a strong reform agenda** (Table 2). Medium-term growth prospects depend on a number of factors, including improved economic ties with the EU, improved relations with Russia (which will benefit trade and tourism), and the robust reform program outlined in the SDS, which will support growth in private investment and reduce reliance on public capital spending. Growth prospects depend on Georgia's ability to leverage the DCFTA and Association Agreement with the EU, which will

improve market access and encourage FDI. A trade sustainability impact analysis[7] commissioned by the EU suggests a potential increase in GDP growth of 4.3 percent in the long-run. This will call for labor and capital reallocations to more productive sectors, involving capacity building on regulatory approximation particularly in trade facilitation, technical barriers to trade, and intellectual property rights and upgrading of and investment in human capital.

Table 2: Macroeconomic Trends and Projections

	(In percent of GDP, unless otherwise indicated)							
	2010	2011	2012	2013	2014p	2015p	2016p	2017p
	Actuals				Projections			
National Accounts								
Real GDP growth (percent change)	6.3	7.2	6.2	3.2	5.0	5.5	6.0	6.0
Consumer Price Index (percent change)	7.1	8.5	-0.9	-0.5	4.0	4.5	5.0	5.0
GDP per capita (in U.S. dollars)	2,614	3,220	3,515	3,597	3,716	4,031	4,397	4,844
Gross investment	21.6	26.2	28.9	24.8	26.2	27.4	27.8	28.0
Public	7.4	8.0	6.8	5.2	5.9	6.0	6.1	6.1
Private	14.2	18.2	22.1	19.7	20.2	21.4	21.7	21.9
Gross national savings	11.3	13.4	17.3	18.9	18.0	19.7	20.2	20.5
General Government Operations								
Revenues and grants	28.3	28.2	28.9	27.6	26.9	27.4	27.4	27.4
Tax revenues	23.5	25.2	25.1	24.8	24.2	24.8	24.8	24.9
Non-tax revenues	4.8	3.0	3.7	2.8	2.7	2.6	2.5	2.5
Expenditure and net lending	34.8	31.7	31.7	30.1	30.7	30.5	30.1	29.7
Current expenditure	26.4	23.0	24.8	24.9	24.8	24.5	24.0	23.6
Social expenses	7.8	6.8	6.7	8.6	9.6	9.6	9.5	9.3
Capital expenditure and net lending	8.4	8.8	6.8	5.2	5.9	6.0	6.1	6.1
Overall fiscal balance	-6.5	-3.5	-2.8	-2.5	-3.8	-3.0	-2.7	-2.3
External Sector								
Current account balance	-10.3	-12.7	-11.7	-5.9	-8.1	-7.8	-7.6	-7.5
Exports of goods and services	34.9	36.5	38.1	44.7	45.3	46.4	47.1	47.9
Imports of goods and services	52.7	55.5	57.8	57.7	59.2	59.4	59.8	60.0
FDI (net)	5.8	6.2	3.9	5.6	6.2	6.3	6.3	6.3
Gross international reserves								
(Months imports of goods and services)	4.4	4.2	3.8	3.7	3.6	3.8	3.8	3.9
(In millions of dollars)	2,264	2,818	2,873	2,823	2,914	3,362	3,739	4,183
Total public sector debt	38.7	33.6	32.2	32.2	34.5	33.4	33.0	32.7

Source: World Bank staff estimates based on data from the IMF and the Georgian authorities.

15. **Fiscal consolidation is a policy priority for the government in spite of a widening deficit in 2014**. Due to under-execution of the budget, the overall fiscal deficit was estimated at 2.5 percent of GDP in 2013. The deficit is expected to widen in 2014 with a pick-up in social expenditures and relatively lower revenues due to the lagged impact of the growth slowdown in 2013. Over the medium-term the deficit is expected to narrow again, mainly because of strengthened expenditure efficiency. The share of capital expenditures will level off, with social

[7] See Trade Sustainability Impact Assessment in Support of Negotiations of a DCFTA between the EU and Georgia and the Republic of Moldova, October 2012.

spending – which grew significantly in 2013 and will rise to over 9 percent of GDP in the medium term – rising to tilt the balance in favor of current expenditures. The introduction of universal health care in 2013 and higher planned benefit levels under pensions and targeted social assistance will contribute to budgeted social expenditures being 51 percent higher by 2014 than in 2012. To achieve the desired outcomes, strengthening the effectiveness of social spending and supporting the Government on developing the institutions and capacity to support program implementation and strategic, evidence-based planning will be crucial, especially given Georgia's ageing population and the high dependence on fiscal transfers among vulnerable groups. Debt is sustainable in the medium-term according to the most recent WB-IMF analysis.

16. **The renewed focus on competitiveness and fiscal consolidation will support external sustainability.** Lower spending in 2013 helped reduce the current account deficit. Higher economic activity and public spending in 2014 will cause the current account deficit to increase before falling again in the medium-term due to improved competitiveness – driven by the Government's ambitious structural reforms – and a narrowing fiscal deficit. Net FDI is expected to average around 6.3 percent of GDP while the national savings rate is expected to increase to 20.5 percent by 2017, reducing dependence on debt creating capital inflows.

17. **The Government's commitment to sound macro-economic and prudent fiscal management is a pre-condition for faster, inclusive and sustainable growth.** Various measures to strengthen macroeconomic fundamentals and promote longer term and local currency credit instruments to deepen financial access and reduce reliance on forex borrowing will improve the credibility of the banking system, support domestic savings, and help create conditions for macroeconomic stability and external sustainability. Currently high dollarization and limited capital market development has weakened the transmission channels for monetary policy generating reliance on fiscal policy for responding to even temporary shocks. The Government's commitment to work with the World Bank and the IMF on these issues, along with the program of structural reforms outlined in the Government's Strategy document, will help reduce this excessive reliance on fiscal policy instruments. Plans to increase social expenditures in the medium term while maintaining capital expenditures will require a rigorous prioritization of spending and efficient implementation, with a strong focus on results. The government plans to develop Public-Private Partnerships (PPPs) to leverage public resources and strengthen private participation in the provision of high quality and accessible public services, which will also strengthen its fiscal position.

18. **Reducing poverty and promoting shared prosperity calls for a combination of policies aimed at more efficient and effective public service delivery and enhancing economic opportunities.** Expansionary fiscal policy was been the main driver of poverty reduction and shared prosperity in 2010-2012 and the Government has committed to increase social spending from 6.8 percent of GDP in 2011 to 9.3 percent in 2017. However, improving the efficiency and effectiveness of this expenditure will be essential to ensure fiscal sustainability and impact. In particular, challenges related to funds absorption and adequate implementation of policy reforms could be significant, especially in the context of decentralization, which will move the management of some aspects of key social services to local governments.

D. Opportunities and Challenges to Achieving Inclusive Growth

19. **Georgia has the potential to increase sustainable and inclusive growth through strengthened focus on private sector-led job creation and the effectiveness of public spending.** Although Georgia has achieved good growth rates, unemployment remains stubbornly high, especially among the bottom 40, leading to a weak performance on poverty reduction and on shared prosperity. At the same time, low agricultural productivity and uneven access to public services has contributed to high rural poverty. Women's participation in the labor force is low and vulnerable groups remain marginalized, both socially and economically. Progress on poverty and shared prosperity since 2010 was largely driven by fiscal transfers, which is not sustainable. The Government envisions a comprehensive reform effort that aims at addressing a two-fold challenge: (i) ensure effective public service delivery, particularly in the social sectors, to support inclusion; and (ii) improve competitiveness to enable private sector led job creation and sustainable growth

Opportunities for faster and more inclusive growth

20. **The DCFTA offers an opportunity to enhance prospects for exports and investment.** While legislative and regulatory approximation with the EU has proceeded at a good pace, Georgia must now address a complex complementary policy reform agenda to support private sector competitiveness. Domestic firms will need to modernize in order to enhance productivity, which will call for access to both human and financial capital and efforts to facilitate resource reallocations to the productive and tradables sectors, which need to expand. At the same time, foreign investment in these sectors will help bridge financing needs and support transfer of improved technology and skills. Improving standards by developing the requisite quality infrastructure and sanitary/phyto-sanitary systems according to EU requirements and norms will be essential for entry into the more lucrative and stable EU market.

21. **Continued strengthening of Georgia's transit infrastructure will support competitiveness.** Located along a strategic transit corridor connecting Europe and Asia, Georgia is strengthening connectivity to the global economy by developing the strategic East-West Highway corridor between the Black Sea ports and the Caspian Sea. This will provide direct access to 2.2 million people, or around half of the population and will allow Georgia to lower transit costs and become more competitive as an international transport route. Additionally, most of the rural population is in regions that rank low on accessibility and have worse socio-economic outcomes than the national average. Investments in local and secondary roads will address the transport needs of low-income populations, and the improved domestic connectivity will facilitate access to economic opportunities and promote inclusive growth in rural areas.

22. **Georgia's energy sector has potential for transformational change, particularly through renewable energy exports.** Over the last decade, the Government has transformed the energy sector, ensuring fast growth with improved efficiency. The government is pursuing two strategic objectives: to ensure continued reliable domestic energy supply for firms and homes; and to facilitate and bolster electricity production from hydropower plants (HPPs) to expand regional electricity trade. Important institutional and regulatory reforms have been initiated to support private investment in energy. The priorities now are to work for: (a) adopting market rules to facilitate trade through compliance with the EU Energy regulations applicable to Georgia under the Association Agreement and the Community Treaty; (b) implementing international standards for environmental and social impact assessments and mitigation; (c) strengthening the

transmission network capacity to improve reliability and support electricity trade; and (d) creating the conditions for efficient private investment in hydro power and other renewables. Given its geographic location, Georgia remains an important regional transit route for oil and natural gas and can leverage this advantage for electricity trade.

Box 1: Building on a Good Track Record in Public Sector Management and Governance

- Georgia has advanced in public sector management practices with progress evident across the majority of indicators under the PEFA assessment. Its latest ranking on the 2013 Transparency International Corruption Perceptions Index was 55 out of 175 countries. The challenge going forward is to consolidate and continue to progress to ensure effective service delivery and partnership with the private sector, especially in the light of the need to improve effectiveness of social and public investment spending.
- There are capacity weaknesses in budget implementation, monitoring of fiscal risks from State-Owned Enterprises (SOEs), internal controls and audits, and public sector accounting and oversight. Improving public enterprise performance will require fundamental changes in their governance structures as corporate governance of the SOEs falls short of internationally accepted good practice. The absence of adequate accounting and reporting standards is a bottleneck to fiscal transparency and accountability.
- The Government plans to develop a PPP framework with institutions for project identification, coordination, and implementation. This will also support effective functioning of the investment funds. The infrastructure investment needs, including those emerging from the decentralization, will require a strong public investment management system to ensure value for money, contain fiscal risks, and maintenance of existing infrastructure. Public procurement must continue to be strengthened to bolster good implementation.
- A decentralization strategy setting out a preliminary framework for public financing of municipal regional development was adopted in early 2013, which has the potential for better delivery of services. Despite overall improvement in accessibility to municipal services and infrastructure (almost meeting the MDGs), there is a pending agenda on quality and reliability of services, especially in secondary cities, towns and villages. Strengthening the effectiveness of municipal asset management plans and provision for annual maintenance is essential to support sustainability.
- There is a need to establish an effective system to carry out decentralized functions, with sufficient transfers based on an incentive compatible intergovernmental fiscal relationship. Realism about the pace of reform will help focus scarce administrative capacities. Increased civic engagement through strengthened local participation and social accountability in local decision making is an objective of the Government although mechanisms available are still nascent. Decentralization may help strengthen public sector delivery at the local level if effectively managed, but significant investment in the municipal sector is still needed.

Challenge: Strengthening public sector delivery

23. **The public sector's capacity to deliver positive outcomes on poverty and shared prosperity will have to be strengthened.** The Government has committed to increase the resources allocated for social spending. However, it needs to improve its capacity to deliver services in order to avoid fiscal pressures and to assure timely results on the ground to build the confidence of its population. The move towards decentralization puts added pressure to improve efficiency because some of the high priority social services – including universal pre-school education – are delivered by local governments which lack capacity. The introduction of universal health coverage will also call for significant support, especially to strengthen implementation capacity.

24. **While there is a well-designed TSA program in place, coverage of the chronically poor needs to be broadened.** Currently less than half of the bottom decile is covered. Broadening this would create more positive impacts on poverty without compromising fiscal policy: the TSA costs about 1 percent of GDP (in line with the rest of the ECA region). Any increased focus and expenditure on the social sectors will need to be carefully implemented to

ensure fiscal sustainability and effective results. A notable feature in Georgia is that the increased impact of the social protection system to date was brought about in the context of an overall fiscal consolidation.

25. **Improvement in the pension system has to be reconciled with the requirements of fiscal sustainability while ensuring adequate pension levels over time.** Projections of the current pension system show that due to population aging, the costs of the universal flat benefit may double from the current 4 percent of GDP to 8 percent in 2050 *ceteris paribus*. The current universal basic pension (GEL 150 per month) is major source of income for the poor (and even the upper deciles). Reforms aimed at development of a new and relevant pension system will improve social security and support capital markets development.

26. **An important part of the new Government's plan is the expansion of health coverage through the universal health care program for a package of health services**. Government funding of the health sector has been lower than in most ECA countries and thus the doubling of budgetary allocations to the health sector between 2012 and 2013 and extending coverage to the entire population is welcome.[8] The universal health care program is set to add over 2 million persons to the approximately 1.7 million already covered by other state-financed health programs, but the implementation arrangements need to be strengthened. The establishment of a Unified Insurance Fund would play the role of a single payer, effectively moving away from the current reliance on private insurers to purchase publicly funded health services.[9] The new institutional structure is not yet implemented. In addition to the expansion of coverage, there is need for a range of policy actions on quality of care, financial management and pharmaceuticals (e.g. introduction of reference pricing and distribution controls, generic substitution, and patient education).

27. **Significant efforts are needed to improve the overall quality of the education sector.** Systemic quality improvements in priority areas are needed: early childhood education (ECD); general education; and tertiary education. Pending priorities for public policy include the need to clarify the roles of different government agencies, set up standards and quality assurance systems, strengthen local government, and improve capacity for service delivery and service provision.

28. **A new law guaranteeing free provision of universal pre-school education supports the goal of inclusion.** Evidence shows that early childhood development is a rare public policy with no equity-efficiency trade-off as it promotes social justice and fairness by raising the productivity of society.[10] In Georgia, there would be several positive impacts of pre-school education: (i) more women could participate in the labor market if their children were in pre-school; (ii) attending at least one year of pre-school has a positive effect on academic achievement throughout the student's lifetime; and (iii) access to pre-school is currently inequitable: enrolment rates in pre-schools for the richest and poorest quintiles are 55.7 percent

[8] The "Life in Transition Survey" (2010) showed that health was the population's top priority for Government spending

[9] The objective to provide some universal health benefits for the entire population is in line with the recommendations in the World Health Report 2010 "*Health Systems Financing: the Path to Universal Coverage*".

[10] The recent ECA jobs report "Back to Work" highlights the importance of improving early childhood development policies and the quality of pre-schools for the development of non-cognitive and "soft" skills, critical for functioning in the modern global economy.

and 30.5 percent respectively. However, the institutional arrangements must be defined to ensure access and support quality. The concern is that making public pre-school education free of charge may result in higher coverage but it is not likely to enhance the quality of the service without significant institutional mobilization. Leveraging private resources to broaden further the coverage of ECD services for children aged 0-2 years will also be critical.

Challenge: Enable Private Sector-led Job Creation through Improved Competitiveness

29. **Strengthening competitiveness and supporting labor reallocation to new, higher value-added sectors will help Georgia create more and better jobs, essential for sustainable poverty reduction and growth.** Reducing Georgia's unemployment will call for policies that support labor mobility across sectors and facilitate the functioning of the labor market. In particular, actions will be needed to support labor demand through strengthened firm productivity and to ensure a supply of workers with the relevant skills through investment in human capital.

30. **There is a significant pending reform agenda in the financial sector and capital markets.** Lending remained concentrated in loans to trade companies, households, and real estate, with insufficient financing to agriculture, manufacturing and SMEs over the past decade. 2013 saw an increase in agriculture lending mainly due to a subsidized credit scheme. However, the overall pace of lending slowed in 2013, with outstanding loans to manufacturing and construction recording negative growth in spite of the fall in the NBG's policy rate and a significant injection of local currency liquidity into the domestic banking sector. The share of non-performing loans (NPLs) declined to 7.5 percent in 2013 from 17.9 percent in 2009, though the preponderance of foreign currency loans is a risk. Banking profitability improved recently though high interest rates and collateral requirements have lowered the appetite for borrowing, creating a challenge for banks' future growth and profitability. Local currency lending to the real sector, especially for medium to longer term investments remains insignificant.

31. **Increasing access to finance, especially for small and medium size enterprises (SMEs) remains a priority.** The SME sector represents nearly 96 percent of registered businesses and employs 42 percent of workforce, but accounts for only 17.7 percent of business turnover in 2013. Firms cite high interest rates, risk-averse lending policies with high collateral, and absence of venture capital as major constraints to growth. SMEs currently rely on own resources or on retained earnings for investment. Poor development of securities and capital markets, limited local currency and long-term financial instruments, and reliance on a fully publicly funded pension scheme, are hindrances to increasing the savings rate. The limited options of non-bank credit institutions and instruments, as well as weak financial and business illiteracy, hinder the financial access of micro and small firms. Georgia is the only country in ECA without an explicit statutory deposits insurance system, fundamental for enhancing trust in the financial sector and encouraging savings – a pre-requisite for strengthening financial access.

32. **Export competitiveness needs to improve.** The share of exports in GDP was only about 38 percent in 2012 in Georgia, compared with over 90 percent in Estonia and the Slovak Republic, 78 percent in Lithuania, and 59 percent in Latvia. While there has been growth in exports in absolute terms, an analysis of the composition and dynamics of the export basket reveals significant weaknesses: (i) loss of market share in key markets and products; (ii) stagnant and low product sophistication and quality for its level of development; (iii) lack of product

diversification with scrap metal, re-export of used cars, wine and processed food, water and tourism dominating; and (iv) low survival of export firms.

33. **Development of new firms and export lines in high value addition sectors is hampered by the lack of a skilled workforce, low R&D spending, and limited use of innovation and technology.** There is need for diversified tertiary education and training, especially in the technical and vocational areas. The role of the private sector in shaping curricula and programs and providing training must be strengthened to ensure the workforce has relevant skills. The Government needs to develop an institutional framework to facilitate innovation and scale up of the most productive and innovative SMEs. Currently there is limited use of Information and Communications Technology (ICT) in industry (Georgia's ranking is 73 out of 142 on the World Economic Forum's Global Innovation Index) and there is a lack of understanding in the private sector of how ICT can make businesses internationally competitive.

34. **The Government has committed to addressing pending gaps in the business environment.** While Georgia has done well on the Doing Business index, there is a pending reform agenda. This is mainly focused on the need for property and intellectual property rights protection and enforcement, improved land titling and collateral registration, establishment and enforcement of a competition framework aligned with international standards, and facilitating access of MSMEs to markets and information.

35. **Active policy efforts are needed to facilitate effective functioning of the labor market and formal work force participation, especially for women.** Currently only a third of the labor force is in the formal wage sector and active labor market policies will help increase this share. This includes attention to the urgent need for better data and information on labor movements in and out of employment and across different types of jobs to both inform policy design and monitor impacts of interventions. Women are more likely to be employed in the informal sector and will require more policy support to secure stable and formal sector employment.

36. **Improving agricultural productivity and facilitating the movement of labor from agriculture into higher productivity activities are essential for strengthening economic opportunities in rural areas.** Subsistence agriculture accounts for 75 percent of rural employment and 45 percent of rural income. The low productivity level is driven by low investment, and low farmer participation in credit, input and output markets. Improving agricultural productivity is essential for a competitive agri-business sector. The welfare of a large share of population depends on agriculture becoming more productive. The Government is increasing public funding to agriculture, either through specific funds (to promote private sector participation) or subsidies to small-holder farmers. Such a level of public support through subsidies generates risks, which can be mitigated by strengthening targeting at small-holder farmers and containing and fiscal risks through the establishment of a transparent sunset clause.

37. **High rural poverty and significant regional disparities along most socio-economic indicators suggest that investment in regional development is critical to increasing inclusion.** Georgia has adopted a State Strategy for Regional Development to address persistent regional disparities, focusing on developing the potential sources of growth in each region. The development of the tourism sector, and related business opportunities and private investments, is a priority in this context. International tourist arrivals have grown rapidly (more than 5 million visitors in 2013, representing a 66 percent increase since 2011). Tourism and travel is therefore one of the fastest growing sectors in Georgia and a key generator of jobs, accounting for 14.2

percent of total employment in 2013 and 16 percent of GDP (directly and indirectly), and forecast to continue growing by 4.8 percent per annum. The sector currently provides nearly 20 percent of export earnings. A national tourism development strategy is now needed to determine how to improve the sector's performance, align implementation priorities and enable job growth.

38. **Public policies to protect the environment and natural resources are not at par with the impressive economic growth**. In recent years, there has been extensive environmental deregulation, exacerbating existing problems and resulting in unsustainable use of natural resources and environmental damage. Several areas need priority attention: air and water quality, waste management, land and landscape management, coastal and marine protection, chemicals management, and nature resources use and protection. Georgia is considered amongst the most vulnerable countries to climate change in ECA. It needs to strengthen institutions and increase capacity to assess and manage environmental and disaster risks and impacts, particularly in light of increasing occurrence and intensity of flash floods, strong winds, storms, etc.

39. **Georgia is highly exposed to several natural hazards and needs to strengthen disaster preparedness**. Over the past thirty years, major disasters such as droughts, storms, floods, and earthquakes have hit Georgia. The 1987 floods destroyed 2,600 buildings, resulting in US$300 million in damages. The drought in 2000 impacted 696,000 people causing US$200 million in damages. The earthquake that hit Tbilisi in 2002 caused damages estimated at US$350 million with more than 100 buildings damaged. Studies have shown that these disasters can cause economic losses exceeding more than 9% of GDP. Georgia needs to increase its capacity to manage the increasing occurrence and intensity of such disasters. New institutions with appropriate capacity are required to manage disaster risks and to develop preparedness plans and early warning systems.

II. GOVERNMENT SOCIO-ECONOMIC DEVELOPMENT STRATEGY

40. **Georgia's medium-term development vision is articulated in the Socioeconomic Development Strategy 2020 (SDS).** The overarching objective of the SDS is to achieve faster, inclusive, and sustainable growth averaging 7 percent p.a.. This assumes that structural reforms will support rapid growth in investment, employment, and firm productivity and also ensure the realization of potential benefits associated with the DCFTA in terms of higher exports and FDI. The SDS plans to help the private sector develop into the engine of growth and, at the same time, emphasizes the redefined role for the state to facilitate inclusion through better delivery of public services, addressing market failures and cross-cutting constraints. The SDS intends to establish an evidence based policy framework, supported by monitoring and evaluation mechanisms, to ensure that policy interventions are relevant, have impact, and enable course correction.

Box 2: Pillars of the Socio-Economic Development Strategy (SDS)

Pillar 1: *Establishing the pre-conditions for growth in terms of a stable macroeconomic environment, effective public sector management, and fiscal efficiency and responsibility;* (i) Inflation and exchange rate stability; (ii) Creating and maintaining fiscal space through medium term expenditure and debt management frameworks, pension reform, and prioritizing spending based on results and effective M & E; (iii) Effective public sector management; and (iv) External sustainability through sound macro-prudential regulation, policies to bolster savings, and actions to strengthen systemic credibility and support de-dollarization.

Pillar 2: *Strengthening human capital - health, education, and social safety nets;* (i) Ensuring 100 percent pre-school enrollment; currently only 46 percent of children attend kindergarten; (ii) Supporting an effective VET system, responsive to private sector needs; (iii) Improving the quality of the education system overall; (iv) Improving labor market information and ensuring coordination with the TSA program; (v) Tightening the social safety net through improved targeting to ensure expanded coverage to the bottom decile, and pension reform; (vi) Establishing an effective system of universal health coverage. The SDS highlights the need for reforms aimed at ensuring a supply of cost effective pharmaceuticals, and also prioritizes improved primary and preventive care.
Pillar 3: *Improving private sector competitiveness by building on past successes and further enhancing the investment climate, especially for SMEs, and focusing on firm productivity;* (i) Moving from deregulation to smart regulation to fill gaps in the existing business environment (competition policy, strengthened legal enforcement of property rights including intellectual property rights, updated investment legislation, improved bankruptcy procedures, and more effective dispute resolution); (ii) Establishing a National Development Council (NDC) to support public-private consultation and implementation of the strategy; (iii) Promoting exports by leveraging the DCFTA to support market access, and realizing Georgia's potential as a regional logistics and transit hub and on increasing productivity and exports in the agriculture sector; (iv) Strengthening innovation capacity through financial support and a well-defined framework for collaboration between the private sector, research, and the Government; and (v) Leveraging Georgia's locational advantage and renewable resource potential to both meet its growing energy needs of the services sector and develop electricity exports as a source of revenues.
Pillar 4: *Increasing access to finance*; (i) Promoting retirement savings, local currency financing instruments, accessible financing for smaller firms, deposit insurance, and macro-prudential credibility; (ii) Strengthening financial architecture through developing capital markets, non-bank financial institutions (NBFIs), and improvement of financial market infrastructure, includes development of an appropriate legal and institutional framework for credit information sharing and the establishment of a centralized collateral agency; and (iii) Expanding access to finance for SMEs, start-ups and for agriculture.

III. WORLD BANK GROUP PROGRAM

A. Lessons Learned from previous CPS and Stakeholder Feedback

41. **The CPS Completion Report (CR) highlighted the importance of maintaining balance in the program between stimulating growth and supporting poverty reduction through the social protection system.** The CPS CR concluded that poverty reduction achievements in the latter part of the previous CPS period (from 2011 onwards) were mainly brought about by an improved social protection system (pensions and TSA) that allowed for increased transfers to the poor. Through its Analytic and Advisory Activities (AAA) and the Development Policy Operation (DPO) series, the WBG program had contributed to the design and implementation of the TSA while, at the same time, carried out rigorous poverty analysis to evaluate impacts. In parallel, the WBG program continued to focus on the growth agenda through identifying constraints to private sector-led growth and through investing in strengthening infrastructure and services for competitiveness.

42. **Analytical work remained essential to the program, providing the underpinning for DPO-supported reforms and complementarity to lending**. The AAA helped in understanding growth dynamics, poverty, and public sector performance, and played a key role in proposing development solutions and informing the Government's SDS. For example, the FY12 Public Expenditure Review, together with a series of Poverty Assessments, provided knowledge on understanding how out-of-pocket expenditures in health care were impacting poverty, which in turn has informed the Government's program on universal health insurance. The AAA program

was aligned with lending, whereby key analysis nourished the design of operations and helped prioritize reforms and engagements. The CPS CR recommended continued focus on analytical work. The 2013 Country Survey highly rated the Bank's analytical work and capacity building activities, considering them essential to policy formulation and implementation (Box 4).

43. **The selectivity and complementarity between IBRD, IFC and MIGA has been effective.** The CPS CR concluded that WBG funding was channeled to maximize comparative advantage, technical knowledge, and complementarities. The selectivity in the Bank's program allowed for an approach that balanced concerted focus on strengthening the effectiveness of public expenditure and administration through AAA and DPO policy reforms, together with targeting specific investments in infrastructure and regional development programs. This complemented IFC support, which continued to focus on strengthening the financial system and supporting enterprises in agribusiness, as well as MIGA's engagement in the financial sector. More recently, the energy sector has become an area of concerted joint WBG focus, which will be consolidated in the program going forward.

Box 3: Key Results of the Georgia Country Survey (Spring 2013)

Stakeholders[11] reported high levels of optimism about the country's development path and believed that shared prosperity would be achieved through raising the middle class and providing better opportunities for entrepreneurs, and training to increase employment. Education and economic growth remained the top development priorities (same since FY05). In addition, job creation/employment and agriculture/rural development emerge as critically important for reducing poverty. FDI and private sector development were considered as key drivers for growth.

Respondents across all stakeholder groups saw an important role for the Bank in Georgia's future development. As had been reported in past country surveys (FY03 and FY05), stakeholders reported that education is the most important area in which the Bank should focus its support (financial resources and knowledge work). Respondents believe that the Bank should be also involved in private sector development, agriculture/rural development, transport infrastructure, public sector governance and overall economic growth. The vast majority of stakeholders consider financial resources (both investment projects and policy based lending) as the greatest value brought to the country by the Bank. More than a quarter of respondents consult the Bank's knowledge work on a regular basis. Stakeholders consider the Bank's knowledge work of high technical quality, and its content is rated high in terms of relevance, feasibility of recommendations, accessibility, usefulness, and program implementation support.

44. **Program selectivity has been a strong feature of the program, facilitated by donor coordination**. The program was selectively focused on one DPO series that channeled reform measures, complimented by support from other donors particularly in the social sectors (EU, MCA in education, USAID in health, see Annex) The investment lending portfolio included projects in infrastructure and regional development programs, whereby selectivity was facilitated by the availability of funds from other donors, e.g., the ADB has taken the lead in the water sector, while the EU and FAO have concentrated efforts in agriculture and rural development. The WBG has taken the lead in transport, and in municipal and regional infrastructure, with an increasing focus on the energy sector to complement policy actions and IFC investments. Selectivity and donor coordination will remain a key feature of the WBG program and will be further strengthened.

[11] In April and May 2013, 276 stakeholders of the World Bank in Georgia were invited to provide their opinions on the Bank's assistance to the country by participating in a country survey. Two country surveys were conducted in Georgia in the past (in FY03 and FY05) and allow for some comparisons.

45. **The CPS CR underlines the importance of continued capacity building in the public administration with more effective monitoring and evaluation (M&E).** The focus in the portfolio on infrastructure has built up good implementation capacity as shown by the strong portfolio performance and disbursement rates: this supports sustainability and provides a good foundation for future support. The AAA program analyses public sector issues and identification of capacity constraints, especially cross-sectoral coordination. The CPS CR concluded that there is a need to support more effective M&E and impact assessments, including improving the way results are monitored. More rigorous impact evaluations should be carried out to measure contributions to poverty reduction, and to influence the design of future projects.

B. Portfolio overview and key features

46. **The portfolio has good implementation performance and satisfactory achievement of results.** The disbursement ratio was consistently high (113 percent in FY10, 54 percent in FY11, 98 percent in FY12, and 49 percent in FY13) and teams are taking actions in this FY to address slow-downs in project implementation linked to the transition with the new Government. All projects have been rated Satisfactory or Moderately Satisfactory by IEG since FY11. Factors contributing to success include high-level commitment to the CPS program, through joint design and implementation, strong implementing agency capacity, and a decentralized WBG team, allowing timely resolution of issues. IFC's portfolio also confirms low levels of non-performing loans (3.7 percent of total outstanding portfolio, or 5.9 percent of total loans), realized net equity gains of US$12.1 million and unrealized gains on equity investments of US$92.3 million.

47. **The current IDA/IBRD program has one DPO and a selective investment portfolio in roads, municipal infrastructure and regional development**, amounting to US$600 million in net commitments. The CPS is, thus, building on a program that balances the pursuit of reforms through the DPO series, while selectively targeting critical infrastructure investments in key areas. Both AAA and Trust Fund programs (amounting to about $11.5 million) are fully aligned and complementary to the CPS and provide the strategic knowledge and capacity building necessary for programmatic and policy-level engagements. They include sub-regional AAA covering the South Caucasus that focus on shared regional issues and opportunities.

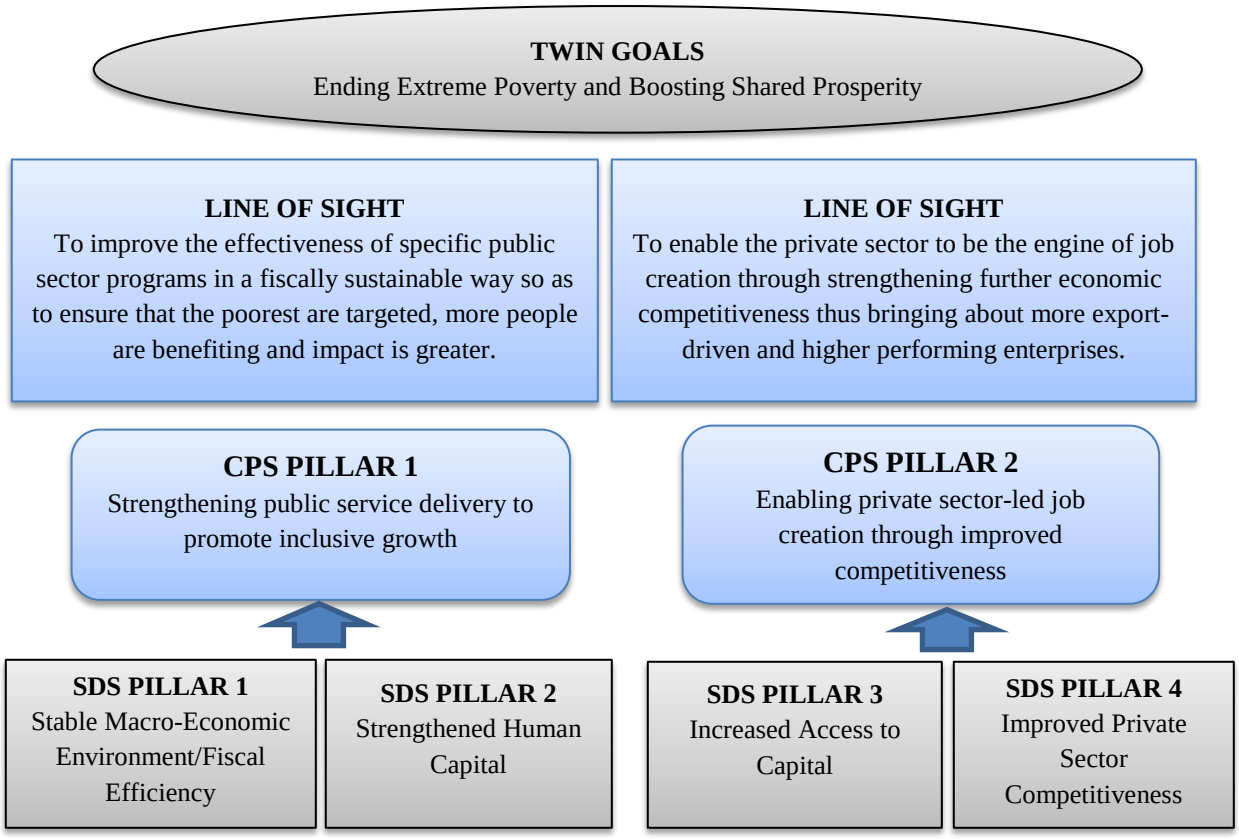
48. **The IFC program comprises investment and advisory operations**. The committed investment portfolio of US$291 million in 28 projects with 15 clients makes it IFC's largest IDA country exposure in ECA. Equity investments account for nearly 30 percent of the current portfolio, well above IFC's average in ECA. IFC operations in the financial sector (65 percent of current exposure) include provision of long-term finance, trade finance lines, and risk management investment products. The investment and advisory support helps banks expand on-lending to SMEs, manage interest rate and currency risks, as well as improve portfolio management practices and corporate governance. IFC is also engaged in the development of housing finance, sustainable energy finance, and under-served markets like female entrepreneurs and micro-finance. In the real sectors, IFC maintains its focus on agribusiness and prioritizes investments and attracting FDI into renewable energy. The advisory programs help support private sector investment by improving the business environment, helping introduce food safety standards, and exploring opportunities for PPPS primarily in infrastructure, closely coordinated with the Bank program. Furthermore, MIGA has three active projects in the financial sector with a total gross exposure of $24.3 million and its full menu of product lines is available for Georgia.

C. Proposed World Bank Group Support

49. **The WBG's objectives during the CPS period in Georgia are to end extreme poverty and boost shared prosperity.** These objectives are the same as the WBG's twin goals and are also fully aligned with the priorities outlined in the Government's SDS. To achieve these objectives in Georgia, two strategic areas of focus have been identified for the CPS:

(i) ***Strengthening public service delivery to promote inclusive growth:*** the goal is to accompany the Government in its commitment to increasing budgetary resources for social sector programs in a fiscally sustainable way. This area of focus supports improving the effectiveness and efficiency in the delivery of public services where there is a known link to reducing extreme poverty and boosting shared prosperity;

(ii) ***Enabling private sector-led job creation through improved competitiveness:*** the goal is to support a sustainable growth pattern that generates employment and provides income opportunities for the bottom 40 percent of the population. The private sector will be the driver of employment creation. The CPS contribution focuses on removing important constraints in finance, infrastructure, technology and skills that prevent the private sector from thriving. In addition, the CPS program is geared to empower the country to take full advantage of opportunities available for growth. Georgia's strategic location must be maximized through continued development of road and energy infrastructure that will facilitate private sector production and exports, integrate the country more effectively in the region and set the longer term foundations for sustainable growth.



50. **Within these two areas of focus, the following selectivity criteria were applied to the choice of specific engagement areas:**

(i) The CPS engagement areas reflect *ownership as they are where the Government has specifically asked for WBG support* taking into account the WBG's value-added and support from other development partners.[12] The design creates synergies between the WBG intervention and the Government's programs and complements the programs of other donors.

(ii) The engagement areas rank high as *potential drivers of poverty reduction and inclusion*, as identified in the analysis of Georgia's development challenges.

(iii) The program going forward *builds on the successful elements of the existing program* where the WBG has a good track record on implementation: stepped up support will be provided to consolidate areas where good development results have been achieved and strong capacity is in place to absorb additional resources effectively.

(iv) The program *allows for the WBG's global knowledge to play a critical role* as regards how to target and implement programs effectively, drawing from best practices in ECA and elsewhere where it has helped address similar challenges.

(v) Finally, the CPS program selectively targets *areas where the WBG can achieve measurable results* during the strategy period while setting the institutional foundations to allow Georgia to pursue its vision over the medium to long-term.

CPS Area of Focus 1: Strengthening public service delivery to promote inclusive growth

51. **This area of focus supports improving the effectiveness and efficiency of public service delivery where there is a known link to reducing poverty and promoting inclusive growth**. The relevance of the CPS supporting public service delivery is magnified by the new Government's own commitment to increasing budgetary allocations to poverty reduction and social sectors. However, a fiscally sustainable framework is necessary to ensure success: in such a context, improvements in the provision of services – especially social services – will have to be achieved largely through efficiency gains, by improving administration and targeting. This requires significant support in the form of policy coordination, implementation support to enhance capacity for service delivery, and effective monitoring and evaluation. The program also aims to develop greater gender focus through monitoring of female beneficiaries of public services and other gender data. These are all areas where the WBG's program is currently active and where it can bring further value added.

52. **The Government has requested that the WBG financial support in this area of focus comes through Development Policy Operations (DPO).** This will allow for strengthening of Government's own systems, with a focus on improving efficiency and capacity to deliver results. The DPOs would also complement the investment financing being provided in the education and health sectors by other donors such as the EU, USAID, MCC and others. In parallel to the DPOs, the WBG will continue the successful approach of delivering jointly with the Government a broad AAA program that will under-pin the design and delivery of the DPO series as well as inform policy choice and institutional strengthening measures. The WBG will adapt the DPO instrument to fit the emphasis on effectiveness and mobilize resources for technical assistance.

[12] Annex 3 provides specific details on other donor programs

WBG INSTRUMENTS
IDA & IBRD Lending: DPO-3 (on-going series, FY14) and new DPO series for CPS Area 1 (FY15-16-17) **AAA:** Programmatic poverty analysis (FY14-17), Country Gender Assessment (FY14), Public Expenditure Reviews (FY14-17), Programmatic TA for social protection, health, education and public sector management (FY14-17), TA on Public Private Partnerships (FY14-15), Report on Standards and Codes (ROSC, FY14-15), PEFA (FY15), Urban Strategy (FY14), Country Environmental Assessment (FY15), **Trust Funds:** Global Partnership for Social Accountability, Institutional Development Funds (IDF)

Supporting a more inclusive public expenditure

53. **The social protection system (TSA and pensions) is expanded and strengthened to support the poor.** The target under the CPS is to expand and strengthen the performance of the TSA so that it can benefit a greater share of the poor; currently, the TSA supports around half of the bottom decile, which calls for a need to broaden the coverage. The CPS will also target strengthening of the basic pension system to be more effective in reaching its intended beneficiaries and be anchored on a more sustainable path. The contribution of the CPS to these goals will come through: (i) the AAA program that includes annual programmatic analysis of poverty (including vulnerable groups); a Country Gender Assessment with analysis of gender issues and indicators; diagnosis of implementation and impact issues of the TSA program, including gender dis-aggregated data; supporting the pension reforms particularly to develop a reform roadmap; and evaluating fiscal implications through regular PERs and policy dialogue in collaboration with the IMF. The WBG is coordinating its technical support to the TSA through partnering with UNICEF, EU, USAID and Sweden; and (ii) a DPO series that accompanies the implementation of reforms, builds institutional capacity and puts in place better accountability mechanisms, including a role for citizen engagement and feedback.

54. **The universal health care (UHC) program is expanded and health service quality assurance processes are institutionalized.** The Government's introduction of the universal health care program provides an opportunity to expand coverage and reduce out-of-pocket expenditures. The cost implications of the UHC, however, need to be carefully analyzed to ensure fiscal sustainability and improved efficiency in service delivery. The CPS will support the UHC implementation through the DPO series, in parallel with a programmatic TA to assess and review implementation progress and results, including female registration in the UHC. These assessments can focus on technical areas and help identify corrective measures if necessary. The program will also support the institutionalization of a health service quality assurance through an assessment of the current system, identifying institutional gaps and providing options going forward. Furthermore, the Bank's overall work on procurement will look at possible reform options for improving procurement in the pharmaceutical sector. IFC is ready to support private sector participation in the health sector by investing in private sector providers. Investment financing for specific health projects is available from other donors – such as USAID, EU and UN agencies. The Government has thus requested the WBG to focus on policy formulation and capacity strengthening for implementation through DPOs and TA.

55. **Essential knowledge base for general education and pre-school education is established.** The current WBG engagement in education is through the on-going DPO series and through TA, which is also supported by an IDF grant focusing on developing methodologies and

instruments for evaluating teaching effectiveness. Going forward, support to education quality improvement will ramp up the focus on comprehensive diagnostics on education quality issues, and institutionalizing an M&E system for quality assurance. This knowledge base is essential to guide further investment in the sector by the Government and other development partners. Notably, partners such as MCC,[13] USAID and EU have important investments in education and, consequently, the Government has requested the WBG's support to complement this through knowledge and policy advice. As regards the provision of free pre-school education, its successful implementation will significantly contribute to narrowing the learning outcome gap of disadvantaged children, as well as providing opportunities for increasing female labor force participation. Together with UNICEF, the CPS will provide knowledge on the appropriate institutional framework required and identify the capacity building needs for municipalities (which are responsible for service delivery), as well as support a better evaluation framework for assessing impact.

(i) Strengthening the effectiveness and accountability of the public administration

56. **The identification, prioritization and implementation of public investments improve**. The WBG will help strengthen the Government's capacity, at the local and central levels, to prioritize, procure, implement and monitor programs and projects, while ensuring their fiscal sustainability. The CPS will support the Government in its management of the public investment funds and State-Owned Enterprises (SOEs), especially their governance, accountability and financing frameworks.[14] The program includes support on strengthening public procurement, including improving the capacity of the Competition and State Procurement Agency, that would result in increased competition in the procurement of Government projects and in the use of e-procurement. A Country Environmental Analysis (CEA) is currently underway with the objective to further the integration of environmental and sustainability risks in development projects with improved management of natural resources. A similar approach will be taken to ensure social sustainability with support from the Global Partnership for Social Accountability (GPSA). The Government is also looking to enhance its capacity for undertaking PPPs in order to "crowd-in" sources of financing from the private sector. The WBG is providing TA to support the preparation of a "road map" for building government capacity to legislate, select and implement PPPs and to attract private capital to finance large infrastructure projects. MIGA is exploring potential support through: (i) risk mitigation instruments to ensure robust PPP transactions and to improve access to international private sector financing; and (ii) diverse insurance coverage to mitigate non-commercial risks associated with Government commitments to the private sector. The CPS support will be largely through AAA and the DPOs and will be coordinated with significant capacity building financing that's available from other partners - USAID, EU, Sweden and Switzerland.

57. **The adoption of modern public sector and fiscal management systems is consolidated.** The WBG will support the Government's adoption of improved programmatic budgeting, including the intergovernmental fiscal relationship, strengthening the results focus in

[13] The MCC "compact" was approved in July 2013 for $140 million, all targeted towards the education sector. It draws from the Bank's knowledge of the education sector, institutional engagement on past reforms and achievements and targeting of investments.

[14] This includes the *Financial Oversight Study of the SOE* which would help design reforms required to introduce modern commercial, financial management principles and resolve systemic weaknesses in the current system

local government budgeting to facilitate more inclusive and effective governance, and ensuring better public services across the municipalities. The follow-up Regional and Municipal Infrastructure Development Project will support these objectives, while leveraging funds from the Council of Europe Development Bank (CEB), Swiss Development Cooperation (SDC), Swedish International Development Agency (SIDA), and coordinating with USAID, EU, KfW and UNDP. The dialogue around the DPOs will remain active regarding fiscal and debt management, public sector modernization and risk management. The program will also support efforts to streamline and harmonize public sector accounting and reporting standards, support the further strengthening of the public internal and external audit, public financial internal control and oversight systems. The WBG will provide support through a range of AAA: PER, Urban Strategy, PEFA, ROSC and other PFM tools.

58. **Pilot programs will test innovative mechanisms for participatory local development and greater social accountability.** Georgia is engaged in a process of decentralization that, to be effective, requires building capacity at the local level where the mandate and responsibility for social programs critical for inclusion would be transferred. Pilot programs are intended to improve the capacity of local governments to incorporate local demand into planning and to respond to users so that local institutions are held to account. This improved citizen engagement in government decision making will be pursued through the regional and municipal development projects and supported through the use of trust funds (GPSA) in youth inclusion and social accountability.

CPS Area of Focus 2: Enabling private sector led job creation through improved competitiveness

59. **This area of focus aims to address the challenge of bringing about inclusive growth in a more sustainable way through the private sector creating more jobs.** The CPS program focuses on removing the most important constraints that prevent the private sector from thriving and thus constrain employment creation. These constraints pertain to weaknesses in the overall competitiveness of the economy including the need to increase access to finance, support the development of exports to exploit fully the potential benefits of the DCFTA, boost innovation and skills and step up investment in regions both to address significant disparities in poverty levels and to help the country make the transition from subsistence agriculture to more sustainable livelihoods. At the same time, Georgia's strategic location must be maximized through continued development of road and energy infrastructure that will facilitate private sector production and exports, integrate the country more effectively in the region and set the longer term foundations for sustainable growth.

60. **The choice of instruments harnesses the synergies and maximizes the potential value added of the whole WBG through a consolidated package of support.** Selectivity is driven by the targeting of certain priority areas and choice of instruments:

(i) Given the breadth of the key legal, regulatory and institutional constraints in private and financial sector development, a new DPO series will be developed specifically for this second CPS area. This DPO series will be informed by the AAA program and will complement investment by other donors.

(ii) The selectivity in the IDA/IBRD investment lending builds on on-going engagements and focuses mainly on the consolidation of results in roads, regional and municipal development, which currently make up the on-going investment portfolio.

(iii) IFC's program will continue to prioritize investment and advisory services that contribute to financial intermediation and increased access to finance for MSMEs, promote investment climate improvements, and support development of hydropower and agribusiness, while seeking investment opportunities in other sectors and developing related advisory services.

(iv) MIGA's role would support transformative transactions in transport, regional infrastructure and renewable energy as part of the WBG overall support.

WBG INSTRUMENTS
IBRD and IDA Lending: DPOs – CPS Area 2, new series (FY15-16-17), Regional and Municipal Infrastructure 2 (FY14), Secondary and Local Roads 3 (FY14, FY16), Irrigation and Land Market Development (FY14), Energy Transmission Grid (FY14), Innovation and ICT (FY15), East-West Highway (FY16), Regional Development 3 (FY15), additional infrastructure operations would be considered for the outer years of the CPS (FY16 and 17). **IFC Investments and MIGA Guarantees:** IFC outstanding and new equity investments, short and long term debt finance, and risk management instruments to support clients in the financial sector (banks, micro-finance organizations), infrastructure (e.g. energy generation and transmission, airports), agribusiness and food retail, manufacturing and services sectors, MIGA Small Investment Program, MIGA support to potential PPPs **AAA:** Energy AAA (FY14-15), Accounting and Auditing ROSC (FY14-15), TA on labor market information (FY14-15-16), TA on Internally Displaced People (IDPs), Country Environmental Analysis (FY15), IFC Investment Climate Project (FY14-16), IFC Regional Renewable Energy Advisory Program (new program), IFC SME Banking Project (FY13-15), IFC Agribusiness Standards (FY14-16), IFC Resource Efficiency Advisory (FY10-16), IFC PPP Transaction Advisory. **Trust Funds:** Regional Financial Sector Development Advisory Facility, JSDF for local SMEs

(i) Addressing key legal, regulatory and institutional constraints for the private sector

61. **The legal, regulatory and institutional framework is strengthened to promote private sector growth, foster access to finance and FDI in export-oriented sectors and facilitate the integration of Georgia into the global economy.** Georgia plans to introduce a "second generation" of business environment reforms aimed at opening up opportunities for SMEs, fostering entrepreneurship, and addressing entrenched market failures. The support will come through a robust AAA program that identifies the reforms and actions needed, with a new DPO series (FY15-16-17) prepared for this area of focus to support appropriate sequencing and implementation. The engagement will be coordinated with donors active in these areas: ADB, EBRD, EIB and EU. The program will support:

- **Establishment of the competitive environment.** Ongoing Bank and IFC engagement in the area of investment climate will continue to help create a level playing field for domestic and international business entry to Georgia. Strengthening the Government's capacity to address competition and consumer protection concerns is fundamental to facilitating the entry of SMEs, the main generator of employment in the economy. Key actions supported by the WBG program will be the establishment of an independent Competition Agency, adoption of regulations that ensure better application of State Aid rules, and improved governance frameworks for State-Owned Enterprises (SOEs). The support also includes simplification of SME entry to public procurement and strengthening enforcement of respective policies on market dominance, both on-going areas of WBG combined support. The STAREP regional program for Eastern Partnership countries—which emphasizes knowledge sharing, peer

learning and implementation support—will complement the ROSC (Accounting and Auditing) in helping Georgia develop institutional capacity in corporate financial reporting, a critical aspect of a well-functioning market economy and improved access to finance for SMEs. Finally, it encompasses support on the improvement of tax transparency for both local businesses and foreign investors and facilitation of cross border trade through the on-going IFC Georgia Investment Climate Project, which will help further reduce the costs of doing business and encourage greater foreign direct investment.

- **Reform of the regulatory framework and institutions for energy.** The AAA and DPOs will support the implementation of a transparent, fair and market-based institutional and regulatory framework (including domestic pricing) and the design and implementation of a strategic plan for investments, including a strategic environmental and social assessment of the investment plans in the energy sector. IFC will complement these activities through a new Regional Renewable Energy Advisory Program designed to help governments improve the regulatory framework for renewables and support IFC and non-IFC projects through provision of sectoral expertise, market assessments, product design and financial structuring.
- **The protection of property rights.** While Georgia holds first place in the Doing Business ranking (2014) for the ease of property registration, this achievement loses its importance if the property is not secure and disputes concerning property ownership are not quickly resolved. Similarly, Georgia has generally brought its intellectual property rights (IPR) legislation into line with EU standards, however, enforcement remains weak and judges and lawyers lack sufficient knowledge of IPR rules. Improvements are needed to catalyze investments in knowledge-intensive sectors. The CPS aims to build the capacity of the state to enforce property ownership rights and IPR by establishing more effective business dispute resolution systems, enhancing the protection of investors and minority shareholders' interests, and reducing IPR infringement.

62. **Access to finance expands, especially for firms in the SME sector.** The CPS will support the development of a more effective and inclusive financial sector (banking, non-bank financial institutions - including pension and insurance- and capital markets) that will channel savings into investment, diversify products and sources of alternative finance. This will improve access to finance which, together with a more competitive environment, will encourage the development of SMEs. A necessary step will be to carry out an FSAP update (jointly with the IMF) that will identify challenges in more depth and set out a financial sector development strategy and action plan that could then feed into the identification of priority policies that the new DPO series can support. Other WBG activities include the Accounting and Auditing ROSC and the use of Trust funds through the Regional FSD Advisory Facility.

63. **IFC will maintain its strong focus on the financial sector strengthening and improving access to finance for MSMEs.** It will continue to support banking sector capitalization through equity investments and sub-ordinated loans. It will provide short-term and long-term financing, guarantees, risk management instruments to financial intermediaries helping them expand lending to MSMEs and farmers, and increase trade, housing and supplier finance. IFC will also explore ways to improve local currency financing, provide advisory services to develop knowledge and capacity in the banking sector to manage risks, promote sustainable energy finance, and provide non-financial services to SMEs aiming to improve their financial and business literacy. MIGA will continue to support its three active projects in the financial sector and seek opportunities for expanding business.

64. **Policies to strengthen firms' capacity to innovate and export are developed.** Implementing new programs to support innovative entrepreneurship and exporting capabilities could contribute to the demand for high-skilled jobs. The CPS support will be through a combination of AAA, policy dialogue and a specific investment lending operation (Innovation and ICT Project, FY15, US$40 million) and will target the design and implementation of new strategies and financing instruments to foster innovation, increase knowledge and technology spillovers, and facilitate scale-up of the most innovative SMEs. The immediate goal is to create appropriate institutional mechanisms at the ministerial and agency levels, including the establishment of the Georgia Technology and Innovation Agency for innovation strategy, which will provide services and programs that foster innovative culture and entrepreneurship, co-finance innovation investments by SMEs, foster technology adoption and R&D commercialization, and support the development of export-oriented IT-enabled startups. An ICT note has recently been finalized which has helped identify the CPS priorities for innovation and skills, and further work is planned to assist in defining and implementing policies and programs to position ICT as both a source and enabler of innovation and job creation in Georgia.

65. **The CPS will also support the design and implementation of policy initiatives, investments and partnerships that integrate exporters into global supply chains and move into high value-added segments.** The program would aim to ensure that appropriate institutional mechanisms are operating at the ministerial and agency levels, including the establishment of the Georgia Enterprise and Export Promotion Agency along with an export and entrepreneurship development strategy. The WBG attention to facilitating further international trade will center on upgrading of the trade logistics platform and customs automation system, as well as streamlining the rules for importing and exporting and assuring their effective implementation. In harmony with the EU's support to Georgia to meet the DCFTA food safety standards, IFC will continue improving agri-business product quality and compliance with international norms. Technical assistance will continue to be provided to those exporters aiming to increase the quality of their products or reach new markets. To this end, IFC's new regional Agribusiness Standards Program (available for IFC clients in ECA) will support upgraded food safety standards, as well as environmental and social standards and practices. To complement these efforts, IFC will explore viable investment opportunities in agribusiness and food retail targeting competitive and export oriented.

(ii) Providing Infrastructure and Services to Facilitate Growth

66. **Efforts at equipping the country with adequate infrastructure are consolidated.** The Bank's current portfolio supports improvement of the quality and access to infrastructure at the municipal, regional and national levels aiming to: (a) maximize the potential for Georgia to participate in the global economy as an "inter-connectivity hub" for transport and energy; and (b) impact people's livelihoods through improving access to markets, reducing travel times and costs, ensuring provision of reliable utilities, and facilitating access to services. The strength and maturity of previous involvement of the WBG in infrastructure assures delivery and that investments have been strategically selected to contribute to growth and inclusion. In addition, new procurement practices will enhance competition in the selection of bidders.

67. **Georgia will enhance its regional position through increased potential of electricity exports from renewable sources.** The WBG will aim to create transformational change in the energy sector through facilitating renewable energy production and overall regional inter-connectivity with Turkey and Azerbaijan. The Bank will help in developing market rules,

network infrastructure and financial solutions to leverage private investment. The engagement will focus on the implementation of international standards of strategic and site specific environmental and social assessments to support development of sustainable hydropower resources and help Georgia leverage its hydropower potential for domestic energy needs and as a source of electricity export revenues. The World Bank will invest in enabling public transmission lines, which will complement IFC and MIGA engagement with the private sector. IFC will continue supporting Georgia to build up to 550 MW of new hydropower plants, equivalent to an increase of about 20 percent of existing hydropower capacity. IFC's contribution will come through mobilizing financing (equity and debt investments as well as significant mobilization from partners) and helping prepare concessions. MIGA will support FDI in hydropower investment by providing the appropriate risk insurance.

68. **Georgia emerges as an "inter-connectivity hub" for transport.** The CPS will support efforts to take advantage of the strategic position of Georgia in the region. The WBG will continue to coordinate with the Government and other development partners (ADB, EIB, JICA etc.) on the strategic prioritization of investments in the East-West Highway to ensure maximum mobilization of resources and to further strengthen the institutional capacity. As sections of the East-West Highway are completed, and an asset management system is implemented, the Bank, IFC and MIGA will explore with Government the possibility of PPPs for operation and maintenance of those sections.

69. **The development of secondary and local roads targets the poverty disparities among regions and provides a platform for the integration of the rural economy.** These roads lead to the reduction of costs to access markets and services, broaden the reach to the poor and isolated regions and create direct employment in the execution of civil works. WBG support will continue with a follow-up Secondary and Local Roads project (FY14 and possible additional finance in FY16). Financing road improvements in these lagging regions with high agriculture potential could directly benefit farmers by increasing farm gate prices thereby expanding access to markets.[15] The Project will also pilot labor intensive methods to execute routine maintenance works of local roads. If successful, this could provide direct long term employment by scaling up the execution of routine maintenance interventions using micro-enterprise schemes for a large part of the local road network.

70. **Greater connectivity within the domestic market helps incorporate the contribution of different regions and address poverty disparities between regions.** The WBG is preparing a follow-up third Regional Development project to contribute to the implementation of regional strategies issued by local authorities, address regional disparities, support competitive sectors in regions and attract private sector to locate in the regions. Improved access to services and strengthening regional inter-connectivity are also focus areas of this project. Trust fund financing through the JSDF has been mobilized to support local micro and small businesses – especially women – to develop and grow. Continuation of a complementary AAA program, carried out jointly by the Bank, IFC and MIGA is supporting preparation of a national tourism strategy and investment promotion plan.

[15] A very useful assessment of community level impact of rural roads on the poor in Georgia (1999-2001) indicates clearly that road and bridge rehabilitation projects generated economic benefits at the community level (Lokshin and Yemtsov, 2005).

71. **Strengthened agricultural productivity to improve competitiveness.** While better rural and local roads facilitate access to markets for rural producers, more is needed to drive the increases in productivity necessary for agricultural products to compete in national and international markets. To date, the EU and USAID have been the main partners to the Government on agriculture and rural development and they will continue to lead donor engagement in these areas. The Bank's involvement will complement their activities by focusing on a pilot project for the rehabilitation and upgrading of existing irrigation infrastructure, with the goal of enhancing agricultural productivity. The Irrigation and Land Market Development Project will develop a national irrigation strategy and improve infrastructure on about 28,000 ha. In addition, the project supports the unfinished land reform agenda by completing the surveying, certification and registration of land, including agricultural land, state land, pastures and forests. The Bank will also carry out AAA on linking smallholder farmers to markets and on public expenditures in agriculture. The formulation of the National Land Reform Strategy and Action Plan, supported by the planned project, will also consider how to enhance the land rights of IDPs and women. To complement this, IFC will target MSMEs in rural areas through the provision of financing to financial intermediaries and through investment and advisory services in agribusiness along its value chain. MIGA's Small Investment Program, that offers political risk insurance for smaller and medium-sized investment, would also look at potential in the agri-business area.

72. **Ensuring AAA sets the knowledge base.** The AAA program is analyzing specific development issues that could be considered for further support in this CPS area of focus at the mid-term point. The AAA is ramping up the focus on climate change issues with recent analytic work completed,[16] a Country Environmental Analysis underway and future AAA to encompass green transportation and logistics, with the aid of a grant from the Korea Green Growth Trust Fund. The latter aims to identify policies to reduce fossil fuel consumption and the negative environmental impacts of transport and a likely output would be a national strategy for greening freight transport and logistics, the identification of a capital investment program and technical capacity building activities for both public and private actors. Strategic social, environmental and cultural heritage assessments are being prepared in relation to the on-going Regional Development Programs, and the follow-through on their recommendations and measures will be incorporated into the implementation of the projects. The UN-CADRI is leading donor support on disaster risk management, including natural hazards, and the CPS complements this by engaging on disaster risk management through technical assistance to understand better the risks of natural disasters and to strengthen disaster risk management in the country. This will help to identify policies and measures needed to mitigate disaster risks.

(iii) Improved framework for matching labor supply and demand

73. **The goal of the CPS here is two-fold: (i) to support better labor market information and analysis that will allow for evidence-based policy; and (ii) develop more effective public employment services.** The CPS will support institutional capacity to collect and analyze more and better data on labor market dynamics and then use this analysis to improve public policy design and implementation. A good labor market information system could be linked to the

[16] A recent AAA report was finalized "Developing Climate Change Adaptation and Mitigation strategies in agriculture" which assesses the potential impacts of climate change on the agricultural sector and identifies strategies for climate change adaptation and mitigation measures to increase resilience of agricultural systems

SIMS, which plans to integrate pensions, TSA and labor market data into a single interface enabling welfare-to-work schemes or other forms of work "activation". This would help in better understanding the dynamics of employment and labor market participation, such as why women tend to self-select into jobs with lower returns rather than enter science, technology or engineering fields. The Bank will facilitate knowledge on best practices in public employment services, with a focus on matching unemployed with training programs, and improved social dialogue, especially to include women and youth.

74. **Continued attention will be given to bringing IDPs into the labor market.** IDPs face special challenges in achieving sustainable livelihoods, improving their income and employment status. They risk becoming dependent on social safety nets as their main form of income. The Bank will continue to engage in TA to ensure that: (i) IDPs are integrated as a special target group in overall economic development strategies; and (ii) the government builds capacity to address the livelihood challenges of IDPs.

Box 4: Consultations with civil society, government and the private sector

A series of broad consultation meetings with civil society representatives took place in the period of November 2013-February 2014. These included meetings with local and international non-governmental organizations, research institutions, foundations, youth groups, and the private sector. Separate meetings took place with think-tanks and with government officials. The meeting with private sector representatives was organized together with IFC. A summary of the draft CPS document was circulated prior to the consultations to allow the participants to prepare for the discussion of the proposed program by the World Bank Group. *(Further details of the feedback from these consultations is attached in Annex 4.)*

D. Implementing the Strategy

75. **Maximizing the Financial Envelope***:* Georgia is expected to graduate from IDA at the end of the IDA16 Replenishment period and the remaining IDA allocation of US$70.8 million will be fully used in FY14. This will complement the US$235 million in IBRD lending in FY14. Thereafter, the Government has confirmed its interest to maximize IBRD borrowing and an indicative envelope of about US$300 million per year is anticipated although the actual volume of IBRD lending will depend on how program performance evolves in the course of the CPS period and on IBRD's lending capacity and demand from other borrowers. Indicative IBRD allocations will be outlined during annual programing exercises with the Government.

76. **Subject to market demand and the availability of viable investments, IFC is planning investments between US$250 and US$350 million** with the goal of mobilizing additional financing from the private sector and IFIs, including though PPPs. In addition to ongoing financial sector support, IFC will aim to grow its real sector portfolio through investments in sustainable energy, and will continue to seek opportunities to invest in competitive manufacturing, agribusiness and services companies, particularly those with strong links to the rural economy and SMEs.

77. **The WBG will continue to collaborate closely with donors and IFIs to bring about greater harmonization in areas of engagement and to assure complementarity in**

financing.[17] Specific good practices on donor coordination that will be continued going forward include:

(i) Implementation of infrastructure projects will continue to be shared with other partners. This involves WBG leadership role with respect to overall transport sector policy and road sector financing. For example, financing of specific road sections of the East-West Highway is split among the main donors (WBG, ADB, EIB, JICA) and there is broad sharing of successful experiences (such as piloting of performance based contracts) and preparation of feasibility studies. This good experience from the transport sector is being broadened to the regional development and energy sectors.

(ii) Broad dissemination of AAA to help inform other partners' programs, particularly on identification of reforms that could be covered by budget support from ADB and EU

(iii) Coordination with the IMF on the monitoring of macroeconomic developments, technical assistance and policy dialogue on fiscal policy and public financial management. The DPO series complement the IMF program, which emphasizes fiscal consolidation within an agreed macroeconomic framework, with a focus on growth-enhancing structural reforms.

78. **The current Trust Fund portfolio amounts to $11.5 million and complements the CPS program**. This includes $9.3 million from SIDA in support of wastewater management (with further leveraging expected of $4-5 million from SDC to support decentralization), three IDF grants (for Parliament, Tbilisi Municipality and Georgia's National Education Examination Center) and a Trust Fund for Statistical Capacity Building. The portfolio will soon be complemented by (i) $3 million JSDF for the Regional Development project to support local communities in Kakheti and Imereti to start and grow micro and small businesses, especially those run by women; and (ii) a grant from the Global Partnership for Social Accountability that will support pilots for participatory local development and greater social accountability. Georgia will benefit from the European Neighborhood Partnership Initiative Forest Law Enforcement and Governance (ENPI FLEG II) project, which supports good forest governance and sustainable forest management in seven countries (total program is $11.2 million). The Austrian Development Agency has recently agreed to support FLEG initiatives in Georgia and Armenia for an additional US$2.16 million

E. Results

79. **This CPS program will mainstream gender analysis, action and evaluation of gender impact of results.** The Bank's AAA program will deliver a Country Gender Assessment, as well as the study on the skewed sex ratio at birth, and continue analysis of gender issues as part of the programmatic poverty work. In addition, the program will generate knowledge on gender through supporting the collection and analysis of gender dis-aggregated data in the areas of engagement. As regards the project portfolio, it will look at some of the following: (a) incorporating mechanisms to ensure women's participation in priority setting and decision-making at the project level; (b) facilitating engagement with organizations (NGOs, women's groups) to enhance project gender sensitivity during preparation; (iii) ensuring gender is encapsulated in the on-going portfolio and re-orienting if necessary; and (iv) ensuring project

[17] Annex 3 provides details on financing by development partners in Georgia

employment opportunities translate into economic opportunities for women. This will be carried out also in the broader context of promoting citizen engagement tools to promote inclusiveness, outreach, and grievance mechanisms. The CPS commits pro-actively to monitoring progress towards gender, introducing corrective measures and fine-tuning as new knowledge is gained.

80. **The WBG will aim to do more and better to understand the impact of interventions**. The challenge is to draw out the specific impacts of project level interventions on poverty reduction outcomes, attribute them in a credible manner and understand the transmission mechanisms of how benefits can reach the poor. The WBG's AAA program on poverty is already looking at links between poverty and economic growth and this will be broadened to look at links with program interventions. Impact assessments, quantitative and qualitative surveys will be used to measure improved access to services or opportunities. An important evolution of the program going forward is the systematic impact evaluation of the road investments to assess their contribution to poverty reduction and boosting shared prosperity. This will include formulating methodologies to validate the expected impacts by providing measurable impact assessments. Baseline Survey Reports were prepared for the on-going Regional Development projects, Municipal Infrastructure Development project, and Secondary and Local Roads project. These baseline surveys identify some of the major constraints faced by the targeted population in accessing services and economic opportunities. Innovations in poverty estimation methodologies (such as survey to survey imputations) and data collection tools (geo-referencing, use of smart phones, etc.) will be explored to enable measurement of local area or village level impacts. Gender disaggregated data and impacts will be embedded in this work.

81. **Performance and Learning Reviews.** This CPS will adopt performance and learning reviews to identify and capture lessons from implementation to determine mid-course corrections, end-of-cycle learning and accountability, and to help build the WBG knowledge base, including effective approaches for integrating inclusion and sustainability dimensions. The program will look at innovations in implementation support to ensure full achievement of project indicators. Sound data systems and analysis that permit real-time evidence, together with improved citizen feedback, should allow for more robust evaluation and facilitate mid-term policy and program correction.

IV. MANAGING RISKS

82. **The domestic political context could impact program performance.** The risk exists that policy uncertainty, that characterized 2013, returns and weakens the ability of the Government to fulfill its election promises. This risk is somewhat mitigated by the stabilization in the political context since the Presidential elections and the new Government has demonstrated commitment in the SDS to developing a vision for inclusive growth and private-sector led job growth. While the WBG role in mitigating this risk is limited, the Government has requested a broad partnership with the WBG in support of a transparent and effective public policy environment that is inclusive and anchored in evidence-based decision making. Should policy uncertainty arise that negatively impacts the implementation of the SDS, the WBG will re-assess the CPS program at the mid-term point. Potential shifts in the strategy at that stage could include decreasing DPO support and substituting investment operations instead.

83. **There are risks related to public sector capacity to deliver results**, particularly in line ministries and at the local government levels. Delivering on the ambitious goals in the social sectors poses a challenge in terms of existing systems, standards, and capacity. Addressing these challenges is at the core of the CPS focus on supporting the Government in "delivering for impact" and requires a concerted focus on the identification of capacity gaps and coordinated capacity building. These risks are also expected to be mitigated by capacity building support from other donors, and by leveraging private resources through PPPs to support the provision of accessible and high quality public services. Should the DPO instrument with the accompanying TA support prove to be insufficient, the choice of instruments will be reviewed at the mid-way point with other instruments being considered such as Program for Results or investment operations specifically designed in support of social sector programs.

84. **Georgia faces risks from the external environment and regional context.** Although its strategic location between Europe and Asia is an opportunity for longer term growth, the complicated geo-politics of the South Caucasus region pose risks and may contribute to the difficulties in attracting private investment and growing jobs. While the relationship with Russia has improved with the lifting of the trade embargo on wine and mineral water from Georgia, any negative political developments between Georgia and Russia could cause greater instability in the region. The frozen conflict between Armenia and Azerbaijan also potentially poses a risk if that situation were to deteriorate. The CPS will carefully monitor this external context and mitigate the risk by pro-actively adapting the program as needed.

85. **Risks also exist to private sector capacity to grow, innovate and create jobs,** mainly stemming from limitations imposed by the current level of private sector and financial sector development, gaps in public sector service provision, and other challenges on skills and labor market issues. The CPS aims to mitigate this risk through a comprehensive package of support on private sector and financial sector development, while recognizing that expectations for radical change on the private sector's role in Georgia should be modest within the CPS time frame. The two-fold focus of the CPS on private sector-led inclusive growth and effective public service delivery allows for balance in the approach, through focusing on both the public and private sector roles in creating a conducive environment for equitable growth and job creation. Further mitigation efforts include strong dialogue between the private and public sectors on policy design, greater inclusion in governance and budgetary planning, strengthened role of private sector institutions such as chambers of commerce and business associations, and efforts to strengthen MSME capacity.

86. **Macroeconomic risks stem from high external debt, the dollarized financial system, limited scope for monetary policy and fiscal pressures.** The government's commitment to fiscal consolidation and efficient public financial management provides a strong framework for the CPS and underscores the importance of pro-poor priority spending and investment planning that is focused on results and development impact and aligned with strategic growth objectives. Financial sector and capital markets reform, along with measures to strengthen the macro-prudential framework will support gradual de-dollarization and strengthen the transmission channels of monetary policy, thereby reducing the pressure for fiscal policy to react to even temporary shocks. This will also support growth in national savings, essential for the current account deficit to narrow to sustainable levels. External sustainability and macroeconomic stability will also be supported through the Government's commitment to exchange rate flexibility and the maintenance of a responsible fiscal framework. Should the macro-economic

framework no longer be adequate and remedies are not implemented effectively, then the WBG will consider adapting the program accordingly with a change of instrument, substituting investment lending in the place of DPOs.

Annex 1: Georgia FY14-17 CPS Results Matrix

Country Development Goals (from SDS)	Development Challenges and Opportunities addressed by the CPS	CPS Engagement Areas and Outcome Indicators	World Bank Group Program
Area of Focus 1: Strengthening Public Service Delivery to Promote Inclusion and Equity			
Improving the Social Assistance System	While the Targeted Social Assistance (TSA) program is well-designed, its coverage and efficiency need to be improved , as currently less than half of the bottom income decile is covered, and some leakages remain. The pension system in Georgia provides universal basic old age security to all elderly. Currently it lacks a firm indexation rule that would allow the basic benefit to maintain at least its purchasing power. In addition, a savings system, whether mandatory or voluntary, would provide adequate replacement of working age income.	**CPS Objective 1:** Expanded and strengthened social protection system (TSA and pensions) ***Outcome Indicators:*** • TSA Coverage of the poorest decile by TSA increases from 40[18] percent in 2012 to 60 percent in 2017; with equitable coverage of men and women of the poorest decile *Note: More detailed gender dis-aggregated data per decile will be developed during the CPS period* • Pension reform roadmap developed	**IDA/IBRD Lending:** DPO-3 (on-going, FY14) New DPO (CPS Area 1, FY15-16-17) **AAA:** Pension reform (FY14-17) TSA implementation and results assessment TA (FY14-17) South Caucasus Poverty, Equity and Gender TA (FY14-17) Country Gender Assessment (FY14)
Provision of accessible and high quality healthcare	The Government's Universal Health Coverage (UHC) program started in 2013 aiming at equitable coverage of health services, as well as financial risk protection. However, reducing households' out-of-pocket health expenditure, which is among the highest in the region at over 70 percent of total health spending, will need major effort in pharmaceutical price regulation and refining UHC benefit package based on evaluative and actuarial studies. Improving quality of medical service delivery will remain key challenges to succeed in improving health outcomes.	**CPS Objective 2:** Expanded "universal health coverage (UHC)" program and institutionalization of health service quality assurance processes ***Outcome Indicators:*** • UHC registration rate from 60% of the target population in July 2013 to 90% in 2017, with tracking of female registration rate *Note: More detailed data on female registration and utilization of UHC will be developed during the CPS period*	**IDA/IBRD Lending:** DPO-3 (on-going, FY14) New DPO (CPS Area 1, (FY15-16-17) **AAA:** UHC implementation and results assessment TA (FY14-17) Health service quality assurance review (FY14-15) Country Gender Assessment (FY14)
Improve quality of education.	Access to general education has been expanded quite successfully with gender parity, but the quality of education remains a pressing challenge, reflected by the low	**CPS Objective 3:** Essential knowledge base for general education and pre-school education elaborated	**IDA/IBRD Lending:** DPO-3 (on-going, FY14) New DPO (CPS Area 1, FY15-

[18] This is the baseline from the current version of the Socio-Economic Development Strategy

	achievement level in international student assessment along with the unsatisfactory labor market outcomes of graduates. Furthermore, the new "free pre-school" policy will pose key implementation challenges in the near term. Its successful implementation will significantly contribute to narrowing the learning outcome gap of the children of disadvantaged background. Access to pre-school education has also been identified as a constraint to female labor force participation.	***Outcome Indicators:*** • School-based education quality monitoring database established • Teacher effectiveness evaluation tools developed & adopted • Institutional framework elaborated for early and pre-school education service delivery and quality assurance, including support to piloting of priority interventions.	16-17) **AAA:** Education TA for implementation of sector strategy (FY14-17) School survey, incl. assessment of learning outcomes (FY14-15) Pre-school service delivery and quality assurance assessment (FY14-15) IDF Education (on-going)
Effective Public Administration and Decentralization.	While Georgia performs above average compared to middle income countries with respect to basic requirements and efficiency enhancing indicators of the World Competitiveness Index, there is a need to improve implementation and delivery of public services. Improving implementation and delivering public services to citizens more efficiently and with more accountability will require a focus on building the necessary mechanisms and capacity of Georgia's public administration. Decentralization and the leading role of sub-national units in stimulating local economic processes are seen as very important factors for achieving national development. Continuing decentralization efforts will require a consistent approach and careful design in ensuring efficiency and effectiveness of public service delivery at the local government level.	**CPS Objective 4:** The identification, prioritization and implementation of public investments improve ***Outcome Indicators:*** • Strengthened capital budgeting reflected in objective and transparent selection criteria for 50 percent of new projects in Tbilisi municipality (Baseline= zero). • Increased number of published annual IFRS based financial statements of SOEs with unqualified audit opinion from 4 in 2013 to 8 in 2017 • Increased number of beneficiaries of improved municipal services and infrastructure from 0 at baseline to 2.4 million, of which 1.22 million females. **CPS Objective 5:** Sustained progress towards the adoption of modern public sector and fiscal management systems • Quality and timeliness of annual financial statements (PEFA PI-25) Baseline: C+ Target: B; 2); • Effectiveness of internal audit (PEFA PI-21): Baseline: C+ Target: B) **CPS Objective 6:** Strengthening participatory local development and greater social accountability • New pilot mechanisms for citizen engagement and feedback are put in place including (i) development of new forum for youth to engage with local government in the creation of joint action plans; and (ii) integrating	**IDA/IBRD Lending** New DPO(CPS Area 1, FY15-16-17) Regional and Municipal Development Projects (FY09, FY14) **AAA:** PER, programmatic (FY14-17) Country Gender Assessment (FY14) PEFA (FY14-15) CEM, programmatic (FY14-17) Local Public Expenditure and Financial Accountability TA to support Govt.'s Public Financial Management strategy and strengthened SOE governance (FY14-15) Urban Strategy (FY15) Country Environmental Assessment (FY15) Procurement TA support (FY14-17) **Other:** Youth Inclusion and Social Accountability Project (FY14, Trust Funds)

		tailored social accountability tools into water supply and sanitation services and local roads rehabilitation. • Increased citizen satisfaction with municipal service provision and municipal response from 40% to 70%.	
Area of Focus 2: Enabling job creation by the private sector through improving competitiveness			
Improve Georgia's investment and business environment, including in the regions. Improving access to finance Supporting innovations and development of technologies, including in the regions.	The extensive regulatory and business environment reforms implemented by Georgia so far have had modest impact on its competitiveness. Despite a consistent policy in market deregulation and liberalization, and high levels of FDI before the 2008 international economic crisis, the economy is still based on low technological sophistication, low levels of innovation, with a dearth of skills. As a result, the growth experienced over the past decade was not coupled with an increase in export competitiveness. Despite Georgia's third ranking in the 2014 Doing Business indicators in this regard, and its private credit registry that already covers close to half of the existing firms, surveys, businesses continue to cite access to finance as a key constraint. According to BEEPS 2013 results, the percentage of firms which developed new products in the past three years has dropped from 35% in 2008 to 9% in 2013; over the same period 2008-2013, percentage of firms that spent any funds on R&D in the previous three years dropped from 16% to 4%. Georgia needs to improve infrastructure services and institutional capacity to support the development of tourism, cultural heritage sites, and agribusiness in the regions.	**CPS Objective 7:** Key legal, regulatory or institutional constraints for the private sector are addressed, including in the regions ***Outcome Indicators:*** (a) <u>Stronger regulatory framework</u>: • Business environment and property rights protection enhanced with Georgia's ranking in economic freedom (Heritage Foundation) improved from 34th position in 2012 and intellectual property rights enhanced from 129th position in 2013 (out of 130) as ranked by the International Intellectual Property Rights Ranking (b) <u>Increased innovation capacity:</u> • R&D investments (private and public) increased from 0.1 percent of GDP in 2012 • Increased Georgia's innovation index ranking from 73rd in 2013 (INSEAD-WIPO report) *Note: The next BEEPS survey will include the "gender module" that has extra questions covering female-headed enterprises and allows for gender dis-aggregated data collection* (c) <u>Strengthening competition in key product markets</u> • Georgia's intensity of local competition improved from 123rd (out of 142 in 2012) in the Global Innovation Index (d) <u>Increased access to finance</u>: • Increased access by SMEs to bank financing with share of loans to SMEs in banks' loans increased from 20 percent (baseline 2013) • Improved access of SMEs to more diversified products	**IDA/IBRD Lending:** DPO-3 (ongoing, FY14) Regional Development Projects Regional and Municipal Development Projects (FY09, FY14) New DPO (CPS Area 2, FY15-16-17) ICT/Innovation project (FY15) **AAA:** South Caucasus Poverty, Equity and Gender TA (FY14-17) ROSC (FY14-15) CEM, Programmatic (FY14-17) National Tourism Strategy (FY15) Urban Strategy (FY14) FSAP (FY14-15) Country Gender Assessment (FY14) **IFC On-Going:** IFC financial markets outstanding investment portfolio comprised of 19 projects (incl. 14 targeting MSMEs) with 8 client banks. IFC agri-business investment portfolio comprised of 2 projects. IFC Investment Climate Advisory Project (FY14-FY16) IFC SME Banking Advisory Project (FY13-15) IFC Agribusiness Standards

		and sources of funds, with share of NBFI assets (including MFI, leasing, factoring and other formal financial sector lenders) in total private financial sector assets increased from 3 percent in 2013 • Volume of outstanding loans to MSMEs in the portfolio of financial intermediaries supported by IFC increased by 50% from US$0.8 billion to US$1.2 billion • Increased financial penetration, with share of private credit to GDP from 30 percent in 2013. (e) <u>Facilitate investment in the regions through support to an improved investment climate and infrastructure</u>. • Increased tourism related SMEs (points of sales) in renovated culture heritage sites and cities by 30 percent (from 248 to 323), generating jobs. • Increased tourist spending in targeted regions by 20 percent	Advisory (FY14-16) IFC Resource Efficiency Advisory Project (FY10-FY16) **IFC Pipeline:** IFC equity investment and debt finance, including trade, MSME, agribusiness, housing, and supplier finance Potential MIGA engagement
Development of infrastructure and maximum realization of Georgia's transit potential. Improving energy independence, energy efficiency and increasing electricity exports Developing agricultural infrastructure	Developing roads and energy connectivity is allowing Georgia to benefit from its critical location between Europe and Central Asia, with the goal of maximizing its transit and trade potential. The focus of the Government's efforts to date in transport has been on developing the East-West highway – the "back-bone" of growth in Georgia. Developing further this critical road will allow Georgia to lower transit costs and become more competitive as an international transit route. Georgia's energy sector is also taking off and the potential for renewable energy exports is promising. Over the last decade, the Government has successfully transformed the energy sector into a fast-growing one, bringing down energy prices in parallel with increased efficiency of the sector. The importance of consolidating this progress is highlighted by Georgian firms who cite reliable and affordable energy supply as a priority. Georgia's hydro-power potential can also be a source of export revenues by providing clean renewable power to countries in the region. Implementing a market platform for electricity exports/trade and international standards for sustainable	**CPS Objective 8:** Provision of infrastructure and services to facilitate growth. ***Outcome Indicators:*** • Decreased travel time and vehicle operating costs in rehabilitated East-West Highway sections by 40% and 10% respectively. • Reduction of travel time and vehicle operating costs in rehabilitated secondary and local roads sections by 20% and 30% respectively • Enhanced energy regulatory system and electricity market rules are implemented in line with EU Energy Policy applicable to Georgia under the AA and Energy Community Treaty. • Improved reliability of the power grid infrastructure is in place, measured by (i) MW550 of added generation capacity (ii) A reduced number of electricity interruptions in the south-western part of the grid, particularly Batumi areas, measured by number of electricity	**IDA/IBRD lending:** DPO 3 (on-going, FY14) DPO (CPS Area 2, FY15-16-17) East West Highway Projects (FY13, FY15) Secondary & Local Roads Projects (FY12, FY14, FY16) Energy Transmission Grid Strengthening Project (FY14) Irrigation and Land Management Project (FY14) **AAA:** Small Farmers TA (FY14) Georgia Energy Sector Review (FY14-15) CEM Programmatic (FY14-17) Green Transport AAA (FY15) **IFC Ongoing:** IFC Paravani HPP

	development of hydropower will be critical for exports and a reliable domestic energy supply. Georgia needs to significantly improve agriculture infrastructure, especially irrigation, which was neglected for a decade. The land management and registration system also needs strengthening to support land consolidation, which small-holder farmers need to access markets.	interruptions at KV220 (iii) Use of net transfer capacity at new back-to-back station increased from close-to-zero today to 300 MW. • There is an increase in agricultural productivity (15%) in at least 75 percent of the area where irrigation rehabilitation takes place.	IFC InfraV Shuakhevi HPP **IFC Pipeline:** Shuakhevi HPP IFC Energy Infrastructure Advisory Program (FY14-18) IFC PPP transaction advisory IBRD/WBG Namakhvani HPP & Grid development. Potential MIGA engagement.
Ensuring workforce relevance to labor market requirements.	With economic transformation in Georgia, some of the older sectors and industries died, shedding their labor force. New industries grew during the same period but have not been able to absorb the workforce as effectively and overall labor demand remains weak while skills mismatches persist. The majority of the work force – more than 55 percent – is employed in agriculture (mostly self-employed), which contributes only 8.2 percent of GDP and is characterized by family-based subsistence farming.	**CPS Objective 9:** Improved framework for matching labor supply with demand ***Outcome Indicators:*** • Procedure to match unemployed with training programs developed and implemented. • Labor Market information system is in place that will allow for evidence-based policy making *Note: More detailed data on female labor force participation will be tracked during the CPS period*	**IDA/IBRD Lending:** DPO (CPS Area 2, FY15-16-17) **AAA:** TA: Labor Market Information System design, implementation, and data analysis (FY14-17) Country Gender Assessment (FY14) South Caucasus Poverty, Equity and Gender TA (FY14-17)

Annex 2: FY10-13 COUNTRY PARTNERSHIP STRATEGY COMPLETION REPORT

CPS Board Discussion:	September 10, 2009
CPS Progress report (Board Presentation):	April 19, 2011
Period Covered by CPS Completion Report:	July 1, 2009-June 30, 2013

1. SUMMARY OF KEY FINDINGS

1. **The FY10-13 CPS was prepared in the aftermath of the August 2008 conflict, and the global economic and financial crisis.** The strategic objectives of the CPS were to: (i) Meet post-conflict and vulnerability needs; and (ii) Strength Competitiveness for Post-Crisis Growth. The Government's *Basic Data and Directions for 2009-2012* (BDD) provided the strategic underpinning of the CPS. The main development objectives of the BDD included macroeconomic stability, improved business environment, increased social welfare, modernization of road and energy infrastructure, agricultural development, better quality of education, and public sector modernization and accountability for results. In addition, a World Bank led *Joint Needs Assessment*, conducted in 2008, helped the Government in identifying the immediate needs of Georgia in the aftermath of the conflict (see Annex 5).

2. **The Program's performance in contributing towards the achievement of the CPS outcomes is rated Satisfactory.**[19] During the CPS period, the WBG supported Georgia's development strategy through a financing envelope of US$823 million from IBRD and IDA (more than twice the original envelope of US$396 million), IFC provided US$251 million of direct financing and mobilized an additional US$36 million. MIGA provided guarantees with a net exposure of US$22.5 million. In addition, a robust analytical and advisory program complemented and supported the lending portfolio. In line with its strategic objectives, the program supported reforms and activities which led to significant achievements in expanding coverage of both the targeted social assistance (TSA) and medical insurance programs to the poorest parts of the population, scaling up benefits and reinforcing targeting effectiveness. It also supported reforms and investments aimed at improving the business environment and overall competitiveness, which were reflected in Georgia's remarkable improvements on several business and competitiveness indicators rankings. Although not an explicit objective of the CPS, poverty rates in Georgia also saw a remarkable improvement in the latter years, decreasing from 21 percent in 2010 to 14.8 percent in 2012. Poverty analysis shows that the decrease was mainly driven by social transfers (pensions and Targeted Social Assistance) and rising earnings, with some contribution from food price deflation. Extreme poverty decreased from 6.7 percent in 2010, to 3.7 percent in 2012. Notwithstanding these notable results, sustaining poverty reduction going forward will necessitate enhanced growth and increased earnings, together with continued fiscally sustainable social expenditures. Shortcomings remain in some of the areas targeted by the CPS such as; business environment (in particular access to finance for SMEs), job creation, and quality of education.

[19] Out of 13 CPS outcomes, 12 were achieved and 1 (health coverage) was Partially Achieved (one indicator was partially but largely met, and all others were fully met). Out of 26 primary results indicators, 25 were met, and 1 (number of out-patient visits per capita) was partially, although largely, met.

3. **Performance of the World Bank Group in designing and supporting the implementation of the CPS Program is rated Satisfactory**. The WBG program grew in size while remaining focused, and adequately responded to Georgia's evolving circumstances. Additional and front-loading of IBRD, IDA and IFC funds allowed the WBG to respond adequately to Georgia's needs during the financial crisis, and in the aftermath of the 2008 conflict. The mix of lending, equity capital, capacity building, technical assistance and policy advice was appropriate and relevant. The CPS results matrix provided overall realistic, relevant and measurable indicators.

2. SUMMARY OF COUNTRY GOALS

4. Georgia made significant gains towards the medium-term objectives outlined in the BDD, as summarized below:

- ***The macroeconomic framework remained generally positive.*** Georgia's GDP grew on average by 9.6 percent annually during 2003-2007, until the 2008 global crisis and conflict. A brisk recovery followed between 2010 and 2012 on the back of a strong public capital spending stimulus. The macroeconomic policy framework over the CPS period transitioned from a focus on stimulus to one on stabilization. Starting in 2011, there was a commitment to medium term fiscal consolidation to contain the persistent current account deficit and align it with debt management objectives and to flexible exchange rates with inflation targeting to support external sustainability. While there has been a slowdown in growth in 2013, this is viewed as temporary and driven mainly by policy uncertainty following elections in 2012 and 2013, and a fall in public investment. Nonetheless, medium term risks remain, stemming from continued Eurozone weaknesses and vulnerabilities in the form of a wide current account deficit, high dollarization, and gross external debt of over 80 percent of GDP. These are mitigated by continued adherence to the IMF program and a new reform program targeting job creation and faster, more inclusive, and sustainable growth.
- ***Georgia's competitiveness and business environment recorded significant improvements in key areas, though others lag behind***: Georgia's *Global Competitiveness ranking during 2012-2013* improved from 90th place in 2008-2009 to 77th, and the *2013 Doing Business* report ranking improved to 9th, compared with the already high ranking of 15th in 2009. Gains were also recorded in areas supported by the Bank-financed *Development Policy Operations* (DPOs) and IFC investment and advisory services: paying taxes, access to credit for infrastructure, trading across borders and protecting investors. However, rankings for many critical ingredients of long-term competitiveness have stagnated or deteriorated (see Annex 4), while access to finance for Micro, Small and Medium Enterprises (MSME) remains a constraint.
- ***Roads and energy infrastructure improved***: Road rehabilitation and upgrading has been a key Government priority since 2004 and even more so in response to the dual crises, with a view to improving access to markets and services, and providing short-term employment. Georgia upgraded parts of the East-West Highway, significantly reducing transit time, vehicle operating costs, and road fatalities. It also made significant strides towards improving secondary, urban, and rural roads. The 2012-2013 *Global Competitiveness Report* rankings improved compared with 2008-2009, from 68th to 56th for quality of roads, and from 78th to 46th for the quality of electricity supply.
- ***Weak performance of agriculture sector***: Agriculture remains an important sector in Georgia given that over 50 percent of the population lives and works on agricultural land and agriculture contributes about 25 percent of exports. However, the share of agriculture to GDP has significantly declined (from 25 percent in 1999 to about 8 percent in 2012, but has started to

increase once again due to the new Government's focused attention to Agriculture, recording 8.2 percent in the first six months in 2013. Between 2006 and 2010, critical public services and infrastructure, including irrigation and advisory and veterinary services, collapsed, resulting in weak sector performance. Agriculture contracted between 2005 and 2010 (averaging -2.1 percent real growth) but recovered strongly in 2011(+5.5 percent real growth). Low investment and stagnating productivity stem from fragmentation of farm land, a generally obsolete rural infrastructure, especially irrigation, high transport costs, and poor access to markets. Poor sector performance is widening the trade deficit and depressing incomes for rural households. In addition, in 2013 the Parliament passed a temporary measure[20] prohibiting foreign ownership of agricultural lands, further inhibiting foreign investment. The Government is working to develop alternative ownership schemes, such as long-term lease.

- ***Despite many important changes to the education sector, reforms have not yet translated into improved outcomes for education in Georgia***. Access to general education has been expanded and girls and boys have largely equal access.[21] However, student academic performance, as measured by international standardized tests, remains low, both by OECD standards and when compared to other countries in ECA. Quality of education, also in view of its impact on labor outcomes, thus remains a pressing challenge.
- ***Public sector management improved***: Georgia made notable strides towards improving the policy orientation and results-based approach of budget planning and management. The use of the Medium Term Expenditure Framework (MTEF) in the BDD ensures better consistency between the Government's action plans and the multi-year budget ceilings for each line ministry, and increased transparency: the 2012-2013 *Global Competitiveness Report* ranked Georgia 36th on transparency of government policymaking, compared with 86th in 2008-09. Fiscal transparency and accountability was enhanced by recent reforms and modernization of treasury, accounting and reporting systems.

3. PROGRAM PERFORMANCE

5. **The CPS Program's performance is rated Satisfactory.** The Program revolved around two strategic objectives, four results areas, and thirteen outcomes.

First Strategic Objective: Meeting Post-conflict and Vulnerability Needs

A. Results Area 1: Economic Stability and Job Creation

6. **Outcomes were largely achieved. All results indicators were met.** The WBG supported these outcomes through four *Development Policy Operations* (*DPO I-III* and *Competitiveness and Growth DPO I*) and several investment projects, including: *Public Sector Financial Management Reform Support Project* (PSFMRSP); *Kakheti Regional Roads Project; Rural Development*; *Regional and Municipal Infrastructure Development*; *First and Second Secondary and Local Roads*; *First and Second Regional Development*,[22] and the *Second Education APL*. IFC continued to provide support to financial sector

[20] A moratorium was announced on purchasing state owned agricultural land by foreign citizens until December 31, 2014.

[21] In primary and lower secondary education, female enrolment rates are slightly below those of their male peers (102.8% vs. 104.8% in primary and 99.9% vs. 101.6% in lower secondary). However, female Gross Enrolment Ratio is 77.3% in upper secondary education, while for males it is 71.3%.

[22] The Second Regional Development Project, however, was only approved in November, 2012.

investment. The Bank also provided support through extensive analytical work and technical assistance, including a Country Economic Memorandum on sustainable development, a Public Expenditure Review, Financial Sector Advisory, a Programmatic Poverty Assessment, and a note on labor market analysis and skills mismatch.

7. **Public resource management improved, including a sharp reduction of the fiscal deficit, the introduction of performance-based budgeting, and the establishment of a new local government budgetary system in all municipalities**. Georgia reduced the overall budget deficit from 9.2 percent of GDP in 2009 to 2.9 percent in 2012, while increasing the budget share of social services to 39.7 percent in 2012 compared with 36.3 percent in 2009 (Annex 1).[23] However, social services expenditure remains below comparator countries in per capita terms and as a proportion of the GDP, especially in education and health. Performance-based budgeting was introduced in all ministries starting with the 2012 Budget Law. A new local government budgetary system was developed and introduced in all municipalities and staff training was provided. The 2013 local budgets were presented in program format. Most projects in the public investment program submitted to the Parliament include complete time profiles of financial information, justification, monitoring indicators and reports on execution of the previous year planned project implementation. Three of the four DPOs approved during the CPS period[24] provided specific contributions in the area of public sector management. These included supporting the Government's *Public Financial Management Reform Policy Vision 2009-2013*, which provided an integrated approach to strengthening the public finance system; contributing to the formulation and implementation of results-oriented and public investment budgeting reforms through the enactment of a new Budget Code that helped to anchor budget planning and management in a unified legal framework; and contributed to strengthening the efficiency of Treasury management and to improvement of the coverage and transparency of financial reporting. PSFMRSP contributed to significant improvements in several dimensions of PFM performance, including the adoption of a stronger multi-year perspective in fiscal planning and budgeting; improved predictability in the availability of funds for commitment of expenditures; improved public access to key fiscal information; and improvement in the scope, nature, and follow-up of external audits.

8. **Systemic banks weathered well the crisis with IFC's support**. The National Bank of Georgia effectively managed the banking crisis. IFC played a critical role in mobilizing debt and equity financing to support Georgian banks' liquidity and capital needs. IFC proactively addressed the risk of a potential banking crisis through counter-cyclical investments that helped recapitalize key systemic banks and restore market confidence. The financial health of systemic banks was monitored by IFC in tandem with IMF reviews under Stand-By Arrangements. This proactive IFC program in Georgia was praised IEG in 2010.[25] IFC also expanded its trade finance program during a time when private international commercial banks scaled back or eliminated their open lines for Georgian banks. Most financial health indicators (capital adequacy and liquidity ratios, return on assets and equity, non-performing loans ratio) recovered from the 2009 crisis. While the sector's capital adequacy ratio and liquidity ratio marginally deteriorated from 20.2 to 17.0 percent and from 40.6 to 39.8 percent, respectively (Annex 1), they are both comfortably above minimum requirements. Banking sector profitability also improved and as of 2013 seems to have stabilized. The deterioration in the loan-to-deposit ratio from 129.8 to 106.7 (Annex 1) was mainly driven by the increased level of non-resident foreign deposits. This somewhat increased external

[23] The CPS definition of social expenditure included social protection, health, education, housing and community development, and culture and recreation.
[24] The Georgia Competitiveness and Growth DPO II was approved on June 27, 2013.
[25] IEG, *The World Bank Group's Response to the Global Economic Crisis* (2010, p. xvi).

vulnerability of the sector, but the IMF recognized that the Central Bank adopted adequate measures to contain nonresident deposits growth going forward.[26] The performance of the IFC portfolio in three banks, representing 66 percent of the total assets of commercial banks, met the CPS milestone of compliance with IFC covenants. The latest IMF assessment of the banking sector concluded that financial soundness indicators are strong for the sector as a whole, although two small banks are close to the minimum prudential requirements.[27] Nonetheless, similar to other countries, the Georgian banking sector is sensitive to economic cycles and highly dependent on capital inflows from IFIs and external lenders. Moreover, high costs of lending and high levels of dollarization may increase non-performing loans (NPLs) and banking sector risks should economic growth and domestic demand slow down.

9. **MIGA supported (on a portfolio basis) two operations covering the Georgian subsidiary of a leading global micro-finance institution, for a total current net exposure of US$ 22.5 million.** The brief performance history of this institution since the MIGA guarantees were issued (2010, 2011) and performance monitoring started (2013), suggests that it is satisfactory and in line with the picture of a recovering financial sector after the 2009 crisis, as described above. The subsidiary's volume of outstanding loans increased, especially loans to smaller businesses, and its volume of customer deposits grew as well. The company's operating results improved and the return on average equity increased. In addition, during 2012, the volume of outstanding green loans increased by 35 percent to EUR 78.2 million (where "green loans" are used to finance investments undertaken for energy efficiency, renewable energy, and environmentally friendly investments). Loan quality is relatively satisfactory, judging by reported arrears within the context of the global portfolio of MIGA.

10. **Temporary employment supported by Bank-financed projects helped mitigate the social impact of the dual crises**. During FY10-13 Bank-financed transport and regional infrastructure projects generated about 45,000 person/months of temporary jobs (exceeding the CPS target of 30,000) and IFC-supported clients generated over 1,400 permanent jobs. The IEG report highlighted the Bank's appropriate response to rising unemployment in the wake of the crisis through labor-intensive operations such as the *Regional and Municipal Infrastructure Development* and the *Secondary and Local Roads* projects.[28]

11. **With the support of the *Education APL II Project,* the percentage of children in grades 1 through 12 learning according to the new curriculum increased from about 2 percent in 2006 to 100 percent in mid-2013. However, evidence of improved education quality is limited.** Georgia does not yet have in place the monitoring framework needed to assess the implementation of the new curriculum and its impact, and thus it is difficult to assess whether, and to what extent, it has contributed to improved student performance and overall quality of education. However, the *Education APL II* Project helped with other important steps in this direction, including the financing of teachers' training on the new subjects, and the use of more active pedagogical practices. Reforms of the school financing system, also supported by the Project, helped reduce the number of schools showing a budget deficit from 1,400 to 167 in 2011, while all schools identified as in emergency conditions were rehabilitated and refurnished.[29] Remaining challenges include the need to address teachers' qualifications, and insufficient incentives and instructional support materials vis-a-vis a constrained education budget (2.6 percent of GDP in 2012).

B. Results Area 2: Improve Social Services

[26] Article IV, August 2013.
[2727] IMF, Staff Report for the *First and Second Reviews under the Stand-By Arrangement* (April 2012; April 2013).
[28] IEG 2010, p.53
[29] *Education System Realignment and Strengthening Project* (APL II, Report No. ICR20124, February 2012).

12. **Three outcomes to improve social services were achieved, and one was substantially achieved.** All key indicators were fully met, with the exception of the number of outpatient visits per capita for the poorest two quintiles, although this was largely achieved. The WBG supported these outcomes through *DPO I-III* and *Competitiveness and Growth (CG)-DPO I* budget support, and through the *Health Sector Development Project* (HSDP), the *Regional and Municipal Infrastructure Development Project* (RMIDP), and the execution of the Trust Funds for Internally Displaced Persons (IDPs). Non-lending support included the Public Expenditure Review, a Programmatic Poverty Assessment, a South Caucasus Pension Technical Assistance, the Kakheti Regional Development Study, and the Joint Needs Assessment Progress Report.

13. **Targeted Social Assistance (TSA) coverage and efficiency improved, significantly contributing to the poverty reduction witnessed from 2011 onwards.** However, more needs to be done to reach more of the poor segments of the population. Over the course of the DPO series, a range of measures were implemented to improve effectiveness of the TSA. These measures included preparing a monitoring report, adjusting the proxy-means testing formula, improving business processes, linking the Social Services Agency database with that of other government agencies, and recertification of beneficiaries. In 2012 the TSA budget reached GEL279 million, compared to GEL124.5 million in 2008. Between 2007 and 2011 the number of TSA beneficiaries increased by 18.6 percent, and leakages were reduced. The share of the population in the bottom decile of consumption per adult equivalent receiving TSA benefits increased from 39 percent in 2009 to 53 percent in 2012, compared to 32 percent in 2007. Pilot modules for the state pension, state compensation, and state social package were launched in May 2013 in Tbilisi and the Rustavi and Mtskheta regional districts, and pensions increased from GEL70 in 2009 to GEL125 in 2013.

14. **Health coverage in general, and for the poor in particular, improved**. *DPOs I-III*, *CG-DPO I* and *HSDP* supported improved safety and quality of healthcare, expansion of health insurance coverage, and stronger oversight of public funding for private health insurance. Enrollment of the poor in the Medical Insurance Program (MIP) increased: the share of population in the bottom two income quintiles with access to publicly-subsidized health care increased by 20.7 percent between 2008 and 2011. The population eligible for MIP increased by 117 percent between 2008 and 2012, from 0.75 million in 2008 to 1.63 million in 2012; overall access to health insurance increased from 12.3 percent of the population in 2008 to 30.8 percent in 2011 due to public subsidies for voluntary health insurance for people not eligible to MIP. In September 2012, the MIP was extended to all the elderly and all children under the age of six, and throughout 2013 about 800,000 new beneficiaries were effectively covered. .[30] The oversight of private health insurance was strengthened through implementation as of December 2010 of upgraded standards in all hospitals to improve safety and quality of healthcare services,[31] creation of a stakeholder oversight forum, financing of health insurance mediation, development of an electronic system for beneficiary identification, enforcement of internationally-recognized reporting for medical claims, and implementation of an information platform for processing medical claims. The Social Information Management System (SIMS) at the Ministry of Labor, Health and Social Affairs provides consolidated automated information about all the registered beneficiaries of government-funded social programs. This has improved management of the MIP and other programs, such as pensions, means-tested targeted assistance, and internally displaced person allowance distribution. By providing a comprehensive database of registered beneficiaries, the SIMS has enabled expansion of MIP coverage to the targeted population. In addition, it highlighted the number of unregistered and allowed a more targeted approach to encourage them to register. The ICR for the *Health Sector Development Project* noted substantial progress towards implementing public health care reform with an emphasis on the family medicine

[30] Government Decree No. 165 dated May 7, 2012 (CG-DPO I prior action).
[31] Government Decree No.385 dated December 17, 2010, implemented as of 2012 (CG-DPO I prior action).

model, introducing a new guideline development process and strengthening institutional capacities, and improvements in critical indicators on public health care provision.[32]

15. **Municipal services improved, providing beneficiaries in targeted urban and rural areas increased access to roads, water, and encouraging private sector investments**. The Regional and Municipal Infrastructure Development Project (RMIDP) financed the implementation of 122 water, wastewater sub-projects, and the rehabilitation of 245 km of roads. These investments led to: (i) an increase in urban piped water services from 7 hours/day in 2008 to 17 hours/day on average by mid-2013; (ii) tripled daily water production, from 40 l/day in 2008 to 120 l/day; (iii) access to improved water sources by 181,700 people in urban areas and 181,835 people in rural areas; (iv) an increase from 6,000 piped household water connections benefitting from rehabilitation in 2008, to 83,847; and (v) a reduction of trip times and vehicle operating costs in selected urban roads by 30 percent from October 2008. Energy efficiency for water production also doubled, from 0.63 Kwh/m3 in 2008 to 0.30 Kwh/m3 by May, 2013. In addition, RMIDP had a catalytic effect through financing the preparation of a National Strategy for Wastewater Management which helped Georgia mobilize a US$10 million Swedish International Development Cooperation Agency (SIDA) grant to promote sustainable wastewater management and pilot implementation of wastewater treatment plans. Similarly, under the first Regional Development Project in Kakheti (RDP), average piped water services in targeted areas increased from 8 hours/day to 12 hours/day; 4,258 household water connections benefit from rehabilitation works; and 40,400 people in urban areas are being provided with access to all-season roads within a 500 meter range. Under the Project, eight private investment proposals were also approved, as part of a pilot to attract private sector investments in the tourism and agro-processing sectors in the Kakheti region.

16. **Housing and living conditions for internally displaced people (IDP) improved**. The 2008 conflict created a new wave of displacement that added to an already sizeable population of IDPs. The RMIDP and the Bank-executed EU Trust Fund for *IDPs Emergency Rehabilitation and Construction in Georgia* financed construction of 783 new houses and rehabilitation of 1,483 existing houses for IDPs, meeting the CPS target of 3,600 IDPs that benefitted from completed emergency relief. The RMIDP also improved access to services, including solid waste collection and disposal system and completed construction of 10 solid waste collection systems. In addition, the recipient-executed Trust Fund for Georgia's IDP Community Development Project (IDP CDP) was designed to complement these activities, and provide a more sustainable socio-economic integration of IDP through increased livelihood opportunities and access to public services. Although the amount was relatively small ($2.1 million) the IDP CDP was able to target the poorest IDP communities, financing 47 micro-projects that benefitted 5,478 households. All 47 implemented micro-projects improved living conditions and access by community members to services and infrastructure, and 25 percent of all completed micro projects provided opportunities for income generation. Fifty percent of community development activities participants were female.

Second Strategic Objective: Strengthening Competitiveness for Post-Crisis Growth

C. Results Area 3: Upgrade Transport Corridor and Increase Connectivity

17. **All outcomes and key indicators for the upgrade of transport corridors and increase of connectivity were met.** The reduction in transit time and road fatalities on key roads met or exceeded targets, and the reduction in vehicle operating costs was substantially achieved. The Bank supported these outcomes through the First, Second and Third East-West Highway projects, the Fisrt and Second Secondary and Local Roads projects, and the Kakheti Regional Roads project. In addition, WBG support

[32] Report No. ICR2179, December 2012.

included analytical and advisory work on improving sustainability of road management and financing, and a policy framework on Green Transportation.

18. **Transit time was reduced on rehabilitated routes meeting targets; vehicle operating costs were also reduced, although the level of target achievement varied for each segment**. The transit time on the Vaziani-Telavi road segment was cut by less than half from 120 minutes to 55 minutes, and the transit time on the Agaiani-Igoeti-Sveneti-Ruisi route was reduced by 30 to 38 percent through upgrading from a two-lane road to a four-lane highway. Operating costs for cars were reduced by 53 percent and 10-15 percent, respectively, while operating costs for trucks were reduced by 38 percent and 5.3-6.6 percent, respectively. The rehabilitation of the Rikoti Tunnel significantly improved the operation of the Tbilisi-Kutaisi highway that links Western and Eastern Georgia.

19. **Road safety increased, exceeding targets**. The number of fatalities per 10,000 vehicles declined nationally from 13.9 in 2008 to 7.9 in 2012, corresponding to a 43 percent reduction. The Highway II and III projects contributed to increased road safety. Fatalities were reduced by 13 percent on the Veziani-Teliavi road, 43 percent on the Tbilisi-Senaki segment and 53 percent on the Igoeti-Sveneti road – against a targeted 14 percent reduction. By mid-2012 traffic conditions were improved at 24 hazardous locations by installing barriers and guardrails, relocating bus stops, constructing highway accesses, and providing traffic marling and signs. A National Road Safety Action Plan, supported under the Highway II Project, is also under implementation.[33]

D. Results Area 4: Accelerate Business Growth

20. **All outcomes to accelerate business growth were achieved.** All milestones were met at the Progress Report stage[34] (one, on "grant support to supply chains", was dropped at the Government's request); all results indicators were met. The WBG supported these outcomes through the *Development Policy Operations*; the *Electricity Market Support, Infrastructure Pre-Investment Facility, Secondary and Local Roads I and II, Kakheti Regional Roads, Rural Development,* and *Avian Influenza Control and Human Pandemic Preparedness* projects. IFC provided significant hydropower investments, as well as support for SMEs' access to finance, and food safety. In addition, the WBG provided extensive analytical and advisory support, including reports on Trade and Development, a report on Fostering Entrepreneurship, and a Competitive Industries Technical Assistance (TA).

21. **The overall business environment improved.** All results indicators have been met. The tax compliance burden was reduced, customs procedures were streamlined and trade reforms advanced, while access to finance seems to be a somewhat less severe obstacle for SMEs.[35] Before 2010 a uniform tax treatment for all businesses led to higher tax compliance costs for smaller businesses relative to their revenue. Georgia adopted laws on food safety, veterinary and plant protection, on free trade and competition, and on general safety and liability needed to meet the requirements of the *Deep and Comprehensive Free Trade Area* (DCFTA) whose negotiation with the EU was successfully concluded in July, 2013. Several Decrees were adopted with a view to enhancing customs efficiency and facilitating trade.[36] The quality of road transport and electricity supply improved. IFC assisted the Ministry of Finance to design a simplified tax regime for micro and small businesses and implement it as of January 1, 2011. Subsequent surveys indicated that micro and small businesses save $15.8 million a year in tax compliance costs.

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[33] *Second East-West Highway Improvement Project* (Report No. ICR2343, December 2012).
[34] *Progress Report on the Country Partnership Strategy for Georgia*, March 9, 2011
[35] *Development Policy Operations I-III* (Report No. ICR2492, December 2012).
[36] CG-DPO I prior actions 1.1 and 1.2 (Report No.67922-GE, July 2012, Operation Policy Matrix).

22. **IFC's program also supported regional integration through hydropower investments aimed at helping Georgia realize its significant hydropower energy potential in an environmentally and socially sustainable manner.** In 2011 and 2012 IFC made a long term loan of $41 million and mobilized an additional $12 million to help construct the Paravani HPP, which is expected to generate 409 GWh of electricity per year, and to avoid GHG emissions by an estimated 32,000 tons of CO2 per year, enabling export of clean electricity to Turkey. In addition, IFC was a co-developer of the Adjaritskali HPP project, a series of cascades of up to 400 MW of hydropower in the Adjara region. As discussed in Section 2, the overall business environment showed impressive gains and *Doing Business* upgraded Georgia's ranking from 15th in 2008 to 9th in 2013. The Global Competitiveness Index (GCI) ranking of Georgia also improved from 90th in 2008-2009 to 77th in 2012-2013.

23. **At the same time, the overall improvement of Georgia's competitiveness ranking conceals important gaps, particularly with respect to innovation and access to finance**. In spite of dynamic growth over the past few years, Georgia's exports have been losing global market share between 2005 and 2010, including top exports such as hazelnuts, water and wine.[37] The sophistication of Georgia's export basket is relatively low and has not significantly improved over the last decade.[38] While lending infrastructure has significantly improved in the recent years, access to finance for SMEs remains limited due to high cost, tight credit underwriting, and collateral requirements. Moreover, 63 percent of loans are issued in foreign currency, which exposes non-exporter SMEs to foreign currency risks. The 2013 BEEPS survey indicates a significant decrease in the percent of firms that identify access to finance as a moderate, major or very severe obstacle, from 55 percent in 2008 to 30 percent in 2013. This trend towards an improving perception by firms of access to finance is consistent with what IFC has observed in the banking sector over the same time period. In 2009 and 2010 Georgian banks were still recovering from weakened balance sheets resulting from the effects of the 2008 conflict, the fallout from the global financial crisis, and a spike in NPLs. During these years, banks focused largely on restructuring their portfolios rather than on new lending. However, starting in 2011 and 2012, banks returned to lending, and private sector credit as percent of GDP increased from 29.2 in 2009 to 33.3 in 2012. Notwithstanding these positive indications, access to finance continues to be a challenge for business growth in Georgia, as confirmed by the 2012 IFC Business Perception Survey and the 2013-14 Global Competitiveness report. Both sources rank access to finance as a problematic factor for doing business in Georgia. While MSMEs represented 96 percent of Georgia's 42,530 registered businesses and employed almost 43 percent of the country's workforce in 2010, SMEs share in GDP was less than 19 percent, as compared with an ECA average of 60 percent. According to the USAID 2011 report on financial sector development, MSMEs in Georgia received only 20 percent of total bank loans. The World Bank undertook in-depth analyses of growth challenges, export vulnerabilities, constraints to entrepreneurship and private sector growth and jobs creation through the *Country Economic Memorandum* (CEM), a *Trade and Development* study for the South Caucasus, a *Competitive Industries* TA, and the *Fostering Entrepreneurship Report*. Based on this extensive analytical work, the Bank proposed policy options and helped organize several high-level policy discussions, including a *Competitiveness Workshop*, high-level policy discussions on innovation-led growth and the role of ICT development, an international conference on Deposit Insurance, and brainstorming on Pension Reform to support discussions about second generation reform options. This work contributed to the preparation of Georgia's longer term *Development Strategy 2020*,[39] which reflects many of the Bank's proposed recommendations on fostering entrepreneurship, innovation and technology

[37] Wine and water exports were significantly affected by closure of the border with Russia. Wine exports to Russia were resumed in June, 2013.

[38] World Bank Institute's (WBI) 2012 *Knowledge Assessment Methodology*; Innovation Index of the WBI *Knowledge Economy Index*; INSEAD-WIPO *Global Innovation Index 2012*; *Georgia-Export Competitiveness Framework* (draft working paper, ECSF2, January 2013).

[39] *Georgia: A Roadmap to Competitiveness* (World Bank Country Office, Tbilisi, March 2013).

adoption, developing skills, enhancing firm-level productivity, deepening national savings through further reforms in the financial sector, and improving access to markets and finance for SMEs. Farmers' access to rural finance also increased with the support of the Bank-financed *Rural Development Project*, with 41.4 percent of the rural households getting access to finance in June 2011 compared with 28.3 percent in October 2005. However, although agribusiness financing remained severely restricted in 2000s, with bank lending to agriculture not exceeding 1 percent of the total lending portfolio, the Agriculture Fund established by the new Government in 2013 started to yield results by providing several financing schemes to farmers and food processing. This resulted in an increase in the agriculture lending portfolio, which almost doubled in nominal terms during 2013, although its share in the total lending portfolio remains low at 1.5 percent of the total (as of January 1, 2014). IFC played an important role in facilitating access to finance for SMEs. As of end-2012, IFC client banks held an outstanding MSME portfolio of 76,158 loans totaling US$900 million, above the pre-crisis level of US$750 million. However, more fundamental structural reforms in the private and financial sector will need to be undertaken to improve financial access and creditworthiness of enterprises, so that they can grow in quality and size, innovate and create new jobs.

24. **There were improvements in agriculture incomes and exports, but within an overall declining sector performance** (see Section 2). The income of farmers and enterprises (proxy for unavailable production data) supported by the Bank-financed *Rural Development Project* increased by 28.3 percent between October 2005 and June 2011. Domestic sales and exports are expected to benefit from the enactment in May 2012 of Laws on food and feed safety, veterinary and plant protection, general safety and liability, and free trade and competition, and from the proposed legislative package for a DCFTA with the EU (supported by the *CG DPO* series). Roads financed by the *Secondary and Local Roads I* and *II* and the *Kakheti Regional Roads* projects improved access to markets, reducing transit time by an estimated 30 percent in the Kakheti region. Food safety monitoring and enforcement capacity was supported by the *Avian Influenza Control and Human Pandemic Preparedness* and *Rural Development* projects, which helped establish a Food Safety Agency, develop procedures in line with international standards, and build capacities.[40] The IFC *Food Safety Project* increased food processors' awareness of food safety issues, helped increase sales and investments and strengthened the Government's capacity to enforce food safety regulations. IFC also invested $1.5 million in Georgia's largest wine exporter, enabling the company to expand its production and exports, as well as lent $1.5 million to Georgia's largest mushroom producer. Agriculture exports increased to US$450.6 million in 2012 compared with US$286 million in 2009.

4. WORLD BANK GROUP PERFORMANCE

25. **The World Bank Group's overall performance is rated Satisfactory** based on: (i) the CPS scope and focus addressed well Georgia's emergency needs and development goabyebls, and were consistent with the post-conflict recovery program underwritten by the donor community in October 2008; (ii) the CPS provided an adequate framework for WBG-financed operations, technical and advisory activities, and had explicit monitorable targets; (iii) the CPS program was effectively implemented and substantively contributed to Georgia's post-conflict recovery, crisis mitigation and strategic development goals through budget support, financing of critical investments and equity participation, capacity building, policy advice, and technical assistance (Annex 1); (iv) the WBG carried out a constructive and effective dialogue with the Georgian Authorities and other stakeholders, responded promptly to evolving circumstances and country needs, and mitigated risks appropriately; and (v) the WBG coordinated effectively with other IFIs, the UN system and bilateral partners.

[40] *Rural Development Project* (Report No. ICR2352, June 2012) and *Avian Influenza Control and Human Pandemic Preparedness Project* (Report No. ICR2046, December 2011).

A. Design

- ***The CPS program maintained focus and selectivity.*** The Bank-financed program remained focused on supporting Georgia's post-conflict and vulnerability needs, particularly in the first half of the CPS period, and on strengthening competitiveness and growth, which increasingly became the focus of the program in the second half. It did so by focusing on: (i) budgetary support through five DPOs (amounting to US$295 million), supporting deepening reforms in social assistance, the business environment, and the expenditure framework; (ii) regional development to improve municipal infrastructure and promote tourism; and (iii) infrastructure, particularly roads, to strengthen internal connectivity and Georgia's role as a transport corridor within the South Caucasus. At the end of FY13, the Bank's investment portfolio focused on two main sectors: Transport (68 percent), and Regional Development (32 percent). IFC's investments in FY10-13, totaling US$251 million of direct financing and an additional US$36 million in mobilized funds, continued to support the recovery of Georgia's financial system and was invested to create new renewable energy assets and support agribusiness for export. Analytical and advisory support, including Trust Funds, complemented the lending and investment portfolios, and remained strongly linked to the CPS outcomes and overall strategic objectives.
- ***The mid-term CPS Progress Report was used as an opportunity to respond to evolving circumstances***. At mid-term, a plan for additional program interventions was laid-out to address the continuing economic and social vulnerabilities, while also supporting recovery and medium-term growth. Additional IBRD and IDA resources were made available, including continued access by Georgia to IDA-16 at the same levels as the previous IDA replenishment.
- ***Critical risks to the implementation of the CPS program were well identified.*** They included: (i) the potential for the economic downturn to be longer and deeper than anticipated; (ii) limited scope for Bank financial support to respond to emerging needs in the outer years of the CPS; and (iii) rapid growth of non-concessional borrowing in the wake of the crisis. The program's design, which included building a strong basis for recovery and post-crisis growth, medium term fiscal adjustment and careful debt management, helped mitigate such risks.
- ***The CPS Results Matrix was realistic and measurable.*** The Progress Report reconfirmed virtually all primary results indicators, occasionally with more ambitious goals and clearer definitions. Some outcomes, for example quality of education, were measured through proxy indicators (in this case the percentage of children learning through revised curricula), which is considered appropriate considering the CPS timeframe and the numerous factors influencing quality of education.

B. Implementation

- ***The Bank's financial support helped address Georgia's post-conflict needs, mitigate the impact of the economic crisis, and advance its development goals***. The 2010 IEG report on *The World Bank Group's Response to the Global Economic Crisis* highlighted the fast, relevant and high quality WBG response to Georgia's crisis. IDA/IBRD lending exceeded by 107.8 percent the original CPS planned program of US$396 million and by 35.8 percent the CPSPR increased program of US$606 million: FY10-13 commitments totaled US$823 million, in addition to the US$135.4 million in undisbursed balance of previously approved operations (Annex 2).
- ***Georgia's financing needs to address its economic and social vulnerabilities, and its subsequent recovery and medium-term growth agenda, were adequately addressed through additional and frontloading of WBG resources, and through continued IDA eligibility for the period FY12-14.*** During the CPS cycle the Board approved 11 projects, including five DPOs that provided US$295 million (about 35 percent of total Bank lending) in budget support, and three Additional Financings. The new projects and additional financings were aligned with the CPS strategic objectives. Lending

was front-loaded in response to Georgia's urgent needs, with 73 percent of the original CPS proposed lending committed in the first year. The 2013 *Country Survey* ranked the Bank's financial support as its most important contribution to Georgia's development goals (Annex 6). The DPOs provided essential budget support for reforms directly aimed at increasing competitiveness and mitigating social vulnerabilities.

- ***IFC's continued support to the banking sector helped accelerate recovery of bank lending, mitigating the impact of the economic crisis.*** IFC continued its lending to commercial banks to support small and medium sized enterprises which are an important driver of employment and diversified economic growth. IFC's support in trade finance was critical to keep imports and exports flowing, as private international commercial banks reduced or suspended their trade lines for local Georgian banks. IFC also provided important risk management tools and additional equity investments.

- ***Complementarity between the Bank and IFC, enhanced by the co-location of the Bank and IFC offices in Tbilisi, maximized the effectiveness and impact of the Program.*** In order to increase focus on Georgia and the South Caucasus sub-region, in 2009 IFC moved senior staff resources to Tbilisi for the first time. This enabled an expanded IFC program and enhanced cooperation with the Bank. Specific examples of close interaction and complementarity include: (i) *road infrastructure*, where Bank financing of highways was paralleled by IFC advisory and a pre-feasibility study for a potential East-West Highway PPP project; (ii) *energy*, where the Bank and IFC are assisting Georgia to develop its significant hydropower potential, including the 400 MW Adajritskali HPP Project; (iii) *tourism*, where the Bank is financing regional development projects in Kakheti and Imereti that will be supported by IFC through the development of municipal infrastructure and a business environment attractive to investors; (iv) *agribusiness*, where Bank support for the creation of a regulatory Food Safety Agency and articulation of food safety guidelines through the *Avian Influenza Control and Human Pandemic Preparedness Project* and the *Rural Development Project* was complemented by the IFC *Food Safety Project*, which enhanced food processors' awareness, helped increase their sales and investment, and helped build government oversight capacity.

- ***Technical assistance and advisory activities helped mitigate Georgia's capacity constraints.*** The 2013 *Country Survey* highly rated the Bank's TA and capacity building activities (see Annex 6), and considered them essential to Georgia's policy formulation and implementation. The advisory financing provided to Georgia in FY10-13 through Trust Funds, including Institutional Development Funds and IFC, totaled about US$22 million.[41] On the analytical front, joint Bank and IFC collaboration focused on fostering entrepreneurship and access to finance, improving the investment climate, and developing Georgia's tourism strategy.

- ***Georgia's portfolio has been characterized by good implementation performance and satisfactory achievement of results*** (see Table 1)**.** Georgia's disbursement ratio (for IBRD and IDA) has been among the highest in the Bank and the ECA region, with an average of 79 percent during the CPS period. The percentage of Problem Projects has historically been very low, and decreased to zero in FY12 and FY13. The high quality of the portfolio is the result of well-designed projects that benefit from strong client ownership and capacity and of a close, joint implementation by the Government and the Bank. In addition, because all Bank-financed projects are implemented by line ministries or by implementation units fully integrated into them, the level of ownership is further strengthened. IFC's investment portfolio at the end of FY13 also maintained strong performance with low levels of non-performing loans standing at about 2.7 percent of the total outstanding portfolio, realized net equity gains of US$12.1 million, and unrealized gains on equity investments of US$62.9 million.

[41] Twenty four TFs with disbursements amounting to US$7.3 million approved in FY10-13, in addition to another 18 operations approved in previous years with US$14.5 million disbursed to date.

Table 1: Selected Bank Portfolio Indicators

Indicators	FY10	FY11	FY12	FY13
Disbursement ratio:				
Georgia	113	54	98	49
ECA Average	19	20	26	24
Number of projects	12	8	6	8
Projects at risk	1	3	1	0
Problem projects	1	2	0	0

- ***Coordination with external partners took advantage of the location of the Bank's Regional Office in Tbilisi***, which facilitated senior-level consultations and provided more extensive technical capacity in the field. The JNA process, which was led by the Bank, strengthened donor coordination and provided a more permanent and transparent framework for supporting Georgia. Coordination is particularly strong at sector level and for capacity building, the latter evidenced by the mobilization of Trust Funds. An example of aid coordination is the engagement in the Education sector, where the Bank worked closely with the Millennium Challenge Corporation (MCC) during its preparation of a US$122 million education project. The Bank provided technical support, and was engaged in the project design. The Bank and MCC subsequently collaborated and jointly funded a tracer study on vocational education graduates in 2013. In the Transport sector, the Bank has taken the lead in convening annual donor meetings to exchange ideas and strengthen coordination with respect to the overall transport sector policy and road sector financing plans. In addition to the Bank, key donors in the Transport sector include ADB, JICA, and EIB. The Bank closely coordinated with the IMF during the preparation and supervision of DPOs, and on analytical activities of common interest. IFC also made numerous co-investments alongside other partners such as EBRD, DEG, FMO and OPIC. This positive assessment notwithstanding, feedback from donors and stakeholders suggest room for improvement to increase harmonization on Georgia's strategic development agenda, technical assistance, and analytical and advisory activities.
- ***Mitigation of risks has been effective.*** With respect to economic risks, the WBG contributed through budget support, increased and front-loaded financing, financing of systemic banks, and capacity building, to Georgia's resumed strong growth in 2010, bringing the fiscal deficit and inflation under control, maintaining banking sector health, easing bank credit constraints, and keeping external debt within manageable limits.

5. MAIN LESSONS

26. **Importance of maintaining balance in the program between stimulating growth and supporting poverty reduction through the social protection system.** Poverty reduction achievements in the latter part of the previous CPS period (from 2011 onwards) were mainly brought about by an improved social protection system (pensions and TSA) that allowed for increased transfers to the poor. Through its Analytic and Advisory Activities (AAA) and the Development Policy Operation (DPO) series, the WBG program had contributed to the design and implementation of the TSA while, at the same time, carried out poverty analysis to evaluate impacts. In parallel, the WBG program continued to focus on the growth agenda through identifying constraints to private sector-led growth and through investing in strengthening infrastructure and services for competitiveness.

27. **Analytical work should remain an essential component of the program, continuing to provide the underpinning for DPO-supported reforms and complementarity to the lending program.** During the CPS period, the analytical work helped in understanding growth dynamics, poverty, and public sector performance, and played a key role in proposing development solutions and informing the Government's own development strategy. For example, the FY12 Public Expenditure Review,

together with a series of Poverty Assessments, provided critical knowledge on understanding how out-of-pocket expenditures in health care were impacting poverty, which in turn has informed the Government's program on universal health insurance. The AAA program was aligned with lending, whereby key analysis had nourished the design of operations and helped prioritize reforms and engagements. The 2013 Country Survey highly rated the Bank's analytical work and capacity building activities, considering them essential to policy formulation and implementation.

28. **The selectivity and complementarity between IBRD, IFC and MIGA has been effective.** WBG funding was channeled to maximize comparative advantage, technical knowledge, and complementarities. The selectivity in the Bank's program allowed for an approach that balanced concerted focus on strengthening the effectiveness of public expenditure and administration through AAA and DPO policy reforms, together with targeting specific investments in infrastructure and regional development programs. This complemented IFC support, which continued to focus on strengthening the financial system and supporting enterprises in agribusiness, as well as MIGA's engagement in the financial sector.

29. **Program selectivity has been a strong feature of the program, facilitated by donor coordination, and should be continued.** The Bank's program was selectively focused on one DPO series that channeled critical reform measures, complimented by support from other donors particularly in the social sectors (EU, MCC in education, USAID in health, etc.). In parallel, the investment lending portfolio included projects in infrastructure and regional development programs, whereby selectivity was facilitated by the availability of funds from other donors. For example, the ADB has taken the lead in the water sector, while the EU, FAO and USAID have concentrated efforts in agriculture and rural development. The WBG has taken the lead in transport, and in municipal and regional infrastructure, with an increasing focus on the energy sector to complement policy actions and IFC investments.

30. **Lending flexibility and continued IDA eligibility proved essential in responding to Georgia's needs.** This included front-loading of IBRD and IDA funds to adequately respond to Georgia's priorities and needs during the financial crisis, and in the aftermath of the 2008 conflict. In addition, Georgia retained eligibility for IDA-16 over the period FY12-14, thereby allowing access to critical resources, while also maintaining other IFIs' funds on a concessional basis.

31. **Importance of continued capacity building in public the administration with more effective monitoring and evaluation (M&E).** The concerted focus in the portfolio on infrastructure has resulted in significant implementation capacity being built as evidenced by the strong portfolio performance and disbursement rates: this supports sustainability and provides a good foundation for enhanced support. The AAA program included analysis of public sector implementation issues and identification of capacity constraints, recommending that a stronger focus on capacity building across Government, especially cross-sectoral coordination. There is a need to support more effective M&E and impact assessments within Government and within the CPS program, including improving the way results are monitored. More rigorous impact evaluations should be carried out to measure contributions to poverty reduction and shared prosperity, and to influence the design of future projects. This is essential for strengthening the science of delivery approach in the program.

32. **Gender should be an increasingly embedded and cross-cutting element of the Bank's program, with emphasis on monitoring gender impacts.** A number of projects included gender-disaggregated data monitoring as part of their results framework. This approach should become more systematic and encompass, to the extent possible, the entire portfolio, with a view to better capture gender impacts.

33. **Strategic donor coordination can help enhance impact, by focusing on the Bank's comparative advantage and value-added.** Although the Bank has played an active role in involving

other donors in the development and the implementation of the CPS, both the Client and donors noted some limitations of the sector focus of donor coordination, such as in the areas of capacity building and technical assistance. The Government itself could take a stronger lead role in donor coordination, by strengthening its own capacity for strategic planning, inter-sector harmonization and arbitration, and interface with the Parliament, other stakeholders and the civil society. The Bank, on the other hand, should take the opportunity, during the design of the new CPS, to identify maximize complementarity, effectiveness, and efficiency of resources across sectors.

Georgia FY10-13 CPS Results Matrix

CPS OBJECTIVE 1: MEETING POST-CONFLICT AND VULNERABILIY NEEDS

Key Government Goals

- Maintain macro and fiscal stability. Promote growth in 2010 and beyond *(to be monitored in growth rates, inflation rates, public external debt)*
- Increase bank lending and build a strengthened banking and supervision system, capable of supporting private sector growth *(to be monitored in increase in bank lending, level of NPLs)*
- Create and maintain jobs *(to be monitored in the overall unemployment rate)*
- Enhance learning outcomes *(to be monitored by TIMSS and PIRLS)*
- Increase social support and services, including social safety nets, health and IDP support *(to be measured in poverty levels)*

Key Issues and Obstacles:

- Contraction of external trade, remittances and capital inflows is reducing growth and fiscal space
- The August conflict and impact of the fall in GDP growth may lead to a rise in the poor
- Public administration, expenditure management, and procurement practices in need of improvement
- Lower growth is reducing job creation in the private sector and leading to rising unemployment
- Financial intermediation impacted and may be inadequate to maintain vibrant private sector.
- As health care is privatized, access to affordable care needs to be ensured and services improved
- The targeted poverty benefit, which is operating well, needs to be expanded to cover more of the poor
- Progress in improving general education needs to be maintained through further expanding curricula reform, more teacher training, upgrading primary and secondary schools poor physical infrastructure as this limits learning outcomes
- Local infrastructure (water, roads, etc) needs sustainable improvement.

CPS RESULT AREAS, OUTCOMES AND TARGETS – AS REVISED BY CPS PR	PROGRESS TO DATE	LENDING AND NON-LENDING ACTIVITIES THAT CONTRIBUTED TO THE OUTCOME
Results Area 1: Preserve Economic Stability and Create Jobs		
Outcome 1: Improved public resource management --*Primary Indicator (revised):* Fiscal deficit is managed in a non-inflationary way, while maintaining support for key social services (2009 baseline: fiscal deficit = 9 percent. Target = gradual reduction consistent with fiscal sustainability). Share of social sector expenditure in state budget was 36 percent in 2009.	**Achieved.** **Met**. Fiscal deficit 3% of GDP in 2012. Expenditure for social services 39.7% of state budget in 2012	**Lending:** Public Sector Fin. Management Reform Support Project (approved FY06, closed FY12), Regional and Municipal Infrastructure Development project (approved FY09), DPO Series on fiscal and budget policies

Target = no decrease in share of social sector expenditures in state budget). --*Primary Indicatory (revised)*: Introduction of results-based budgeting (Baseline = none. Target = all ministries) -- *Primary Indicator*: Establishment and rollout of local government budget system (Baseline = none. Target = 69 LGUs use this)	**Met**. Budgets for 2012 and 2013 approved in program format. All Ministries have developed performance indicators. **Met**. The Budgetary and Financial management System for the Municipalities and the Ministry of Finance was developed and installed with staff trained in all municipalities at the time of CPS PR. Local government budgets for 2013 were presented in program format.	**Non-lending:** Development of country strategy ROSC (FY10). CEM (FY12). Public Expenditure Review (FY12). Follow up on PEFA (completed in Q1 of FY14). Georgia Book on anti-corruption reforms (FY12). Strengthening Parliament Capacity IDF (Approved FY12). **IFC:** Helping Reform the Tax System (FY10),
Outcome 2: Improved performance of key financial institutions - *Primary Indicator (revised):* Financial health of and lending levels by Georgian commercial banks improved as measured by following indicators (baselines are as of September 2009): Capital Adequacy Ratio: 20.2 Return on Assets: – 1.4 Return on Equity: – 7.2 Level of NPL: 18.2 Liquidity ratio: 40.6 Loan to deposit ratio: 129.8 **Note:** The 2008 baselines for Liquidity Ratio and Loan to Deposit Ratio have been revised, to reflect the correct figures provided by the National Bank of Georgia within the scope of the CPS Completion Report. In addition, the text clarifies that ROA and ROE were negative.	**Achieved** **Met**. Financial indicators recovered from the 2009 crisis (see main text for more background). Capital Adequacy Ratio: 17 Return on Assets: 1 Return on Equity: 5.8 Level of NPL: 9.3 Liquidity ratio: 39.8 Loan to deposit ratio: 106.7	**Lending:** Rural Development Project (Approved FY05, closed FY11). **Non-lending:** South Caucasus Financial Sector Advisory (FY10-FY12), FIRST grant to strengthen the FSA (FY10) **IFC**: Coordinated IFI effort to ensure bank capital and liquidity, trade and micro-finance lines of credit, providing advisory to individual private banks on risk management and NPL workouts and other banking advisory products.

Outcome 3: Increased employment through Bank financed projects -- *Primary Indicator:* Number of new job-months created in World Bank Group financed projects (Baseline = 0. Target = at least 30,000 man-months of labor) **Outcome 4: Improved quality of education** -- *Primary Indicator*: Percentage of children learning according to the improved national curriculum (2006 baseline = about 2 percent. Target = at least 95 percent by 2012).	**Achieved.** **Met.** About 45,000 man-months of labor were created under the Bank financed projects after the CPS approval. In addition, IFC clients generated over 1,400 permanent jobs. **Achieved** **Met.** 100% of children in basic education (grades 1-12) learning according to improved national curriculum as of May 2013.	**Lending:** Regional and Municipal Development (Approved FY09), Secondary and Local Roads (Approved FY04, closed FY12), Secondary and Local Roads 2 (Approved FY12), E-W Highways I (Approved FY06, closed FY13), II (Approved FY08, closed FY12), III (Approved FY10), Kakheti Roads (Approved FY10), Regional Development projects (Approved FY12), Second regional Development project (Approved FY13). **Non-lending:** Georgia Programmatic Poverty - Poverty and Crisis Impact Note (FY10); South Caucasus Programmatic Poverty Assessment – note on Labor market analysis and skills mismatch in Georgia (FY12); **IFC:** Infrastructure CEI (FY11-13); Paravani HEP (FY10-13), Tbilvino (FY12), Rakeen Georgia (FY09), BR Housing (FY09). **Lending:** Education APL II (approved FY07, closed FY12) and PHRD co-financing, CG DPO I (FY13). **Non-lending:** EPDF support to Education strategy (FY11).
Results Area 2: Improve Social Services		
	Achieved	**Lending:** DPO series

Outcome 1: Increased coverage and efficiency of TSA -- *Primary Indicator:* Percent of the extreme poor that receive poverty benefits through TSA (2009 baseline = 38.9 percent. Target = at least 50) **CR Note:** "extreme poor" refers to the "bottom decile of consumption per adult equivalent".	**Met:** 53% of bottom decile of consumption per adult equivalent received TSA benefits in 2011 (UNICEF 2012). **Partially Achieved**	**Non-lending:** Georgia Programmatic Poverty Assessment (FY10); South Caucasus Programmatic Poverty Assessments (FY10-13), Policy Note – Reducing Poverty (FY13); Public Expenditure Review (FY12).
Outcome 2: Wider health coverage facilitated through improved budgeting, infrastructure and information systems. -- *Primary Indicator (revised):* Share of bottom two quintiles with access to subsidized health insurance (2009 baseline = 27.6 percent. Target = over 45 percent) -- *Primary Indicator*: Health care service utilization by poor population as measured by number of out-patient visits per capita (2009 baseline=1.4 Target = 2.6) -- *Primary Indicator*: Better targeting of services through the development of an effective health care information data base	**Met:** Universal Health Insurance introduced in February 2013 ensures 100% coverage. **Partially Met**: Number of out-patient visits per capita - 2.47 for poor (poorest two quintiles). **Met**: The Social Assistance Information System (SIMS) development completed and being rolled out. Pilot modules for state pension, compensation package launched in May 2013 in Tbilisi and the Rustavi and Mtskheta regional districts. **Achieved**	**Lending:** Health Sector Development (Approved FY03, closed FY12); DPO and CG DPO Series. **Non-lending:** Programmatic Poverty Assessments, Pension Technical assistance (FY13), Policy Note – Health Sector Improvement (FY13); Public Expenditure Review (FY12).
Outcome 3: Improved Municipal Services in Supported areas (water, local roads etc) -- *Primary Indicators* -average reduction in KWh consumed per m3 due to introduction of energy efficient water production methods (2008 baseline = 0.7. Target = 0.4) - Average increased # of hours per day of piped water service (2008 baseline = 7 h. Target = 12 h.)	**Met:** 0.3 KWh/m^3 as of May 2013 **Met:** 17 hours per day as of May 2013 **Met:** 70% of 2008 trip baseline as of May 2013	**Lending:** Regional and Municipal Infrastructure Development (Approved FY09), Regional Development Project (approved FY12). **Non-lending:** Sustainable Urban Development Strategy for Kakheti Region (FY12), City Capital Investment Planning and Budgeting Project (FY12), PHRD Rural Development Project (closed FY11), Policy Note – Social Development (FY13), Policy Note – Municipal and Regional Development (FY13).

-average reduction in trip time due to improved secondary roads (2008 baseline = 100%. Target = 70%) **Outcome 4: Improved IDP housing and welfare** -- *Primary Indicator*: Number of beneficiaries from completed post-conflict rehabilitation/construction (2008 baseline = 0 target = 3,600 by end-2009) -- Primary Indicator: Broader support to IDPs: expand infrastructure and improve living conditions (2009 baseline = 0. Target = 3500 IDPs)	**Achieved** **Met**: About 3,600 IDPs have benefited from the construction of 783 houses. **Met**: 139 subprojects for water supply, wastewater collection and road construction implemented.	**Lending:** Regional and Municipal Infrastructure Development (Approved FY09). **Non-lending**: Joint Needs Assessment Progress Report (FY10), IDP Community Development TFs.

CPS Objective 2: Strengthening Competitiveness for Post-Crisis Growth		
Key Government Goals • Strengthen Georgia's role as a regional transport corridor and improve connectivity within Georgia *(to be measured by increased transit traffic)* • Continue to deepen Georgia's private sector friendly environment for higher business growth (*to be measured by the level of growth of foreign investment, SMEs).* • Build a more efficient and productive rural sector. *(to be measured by increase in agriculture exports, farm income)* • Establish greater energy security and efficiency *(to be measured by amount of energy produced and exported)* **Key Issues and Obstacles**: • Transport: E-W corridor needs improvement. Black sea ports need modernization. Road safety needs improvement • Tremendous progress achieved in the business environment to be sustained through further strengthening of several areas (tax, customs) • The financing system remains shallow. SMEs have limited credit access and households to mortgages • Energy: Increased potential for hydropower needs to be developed • Households, businesses and farmers need improved mechanisms to cope with natural disasters • Agriculture – need to improve agriculture productivity, food certification and processing, irrigation framework, crop and livestock disease risk		
CPS RESULT AREAS, OUTCOMES AND TARGETS – AS REVISED BY CPS PR	**PROGRESS TO DATE**	**LENDING AND NONLENDING ACTIVITIES THAT CONTRIBUTED TO THE OUTCOME**
Results Area 3: Upgrade Transport Corridor and Increase Connectivity		
Outcome 1: Transport time and costs reduced along key transport routes *Primary Indicator*: Transit time and vehicle operating costs along various supported segments improved by over	**Achieved** – transit time indicator was overachieved on each of the three sections; vehicle operating costs have been reduced by 38% for cars and by 25% for trucks (calculated as weighted average for the three sections). **Met**: 55 minute target achieved (78% reduction) on	**Lending:** E-W Highways I (Approved FY06, closed FY13), E-W Highways II (Approved FY08, closed FY12); E-W Highways III (Approved FY10); Kakheti Roads (Approved FY10); Secondary and Local Roads (Approved FY09), Second Secondary and Local Roads (Approved

25%: Transit time to Telavi – baseline=120. Target=55 – in minutes) Transit time from Agaiani to Igoeti 2006 baseline = 10. Target = 7 – in minutes) Transit time from Igoeti to Sveneti 2007 baseline = 19. Target = 12 - in minutes) **Outcome 2: Improved road safety** *Primary Indicator*: # of fatalities per 10,000 cars (2008 baseline = 13.9 target = 12)	the 65 km section. Vehicle operating costs have been reduced from 0.36 USD/veh-km to 0.7 USD/veh-km for cars (53% reduction), and from 1.05 USD/veh-km to 0.65 USD/veh-km for trucks (38% reduction). **Met**: 7 minute target achieved (30% reduction) on the 13 km section. Vehicle operating costs have been reduced from 0.20 USD/veh-km to 0.17 USD/veh-km for cars (15% reduction), and from 0.76 USD/veh-km to 0.71 USD/veh-km for trucks (6.6% reduction). **Met**: 12 minute target achieved (38% reduction) on the 24 km section. Vehicle operating costs have been reduced from 0.20 USD/veh-km to 0.18 USD/veh-km for cars (10% reduction), and from 0.76 USD/veh-km to 0.72 USD/veh-km for trucks (5.3% reduction). **Achieved** **Met**: Number of fatalities per 10,000 cars was 7.9 in 2012.	FY12) projects including Additional Financings. **Non-lending:** Regional Standards and Quality Infrastructure (FY11), Improving sustainability of roads management and financing in Georgia (FY11); A policy framework on Green Transportation in Georgia (FY12); Road safety management capacity diagnostic review in Georgia (FY13) **IFC**: Public-Private Infrastructure Advisory Facility (PPIAF, FY12), Regional Roads Advisory (FY10).
Results Area 4: Accelerate Business Growth **Outcome 1: Sustained improvement in Business environment** -- *Primary Indicator:* Selected business environment indicators including:	**Achieved**	**Lending:** DPO series, Rural Development project (approved FY05, closed FY11); Electricity Market Support Project (closed in FY10); Infrastructure Pre-Investment Facility Project (closed in FY11).

-- "Paying Taxes" rank in Doing Business (2009 baseline = 110. Target = improvement in ranking) -- # of days required to import and export from Doing Business (2009 baseline = 12 days to export, 14 days to import. Target = reduction by 10%) - "Access to finance" rating in BEEPS (2008 baseline = 55% of firms indicated a problem. Target = under 40%) -*Primary Indicator*: Global Competitiveness Index (2010 baseline = rank 93, score 3.86. Target = improved rank and score) **Outcome 2: Increased support to Small and Medium Enterprises** -- *Primary Indicator:* Portfolio of SME credits extended by IFC-supported banks. Target is to return to pre-crisis (2007) level of $750 million. **Outcome 3: Improved agriculture production, testing, and sales** --*Primary Indicator*: Sales of enterprises supported by rural development project (2008 baseline = 20 enterprises supported. Target = double # of supported enterprises) -- *Primary Indicator*: Increased exports of agriculture	**Met:** "Paying Taxes" rank 33 – Doing Business 2013 compared to 61 as per Doing Business 2011. **Met**: 9 days to export (25% reduction) and 10 days to import (29% reduction) – Doing Business 2013 **Met:** 30% of respondents to the 2013 BEEPS Survey indicate "Access to Finance" as a moderate, major, or very severe obstacle, vs. 55% in 2008. **Met**: CGI 2013/2014 rank – 72, score – 4.15. **Achieved** **Met:** IFC client banks held a portfolio of $795.6 mln in 41,733 loans extended to MSMEs as of end-2012. **Achieved** **Met:** Proxy indicator of increased income of farmers and enterprises supported by the RDP 28.3% higher in June 2011 (compared to RDP target of 10% increase).	**Non-lending:** Upgrading the National Standards and Quality Infrastructure in the South Caucasus (FY11), Trade and Development in the South Caucasus (FY13); Georgia Competitive Industries TA (FY13), Policy Note – Private Sector Development (FY13), Policy Note – Customs as Trade Facilitator (FY13). **IFC:** Doing Business (annual); Paravani HEP (FY10-13), Bank of Georgia (FY10-13), Bank Republic (FY10-13), TBC Bank (FY10-13), Standard Bank (FY13). **Lending**: DPO - focus on food certification, Kakheti Roads; Rural Development, Avian Influenza Control & Human Pandemic Preparedness & Response Project (approved FY06, closed FY12); Secondary and Local Roads; Regional Development project. **Non-lending:** High Level Agriculture

produce (2009 baseline=$286 million).	**Met**: Exports of Agriculture produce have gradually increased and amounted to $450.6 mln in 2012 (compared to $400.5 mln in 2011 and $303.5 in 2010).	Workshop (FY10), Rural Investment Climate Assessment (FY12); Fostering Entrepreneurship in South Caucasus (FY13); Policy Note – Improving Access to Finance (FY13), Policy Note - Agriculture and Rural Development (FY13) **IFC:** Bank of Georgia (FY10-13), Bank Republic (FY10-13), Standard bank (FY13), Georgia Food Safety Improvement (FY11).

Georgia CPSCR: WBG Portfolio Evolution, FY10-13
US$ Million

FY	IBRD/IDA Planned Operations				IBRD/IDA Approved Operations				IFC Investment		WBG Total
	Operations	**IDA**	**IBRD**	**Total**	**Operations**	**IDA**	**IBRD**	**Total**	**Operations**	**Amount**	
Pre-FY10					**Undisbursed Amounts**			**135.4**	**Total FY09**	238.6	**374.0**
					Health Reform			9.2	Bank of Georgia III	100.0	
					Avian Influenza			5.4	Bank of Georgia Swap I	4.0	
					Regional & Municipal Infrastructure Development			27.2	BR Housing	15.0	
					Highways I & II			19.4	TBC LT Facility	70.0	
					Secondary and Local Roads			52.3	Rakeen Georgia	49.6	
					Infrastructure Pre-Investment Facility			1.1			
					Education APLII			8.1			
					Public Financial Management			3.0			
					Electricity Market Development			5.6			
FY10	DPO I	85.0		85.0	DPO I	85.0		85.0	Bank of Georgia	14.3	
	East-West Highway I AF		23.0	23.0	East-West Highway I AF		28.0	28.0	Bank Republic	20.4	
	East-West Highway III		147.0	147.0	East-West Highway III		147.0	147.0	TBC Bank	2.0	
	Kakheti Regional Roads		40.0	40.0	Kakheti Regional Roads		30.0	30.0			
	Total FY10	**85.0**	**210.0**	**295.0**	**Total FY10**	**85.0**	**205.0**	**290.0**	**Total FY10**	**36.7**	**326.7**
FY11	DPO II 1/	5.0		5.0	DPO II	40.0	10.0	50.0	Bank of Georgia	12.5	
	Other Unallocated 2/	56.0		56.0	Regional & Municipal Infrastructure Development AF	11.5	33.5	45.0	Paravani HPP	40.5	
									SEAF Caucasus Fund	10.0	
									Infra Venture-CEI	2.0	
	Total FY11	**61.0**	**0.0**	**61.0**	**Total FY11**	**51.5**	**43.5**	**95.0**	**Total FY11**	**65.0**	**160.0**
FY12	DPO III	40.0		40.0	DPO III	40.0		40.0	Bank of Georgia	28.5	
	Secondary & Local Roads II	40.0		40.0	Secondary & Local Roads II	40.0	30.0	70.0	Bank Republic	3.5	
	Regional Development I		50.0	50.0	Regional Development I		60.0	60.0	TBC Bank	1.3	
					East-West Highway III AF	43.0		43.0	Tbilvino	1.5	
									Infra Venture-CEI	0.3	
									Paravani HPP	11.5	
	Total FY12	**80.0**	**50.0**	**130.0**	**Total FY12**	**123.0**	**90.0**	**213.0**	**Total FY12**	**87.8**	**300.8**
FY13	DPO I (new series)	40.0		40.0	CG DPO I	60.0		60.0	Bank of Georgia GTFP	18.6	

FY	IBRD/IDA Planned Operations				IBRD/IDA Approved Operations				IFC Investment		WBG Total
	Operations	**IDA**	**IBRD**	**Total**	**Operations**	**IDA**	**IBRD**	**Total**	**Operations**	**Amount**	
	Secondary & Local Roads II AF	30.0		30.0					Bank Republic GTFP	3.4	
	Regional Development II	10.0	40.0	50.0	Regional Development II	30.0		30.0	TBC Bank GTFP	16.6	
					East-West Highway IV	37.0	38.0	75.0	Standard Bank	7.0	
					CG DPO II	28.0	32.0	60.0	Infrastructure-CEI	0.4	
									SB Real Estate	10.0	
									FINCA Georgia	4.0	
									Tetri Quidi	1.5	
									TBC Bank Rights Issue	4.3	
	Total FY13	**80.0**	**40.0**	**120.0**	**Total FY13 as of May 10, 2013**	**155.0**	**70.0**	**225.0**	**Total FY13**	**73.2**	**298.2**
FY10-13	**TOTAL FY10-13**	**306.0**	**300.0**	**606.0**	**TOTAL FY10-13**	**414.5**	**408.5**	**823.0**	**TOTAL FY10-13[3/]**	**262.7**	**1085.7**
	o/w original CPS planning			**396.0**	**Undisbursed from pre-FY10**			**135.4**	**FY09 Commitments**	**238.6**	**374.0**
					TOTAL FUNDING FY10-13			**958.4**	**TOTAL FY09-13**	**501.3**	**1,459.7**

1/ Original CPS allocation of US$45 million for DPO I-II, less DPO3 amount planned under CPSPR.

2/ Recorded as IDA only.

3/ Of which US$195 million in banking sector and US$56 million in real sector, including real estate and hydropower.

Georgia: Selected Macroeconomic and Financial Indicators 2009-2012

Indicators	U/A	Baseline		End-Program Results	
		Year	Value	Achieved	
				Period	Results
Real GDP growth	% per annum	2009	-3.8	2010-12	6.5
Export growth	% per annum	2009	-13.0	2010-12	23.5
Current account deficit	% of GDP	2009	11.3	2012	11.5
Fiscal deficit	% of GDP	2009	9.2	2012	3.0
Inflation	% year-end	2009 2010	3.0 11.2	2012	-1.4
External debt ratio to GDP	%	2009	58.7	2012	63.5
External debt ratio to exports	%	2009	197.0	2012	153
Commercial banks capital adequacy ratio	year-end	2009	19.1	2012	17.0
Commercial banks loan to deposit ratio	year-end	2009	124.2	2012	106.7
Commercial banks non-performing loans	year-end	2009	6.3	2012	3.7
Commercial banks liquidity ratio	year-end	2009	39.1	2012	39.8

Source: IMF/World Bank

Georgia's Selected Global Competitiveness Rankings 2008-09 and 2012-13

Selected Indicators	Ranking		Decile		Percentage change of decile values 2008-2012
	2008-09 (134 countries)	2012-13 (144 countries)	2008-09	2012-13	
Property rights	109	131	8.1	9.1	-11.8
Efficiency of legal framework	100	98	7.5	6.8	+8.8
Quality of infrastructure	80	55	6.0	3.8	+36.0
Quality of primary education	81	91	6.0	6.3	-4.5
Quality of higher education	83	114	6.2	7.9	-27.8
Intensity of local competition	114	127	8.5	8.8	-3.7
Market dominance	95	121	7.1	8.4	-18.5
Anti-monopoly policy	111	141	8.3	9.8	-18.2
Professional management	68	92	5.1	6.4	-25.9
Financial services	94	100	7.0	6.9	+1.0
Local equity market	107	126	8.0	8.8	-9.6
Securities exchange regulation	103	119	7.7	8.3	-7.5
Firm-level technology absorption	108	116	8.1	8.1	0.0
Local suppliers performance	131	134	9.8	9.3	+4.8
Capacity for innovation	97	116	7.2	8.1	-11.3
Spending on R&D	121	125	9.1	8.7	+3.9
University-industry collaboration	109	134	8.1	9.3	-14.4
OVERALL GCI	**90**	**77**	**6.7**	**5.4**	**+20.4**

Source: *Global Competitiveness Reports 2008-09* and *2012-13*.

Georgia: The Joint Needs Assessment

Mitigation of conflict impact. The International Financial Institutions (IFIs) responded promptly to Georgia's needs to mitigate the impact of the August 2008 armed conflict with Russia. The IMF extended a US$750 million Stand-By Arrangement in September 2008. At the same time, the World Bank together with the UN took the lead in preparing a three-year *Joint Needs Assessment* (JNA). The two institutions organized a Donors' Conference in October 2008 which adopted and over-subscribed the JNA program. The Bank and the UN also monitored the implementation of the donors'-supported emergency and recovery program of Georgia, issued *JNA Progress Reports* and organized follow-up Donors' Conferences in June 2009 and June 2010.

The JNA identified Georgia's priority needs, helped mobilize significant resources, and underpinned donors' medium-term programs. The JNA addressed Georgia's immediate priorities: (i) restoring investor and market confidence (economic management and budgeting, banking sector viability); (ii) meeting social needs (return, relocation and resettlement of IDPs, social protection, education, health, agriculture and livelihood, employment); and (iii) modernizing and developing infrastructure (transport, energy, municipal and urban services, environment). The JNA recovery program estimated 2009-11 external financing needs at US$3.15 billion (not including the Stand-By) and assigned specific expenditure targets in each area. Donor pledges exceeded expectations, totaling US$3.7 billion for the public sector and an additional US$800 million for the private sector, of which US$750 million for the banking system. The IFIs pledged US$2.4 billion, of which US$880 million (36.7 percent) from the WBG. The three largest pledges from the US (US$1.0 billion), EBRD (US$927 million) and the WBG represented three-quarters of the total amount pledged at the conference. JNA Progress Reports in June 2009 and June 2010 monitored implementation, refined priorities and actions, and updated sector allocations.

JNA implementation was exemplary. The last JNA review of June 2010 concluded that the implementation of the recovery and reconstruction program was on track: donors respected pledges, the pace of disbursements was brisk, and absorption of investment by the economy was strong. Over the October 2008-March 2010 period donor commitments amounted to US$2.5 billion for the public sector and US$673 million for the banking sector, against JNA projected needs of US$2.2 billion and US$700 million, respectively. The JNA process provided the donor community with a strong institutional framework for coordination and harmonization of assistance programs, which continues to this day.

The World Bank Group contribution to JNA implementation went beyond financing. The scope and design of the WBG program were consistent with the JNA and addressed the economic and social impact of the crisis. The Bank and IFC respected JNA pledges, reflected changed country circumstances and needs in the last year of the ongoing FY06-09 Country Strategy and the new CPS for FY10-13, and coordinated WBG assistance with the other donors. CPS objectives and results areas were well aligned with JNA priorities and factored in the lessons of JNA implementation, while at the same time taking into account challenges for longer-term sustainable economic growth. The 2010 IEG report on *The World Bank Group's Response to the Global Economic Crisis* highlighted the fast, relevant and high quality WBG response to Georgia's crisis. The IEG report stated that "The Bank played a large and constructive role in the international response to Georgia's twin crises. The large volume of the Bank's financial

assistance was well planned and implemented […] But the Bank's role went well beyond lending, as evidenced by its leadership of the joint needs assessment and organization of the donors' meeting. The Bank's internal organization and expertise and its time-tested convening power in leading multi-donor missions to assess reconstruction needs was exactly what was needed in Georgia after August 2008." (IEG 2010 report, p.49). The contribution of the Bank was recognized in March 2010, when the Georgia JNA was one of 12 winners of the award for "Improving the Lives of People in Europe and Central Asia".

JNA implementation provided lessons for future external assistance: (i) budget support can be highly efficient in channeling financing for social and infrastructure spending and counter-cyclical economic stimulus, provided the budget is macro-economically sound and socially responsible; (ii) support for Internally Displaced Persons (IDPs) must be addressed holistically, to include livelihood, social protection and information on rights, and to involve IDPs in all decisions that affect them; (iii) infrastructure spending needs to take into account maintenance and environmental safeguards, and ensure a proper balance between primary and secondary infrastructure; (iv) the financial sector needs technical assistance in addition to financing to promote local currency intermediation and lending, and develop non-bank financial activities; and (v) institutional change requires continuous donor support and coordination, and benefits from an open approach to information disclosure.

Country Survey Selected Findings

Questions	Top Five Responses of Country Survey Respondents				
	1st	2nd	3d	4th	5th
Georgia's development priorities	Education 43%	Economic growth 31%	Jobs/employment 30%	Public sector governance 23%	Private sector development 23%
Poverty reduction vehicles	Economic growth 56%	Jobs/employment 43%	Agriculture/rural dev. 39%	Education 37%	Private sector dev. 33%
Focusing Bank resources	Education 36%	Agriculture/rural dev. 28%	Public sector governance 25%	Transport infrastructure 23%	Economic growth 21%
WBG greatest value	Financing investment 69%	Policy based budget support 45%	Technical assistance 20%	Policy advice 17%	Mobilizing third party financial resources 13% Capacity building 13%
Most effective WB instruments	Investment lending 69%	TA 35%	Policy based budget support 32%	Capacity building 27%	Knowledge products and services 19%
Focusing Bank research	Education 42%	Private sector development 34%	Public sector governance 30%	Economic growth 29%	Foreign direct investment 19% Job creation 19%
Increasing WB value	Better quality of experts 34%	More innovative financial products 29%	Reducing complexity of financing 27%	Reaching more outside government 25%	More innovative knowledge services 25%
WB effectiveness (rating out of 10 maximum)	Transport infrastructure 8.5	Municipal, urban and regional development 7.5	Water and sanitation 7.5	Tourism 7.4	Economic growth 7.2
Rating Bank knowledge services (10 maximum)	Relevant global good practices 7.9	Feasible recommendation 7.6	Accessible work 7.6	Relevance to Georgia's dev. Priorities 7.5	Usefulness 7.5
Perceptions (rating out of 10 maximum)	WB treats clients with respect 8.5	WB contributes to institutional capacity 8.3	WB teams and visits are well coordinated 8.0	WB lending terms are reasonable 8.0	Continuity and effectiveness of support to implementation 7.8-7.9
WB as effective development partner	Collaboration with Government 8.5	Straightforwardness and honesty 8.2	Follo through over time 8.1	Collaboration with other donors 7.6	Staff accessibility 7.4

Source: *Country Survey* (World Bank, Tbilisi, June 2013).

Annex 3: Donor Table

Currency: Thousand USD

Donor	Agriculture/ Rural Devt	Economic Policy	Education	Energy	Environment	Health	Private Sector/Banking & Finance	Public Sector and Governance	Regional/ Municipal Development	Social Protection	Transport	IDPs	Youth Development	Water and Sanitation	Grand Total
ADB				$ 48.0			$ 125.3		$ 0.2		$ 498.8			$ 402.4	$ 1,074.7
GIZ							$ 4.5								$ 4.5
JICA	$ -			$ 4.9	$ -	$ -		$ -	$ -		$ 180.0				$ 184.9
MCC			$ 122.5												$ 122.5
USAID	$ 21.6		$ 16.5	$ 52.3	$ 7.6	$ 36.5	$ 0.7	$ 134.7	$ 8.7	$ 4.4	$ 1.1	$ 75.8	$ 8.1		$ 368.1
EU	$ 130.9	$ 3.5	$ 27.9	$ 20.0	$ 3.3	$ 2.2	$ 76.7	$ 110.9	$ 27.8	$ 9.8	$ 28.0	$ 77.8	$ 13.6	$ 19.2	$ 551.5
EBRD				$ 201.5		$ 4.7	$ 219.3		$ 4.1		$ 1.4				$ 431.0
EIB				$ 142.3			$ 150.9				$ 274.4			$ 109.8	$ 677.4
KfW	$ 48.0			$ 83.3	$ 21.3				$ 80.9			$ 13.7		$ 57.6	$ 304.9
WBG	$ 52.8	$ 80.0	$ 0.3	$ 112.0			$ 291.2	$ 2.4	$ 220.0	$ -	$ 440.0		$ 0.5	$ 9.3	$ 1,208.5
Sweden			$ 1.4		$ 2.0			$ 46.5		$ 4.4		$ 4.6			$ 58.9
Switzerland	$ 24.4		$ 0.4					$ 10.2							$ 35.0
IMF		$ 375.0													$ 375.0
Grand Total	$ 277.6	$ 458.5	$ 169.1	$ 664.4	$ 34.2	$ 43.3	$ 868.6	$ 304.7	$ 341.7	$ 18.6	$ 1,423.6	$ 171.9	$ 22.3	$ 598.2	$ 5,396.8

Annex 4: Consultations on the Country Partnership Strategy (CPS)

The World Bank Group organized a series of consultations (November 2013- February 2014) to seek views on its proposed Country Partnership Strategy for Georgia for 2014-2017. The consultations were held with representatives of civil society, think-tanks, private sector, donor organizations and government officials at all levels. These meetings provided a platform for the World Bank Group (WBG) to tap into the experience and opinion of a broad range of stakeholders, and to hear their ideas on how the WBG can help Georgia achieve its development objectives. A draft of the Country Partnership Strategy (CPS) was shared with audiences before meeting with them, in order to inform the discussions.

OVERALL COMMENTS:

- Participants spoke of the WBG's draft CPS as being comprehensive and adequate.
- Regional development initiatives of the government, supported by the WBG, were largely praised by all participants in terms of creating jobs (if only temporary), paving the way to private investments, attracting visitors to the regions' cultural heritage sites and improving infrastructure.
- WBG's program is well anchored in the Government's Socioeconomic Development Strategy-2020 released recently.
- The government's strategy has its risks and opportunities and requires close cooperation among various state agencies. The WBG can play an important role in ensuring close communication between government institutions.
- Proper donor coordination is essential, since many priorities identified in the CPS coincided with the priorities of other donors.
- The WBG and other donors should closely monitor their assistance to Georgia and condition this (for example on better transparency and disclosure, strong monitoring and evaluation system in place). The World Bank's approach is particularly important, as one of the most reputable international organizations.
- Participants expressed interest in the lessons learned from the previous program, and how those were incorporated in the new CPS.

SECTOR-SPECIFIC COMMENTS:

- **Private Sector Development:**
  - Participants emphasized the importance of ensuring a continuous policy dialogue on private sector led growth.
  - Participants asked about the ways to influence and attract investment (mostly, FDI). Questions were asked about the stronger industries from the investment

perspective and what were the plans in terms of establishing the National Competitiveness Council.

- It was underscored that private sector should continue to be the main source for job creation, at the same time paying attention to skills development. Importance of vocational education was singled out. The intention of the government to use the existing system of colleges for tackling the labor market mismatch was also touched upon.
- Lack of qualified labor, especially in the regions was identified as one of the fundamental challenges faced by the private sector. Need for vocational education and skills development remains a priority. There is a possibility of funding employee training by private sector itself.
- Access to finance remains one of the main issues.
- When addressing efficiency and competitiveness, participants indicated that it would be important to learn from the experience of other countries that effectively manage their economies.
- Private sector was not sufficiently addressed by the draft strategy in terms of SME development. There is a need to have this component more detailed in the proposed CPS.
- Importance of two recent instruments - newly established institutions for supporting the SME development and innovative technology transfer - was noted.

➢ **Skills development:**

- Need for skills development and skills mismatch was identified as one of the most pressing issues in the country, in general. It was emphasized that vocational training should be demand-driven; the question was whether the WBG or other donors performed an analysis of what vocations were most in demand.

➢ **Deep and Comprehensive Free Trade Agreement:**

- The CPS is optimistic about the possible DCFTA impact, especially in terms of export and investment prospects. Georgia needs to be prepared to exploit this opportunity. However, DCFTA expectations should not be exaggerated. Georgia does not have competitive products that can be exported straight away. However, in the longer term, the country's exports base will need to grow.
- DCFTA is a great opportunity for SME development in the long-term perspective, but in the short-term it could exert certain pressure over these enterprises, due to introduction of new regulations and requirements. Participants requested the WBG to help with 'smoothening' this process.

➢ **Regional Development:** While participants acknowledged the WBG's support to regional development, requests were made for more in-depth engagement in tourism sector development (possibly through a stand-alone project). The WBG was calso called upon to help the Government address regional disparities more extensively.

- **Public-Private Partnerships:** Importance of knowledge transfer related to PPP was noted. The project by Swiss Development Agency is focused on inclusive dialogue, and the Swiss experience was distinguished as a very useful in terms of building private-public partnerships.
- **Agriculture:**
  - Economic development greatly depends on agriculture development and in this particular sector, access to finance is a problem. Very few agricultural projects were implemented through funding from local banks, most of them were financed by international institutions such as IFC, EBRD, OPEC or through FDI.
  - The government's initiative to subsidize agriculture oriented companies is welcome.
  - The intention of the EU to support creation of cooperatives through NGOs, did not seem reasonable without involving the private sector.
  - CPS approach to create jobs outside agriculture in the regions is noteworthy.
- **Infrastructure and Transport:**
  - Participants emphasized the need for continued construction of secondary roads through for improving infrastructure and connectivity in the regions.
  - Importance of having proper management and monitoring system for measuring the impact was noted as crucial.
  - Lack of institutional capacity is one of the reasons for Georgian companies being mostly subcontractors and not contractors of the projects financed by the World Bank or other donors. Strengthening of Georgian firms is required, which could be done through announcing small size tenders.

- **Education:**
  - Participants were satisfied to see that the draft CPS had highlighted the issue of pre-school education. They expressed concern about the insufficient number of kindergartens in regions, which were identified as priority issues in need of attention.
  - Introduction of universal preschool care is a huge burden under the conditions of limited resources of local self-government and needs a thorough assessment.
  - Preschool and general school education standards and expediency of implementing good practices is essential.
  - In addition, there is a need for dialogue between employers and higher education institutions including vocational education.
- **Health and social protection:**
  - Access to universal health coverage and the quality of this coverage (as opposed to the number of beneficiaries) is important.

- Social protection of vulnerable groups remains an issue. It was suggested to keep the term “conflict-affected” people in official documents, especially when referring to people living in border villages, since they have to bear many difficulties. Issues of gasification and potable water problems in border villages, and need for strengthening public service delivery were raised.

- **Gender:**
  - Participants noted the employment problems faced by women – applications rejected because of the fact of having a family, a pregnancy, etc. Need for formalization of female employment was underlined.

The World Bank Group team addressed the discussion points raised by the participants of consultations and pledged that it would continue its dialogue with the donors, civil society, private sector and the government to get greater clarity on what would work best in the country considering available resources. The WBG team also emphasized that the next phase of support would see an enhanced focus on ensuring the quality of implementation on the ground.

Annex 5: Selected Indicators of Bank Portfolio Performance and Management

As Of Date 3/31/2014

Indicator	2011	2012	2013	2014
Portfolio Assessment				
Number of Projects Under Implementation [a]	8	6	8	8
Average Implementation Period (years) [b]	4.4	2.6	1.9	2.7
Percent of Problem Projects by Number [a, c]	25.0	0.0	0.0	0.0
Percent of Problem Projects by Amount [a, c]	12.2	0.0	0.0	0.0
Percent of Projects at Risk by Number [a, d]	37.5	16.7	0.0	0.0
Percent of Projects at Risk by Amount [a, d]	22.0	9.8	0.0	0.0
Disbursement Ratio (%) [e]	54.0	98.6	49.4	19.8
Portfolio Management				
CPPR during the year (yes/no)				
Supervision Resources (total US$)				
Average Supervision (US$/project)				

Memorandum Item	Since FY 80	Last Five FYs
Proj Eval by OED by Number	44	8
Proj Eval by OED by Amt (US$ millions)	984.0	150.9
% of OED Projects Rated U or HU by Number	22.7	12.5
% of OED Projects Rated U or HU by Amt	29.9	6.8

a. As shown in the Annual Report on Portfolio Performance (except for current FY).
b. Average age of projects in the Bank's country portfolio.
c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
d. As defined under the Portfolio Improvement Program.
e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.

* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.

Annex 6: Operations Portfolio

Operations Portfolio (IBRD/IDA and Grants)

As Of Date 3/31/2014

Closed Projects 53

IBRD/IDA *	
Total Disbursed (Active)	441.67
of which has been repaid	0.00
Total Disbursed (Closed)	901.53
of which has been repaid	106.59
Total Disbursed (Active + Closed)	1,343.21
of which has been repaid	106.59
Total Undisbursed (Active)	154.37
Total Undisbursed (Closed)	0.00
Total Undisbursed (Active + Closed)	154.37

Active Projects

Project ID	Project Name	Last PSR Supervision Rating: Development Objectives	Last PSR Supervision Rating: Implementation Progress	Fiscal Year	Original Amount in US$ Millions: IBRD	IDA	GRANT	Cancel.	Undisb.	Difference Between Expected and Actual Disbursements[a/]: Orig.	Frm Rev'd
P130413	EAST-WEST HIGHWAY 4	S	S	2013	38	37			70.88841		
P112523	EW HIGHWAY IMP 3	S	MS	2010	147	43			21.45098	11.871815	20.62181
P143060	GEORGIA COMPETITIVENESS AND GROWTH DPO2	MS	MS	2013	32	28					
P117152	KAKHETI REGIONAL ROADS	S	S	2010	30				1.044193	1.0441932	
P110126	REGIONAL & MUNICIPAL INFRASTRUCTURE DEVELC	S	S	2009	33.5	51.5			0.003782	-44.65044	-39.6504
P126033	REGIONAL DEVELOPMENT 1	S	MS	2012	60				10.97873		
P130421	REGIONAL DEVELOPMENT 2	S	S	2013		30			19.53251		
P122204	SLRP II	S	MS	2012	30	40			30.47612	-5.923422	
Overall Result					370.5	229.5			154.3747	-163.2269	-19.0286

Annex 7: IFC Committed and Disbursed Outstanding Investment Portfolio

As of February 28, 2014
(In USD Millions)

Commitment Fiscal Year	Client	Committed						Disbursed Outstanding					
		Loan	Equity	Quasi Equity *	GT/RM**	**Total IFC**	**Total Part**	Loan	Equity	Quasi Equity *	GT/RM**	**Total IFC**	**Total Part**
2012	BOG Holdings Plc	-	22	-	-	**22**	-	-	22	-	-	**22**	-
2000/ 03/ 09/ 10/ 11/ 12/ 13/ 14	Bank of Georgia	25	-	-	9	**34**	-	25	-	-	9	**34**	-
2008/ 09/ 10/ 12/ 13/ 14	Bank Republic	46	-	7	3	**56**	-	26	-	7	3	**36**	-
2011/ 12/ 13	CEI	-	5	-	-	**5**	-	-	5	-	-	**5**	-
2013	Finca Georgia	4	-	-	0	**4**	-	4	-	-	-	**4**	-
2011/ 12	GUEN	41	-	-	-	**41**	**12**	41	-	-	-	**41**	**12**
2013	KSB Georgia	-	-	7	-	**7**	-	-	-	-	-	**-**	-
2009	Rakeen Georgia	23	8	-	-	**31**	-	23	8	-	-	**31**	-
2013	SB Real Estate	10	-	-	-	**10**	-	5	-	-	-	**5**	-
2011	SEAF Caucasus	-	9	-	-	**9**	-	-	7	-	-	**7**	-
1998/ 2000/ 02/ 05/ 06/ 07/ 08/ 09/ 12/ 13/ 14	TBC Bank	-	36	19	7	**61**	-	-	36	19	5	**60**	-
1999	TbilComBank	0	-	-	-	**0**	-	0	-	-	-	**0**	-
2008	Tbilisi Central	8	-	-	-	**8**	-	8	-	-	-	**8**	-
2012	Tbilvino	1	-	-	-	**1**	-	1	-	-	-	**1**	-
2013	Tetri Qudi	2	-	-	-	**2**	-	2	-	-	-	**2**	-
Total Portfolio		**160**	**80**	**33**	**19**	**291**	**12**	**135**	**77**	**26**	**17**	**254**	**12**

* Quasi Equity includes both loan and
** Denotes Guarantee and Risk Management Products.

Annex 8: Proposed Lending

FY14			FY15		FY16		FY17	
	IBRD	**IDA**		**IBRD**		**IBRD**		**IBRD**
DPO-3	70	22.8	DPO-1 (st CPS Area)	50	DPO-2 (1st CPS Area)	50	DPO-3 (1st CPS Area)	60
Irrigation & Land Market Dev't		50	DPO-1 (2nd CPS Area)	50	DPO-2 (2nd CPS Area)	50	DPO-3 (2nd CPS Area)	60
Energy Transmission Grid	60		Innovation & ICT	40	Secondary & Local Roads 3 Add. Fin.	50	Infrastructure	80
Regional & Municipal Infra. 2	30		Regional Dev't	95	East-West Highway	140	Agriculture	60
Secondary and Local Roads 3	75							
Sub-Total IBRD/IDA	**235**	**72.8**		**235**		**290**		**260**
	IFC			**IFC**		**IFC**		**IFC**
Financial Markets	40-50		Financial Markets	20-40	Financial Markets	30-40	Financial Markets	40-50
Real Sector	60-80		Real Sector	20-30	Real Sector	20-30	Real Sector	20-30
Sub-Total IFC	**100-130**			**40-70**		**50-70**		**60-80**

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