

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

November 10, 2015
Report No.: 103609

Operation Name	Second Programmatic Private Sector Competitiveness DPO (DPO2)
Region	Europe and Central Asia
Country	Georgia
Sector	General industry and trade sector (50%); General finance sector (25%); Other industry (25%)
Operation ID	P155553
Lending Instrument	Development Policy Lending
Borrower(s)	Ministry of Finance, Georgia
Implementing Agency	Ministry of Finance, Georgia
Date PID Prepared	November 10, 2015
Estimated Date of Appraisal	February 15, 2016
Estimated Date of Board Approval	July 21, 2016
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Key Development Issues and Rationale for Bank Involvement

Georgia has a consistent track record with regard to macroeconomic stability and improving the business environment. Macroeconomic and financial stability have been preserved in the face of negative shocks, and public sector debt has remained at manageable levels. The business deregulation, anticorruption, legal, tax and trade reforms that Georgia put in place in 2004-12 made the country a more attractive destination for foreign direct investment (FDI) and brought it global recognition as a top reformer. Georgia ranked 15th in the 2015 Doing Business report; and its Global Competitiveness ranking improved from 90th place in 2008-2009 to 69th in 2014-2015. The Government is committed to addressing remaining business environment constraints.

The challenge facing Georgia is to facilitate sustainable and inclusive economic growth. The reforms in the 2000s contributed to robust economic growth but unemployment remains a significant public policy concern. Although significant new employment was created during the last ten years, especially in the service sector, the combination of labor shedding in the public sector and economic transformation in some of the older sectors meant there was little in the way of net job creation. Consequently, unemployment has stayed stubbornly high, never falling below the 12-13 percent range. The country still faces important challenges in eradicating poverty and promoting shared prosperity. There has been progress in the poverty reduction in recent years: the poverty rate, estimated using the \$2.5/day PPP poverty line, fell from 46.7 percent in 2010 to 32.3 percent in 2014. Inequality also remains a problem as Georgia still has inequality higher than the ECA region on average with a Gini coefficient of 40.1 in 2014. There is broad recognition that the social and financial safety nets need to be further strengthened to ensure more inclusive growth dynamics.

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

II. Proposed Objective(s)

The program development objective is to increase private sector competitiveness through second generation business environment reforms, financial sector deepening and diversification, and increasing firms' capacity to innovate and to export. Georgia has undergone extensive business environment reforms over the past decade, achieving a remarkable turnaround in its investment climate. However, further reforms are needed to make the economy more innovative and competitive. The objectives of the operations maps directly into two of the three pillars in the government's Socioeconomic Development Strategy (SDS) – private sector competitiveness and access to finance – which acknowledges that private sector will be the main engine of economic growth and places a business-friendly environment and financial market development at the center of the growth agenda.

Pillar 1 of the Development Policy Operations (DPO) series will support second-generation business environment reforms as a way to stimulate private sector-led growth. Pillar 2 will support financial sector reforms and pension reforms that are essential for increasing savings and mobilizing the investment needed to enhance competitiveness. Pillar 3 will support measures to increase firms' capacity to innovate and to export, including the upgrading of broadband internet services in Georgia. Reforms supported by this operation will help to increase the competitiveness of the private sector leading to inclusive growth.

III. Preliminary Description

The prior actions for this operation are mentioned below.

Pillar I

- (a) **Prior Action 1:** The Georgian Economic Council has implemented an enhanced communication mechanism.
- (b) **Prior Action 2:** The government has introduced the practice of making major draft economic laws that are approved by the Government available for public review and comments.

- (c) **Prior Action 3:** The Ministry of Economy has adopted a Small and Medium Sized Enterprise (SME) development strategy and action plan.
- (d) **Prior Action 4:** The Georgian State Procurement Agency (SPA) has amended the bylaws regulating procurement practices to mitigate possible bid rigging and unlawful practices in public tenders.

Pillar II

- (e) **Prior Action 5:** The government has: (i) approved the Deposit Insurance System (DIS) reform strategy with a time-bound action plan; and (ii) submitted the draft Law on DIS to Parliament for approval.
- (f) **Prior Action 6:** The government has: (i) approved the strategy and roadmap for comprehensive pension reform; and (ii) through the Pension Reform Working Group, has submitted the respective draft pension reform legislation to the Economic Council.
- (g) **Prior Action 7:** The government has designated an authority that will be responsible for coordinating accounting and auditing reforms.
- (h) **Prior Action 8:** The government has approved a capital markets reform strategy with a time-bound action plan.
- (i) **Prior Action 9:** The government has: (i) submitted to Parliament draft legislation to approximate Georgia's legal framework with EU Solvency I margins and strengthen the regulatory powers, funding and capacity of the insurance regulator; and (ii) through the insurance regulator, adopted relevant by-laws.

Pillar III

- (j) **Prior Action 10:** The Georgian National Communications Commission (GNCC) permits the provision of high-speed wireless broadband services by: (i) completing the modification of frequency licenses under technology neutral terms to; and (ii) issuing new licenses (more than one license) for wireless broadband services in the 800 MHz band.
- (k) **Prior Action 11:** The government has submitted the draft Law on Innovation to strengthen commercialization of innovation to Parliament for approval.
- (l) **Prior Action 12:** The Georgian National Agency for Standards and Metrology (GeoSTM) has adopted an Institutional Reform Plan (IRP) that defines the medium term priorities, including development of new services, budget sources and results to be achieved for international recognition of the priority laboratories according to the needs of enterprises.

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

The overall poverty, social and gender impact of the actions supported by this operation are expected to improve the living conditions of Georgian households by enhancing the country's growth and job creation potential. The actions of the DPO are organized around three pillars that will jointly support the creation of a more fertile environment for firms' expansion, especially SMEs. Georgia has been struggling to create more employment and consequently employment creation has played only a minor role in poverty reduction in the 2010-2014 period.¹ In this context, any actions that can boost the potential for employment creation of the country will ultimately impact positively on the living conditions of households in the country. Under the first and third pillar, it is noted that the SME development strategy and action plan and the increase provision of high-speed wireless broadband services can have an indirect positive impact by promoting employment creation. Under the second pillar, the actions supporting the comprehensive pension reform can lead to improving the fiscal sustainability and predictability of the system but it will be important to monitor that all workers can benefit from the incentives under consideration as part of the reform.

Environment Aspects

The proposed prior actions for the second operation will have an indirect positive impact on the environment and will carry no environmental risks. The policy measures focus on legal, regulatory, and supervisory reforms to strengthen and further develop the financial sector, that do not carry environmental risks. The actions in Pillar 1 will promote more active stakeholder engagement in the policymaking processes. In terms of the Economic Council, this will better serve its goals by bringing the perspective of sustainable development into its operation to ensure that new laws and regulations are environmentally informed and sensitive to major health and environmental implications. More active participation by professionals of the field or representatives of environmental NGOs in the public-private dialogue mechanisms would be advised.

V. Tentative Financing

Source:	(\$m.)
Borrower	0
International Bank for Reconstruction and Development	60
Total	60

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¹ Georgia 2015 Poverty Assessment.

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