

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

December 5, 2013

Report No.: AB7453

Operation Name	Georgia Third Competitiveness and Growth Development Policy Operation (DPO3)
Region	Europe and Central Asia
Country	Georgia
Sector	Other domestic and international trade (10%); General public administration sector (30%); General education sector (30%); Other social services (20%); General energy sector (10%).
Operation ID	P146890
Lending Instrument	Development Policy Lending
Borrower	Ministry of Finance, Georgia
Implementing Agency	Ministry of Finance
Date PID Prepared	December 5, 2013
Estimated Date of Appraisal	April 2, 2014
Estimated Date of Board Approval	June 5, 2014
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 experienced a high growth period during 2004-08 but unemployment persisted at 13 percent. Unemployment rose during the crisis and reached 17 percent in 2010 and then fell to 15 percent in 2012, after two years of recovery. The gender difference in unemployment rate was negligible in the 2000s before the crisis but increased thereafter. With economic transformation in Georgia, some of the older 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. Although Georgia has a highly educated work force on paper, the private sector complains of a lack of required skills. This skill mismatch forces highly educated workers to take up less skilled jobs and also contributes to unemployment and eventual poverty. Unemployment among higher education graduates is extremely high, particularly among females. Tackling this unemployment problem will need reforms in both the business environment and the quality and relevance of education.

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

operations. The previous series of DPOs concentrated on crisis mitigation and structural reforms to ensure post-crisis growth.

Georgia's growth run was interrupted during 2008-09 by the crisis and the conflict with Russia but the economy rebounded strongly and posted an average annual growth of 6.5 percent a year during 2010-12. The reforms under the previous DPO were anchored in public finances (new budget code), increased social safety nets, and improvements in the business environment (tax compliance and trading across borders). The current DPO series lays the foundation for increased competitiveness and inclusive growth by furthering reforms in these areas. Specific actions already taken by the government in these areas include the following: the law on safety and free movement of products was operationalized, the automated selectivity for transit traffic was introduced to strengthen the risk-based management of customs, the revenue service can now issue certificates of origin and permits at border crossings, the new national curriculum for grades I to XII was operationalized, higher salaries for teachers was approved, modified cash basis IPSAS2 standards were adopted, budgets of legal entities of public law are included in the e-budget, and universal health care has been operationalized.

## **II. Proposed Objective**

The program development objective of this operation is to strengthen competitiveness and facilitate inclusive growth. The proposed operation rests on three pillars which map to three of the four priority areas outlined in the government's draft development strategy: macroeconomic stability, increased competitiveness of the private sector and human capital development.

- **The first pillar on competitiveness supports:**
  - (i) Promotion of market access with a view to enhance exports and foreign investment.
  - (ii) Improvements in customs efficiency to facilitate trade.
  - (iii) Enhancement in the climate for attracting investments in the power sector.
  - (iv) Strengthening the quality of general education to support competitiveness through improved national curriculum and better human resource policies.
- **The second pillar on public financial management supports:**
  - (i) Strengthening the efficiency of treasury management.
  - (ii) Improvement in the coverage and transparency of financial reporting.
- **The third pillar on effectiveness of social spending supports:**
  - (i) Improvement in the accessibility and quality of healthcare services.
  - (ii) Improvement in the efficiency of targeted programs.

The proposed operation will support the government's agenda of creating jobs via reforms and protecting those who do not gain from these reforms, thereby, enabling poverty reduction and shared prosperity. Georgia has made several improvements in its business environment though more needs to be done, especially in the areas of getting electricity and trading across borders. The sources of productivity growth which aided economic expansion during the last decade have run their course and future productivity improvements will need to come from other areas. These include improvements in market access, logistics infrastructure, skills base, increased

competition, and a supportive macro-fiscal environment. These improvements will spur job creation and help reduce poverty and enhance shared prosperity. The line of sight to their intended impacts is presented below.

- **Pillar one supports increased competitiveness through improvements in trade and trade facilitation, investment climate in the electricity sector and skills development.** These reforms will create more jobs through increased export opportunities and greater price competitiveness by lowering the cost of trading across borders. They will also help ensure better supply of electricity thereby supporting the business environment and the households. Reforms in the education sector will contribute towards greater absorption of the labor force in the domestic economy by addressing some of the concerns on skills mismatches and enhancing the overall quality and relevance of general education.
- **Pillar two supports improvements in public financial management via changes in the accounting system and increased coverage and transparency of the state budget.** These reforms will improve the efficiency of government spending, reduce avenues for corruption and enable better policy formulation. This will support the overall macroeconomic framework which is a pre-requisite for private sector led growth.
- **Pillar three supports improvements in the effectiveness of social spending by improving the quality of healthcare and better targeting of social assistance.** Reforms under this pillar will have a direct beneficial impact on the poor as it will increase their access to better healthcare services and will also improve coverage of the poor in social assistance programs through better targeting.

### **III. Preliminary Description**

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

#### **Competitiveness**

**Prior Action 1: All pending legislative components of the Deep and Comprehensive Free Trade Agreement package are operationalized.** The expected outcome is to improve the quality of Georgian exports. This in turn could increase trade possibilities for Georgia by opening up new markets, thereby, creating more livelihoods.

**Prior Action 2: The Revenue Service uses software (Trade Facilitation System) to integrate processes and simplify transactions.** The expected outcome is to reduce transport and transit service costs through improved flow of information. It will contribute towards making Georgia a transit hub (as envisioned by the government) and increasing the price competitiveness of Georgian exports.

**Prior Action 3: A grid code is issued to improve power system reliability and the Ministry of Energy of Georgia revises as appropriate other relevant laws and regulations to address evolving market needs.** The expected outcome is to improve the reliability of domestic power supply which will support the business environment.

**Prior Action 4: A monitoring framework is established and assessment of the new education curriculum is prepared.**

**Prior Action 5: Continued attention to the teaching profession by designing a more comprehensive teacher performance appraisal system and enhancing opportunities for career development.**

**Prior Action 6: Operationalize quality assessment system for the evaluation of school principals.**

The expected outcome of these policy actions under education is to improve the relevance of the education system and to enhance academic performance through higher teacher effectiveness. This will help address some of the issues related to skill mismatches and enable greater absorption of the labor force in the domestic market.

### **Public Financial Management**

**Prior Action 7: The Ministry of Finance of Georgia prepares financial reports of all central government budgetary organizations in accordance with the modified cash-basis International Public Sector Accounting Standards.**

**Prior Action 8: The Ministry of Finance of Georgia includes budgets of local self-governments and five largest LEPLs in the e-budget.**

The expected outcome of these policy actions under public financial management is to improve accounting standards, expenditure management and budget transparency which will contribute towards better fiscal and macroeconomic management.

### **Effectiveness of Social Spending**

**Prior Action 9: The Ministry of Labor Health and Social Affairs of Georgia ensures implementation of upgraded standards for healthcare providers at primary care and hospital facilities in accordance with the decree of the Government of Georgia.** The expected outcome is to provide households with better healthcare services through upgraded standards for healthcare providers. This will be particularly beneficial to the poor who have limited healthcare options.

**Prior Action 10: Nation-wide rollout of the Social Information Management System.** The expected outcome is to improve the targeting efficiency of the social programs and also provide faster access of benefits to the poor.

## **IV. Poverty and Social Impacts and Environment Aspects**

### **Poverty and Social Impacts**

The overall poverty, social, and gender impacts of the policy measures supported by this DPO are expected to be positive. The supported policy measures under Pillar I are expected to have positive distributional impacts. In the case of the first prior action (related to implementation of Deep and Comprehensive Free Trade Agreement), simulations suggest that in the medium term, improvements in the living standards of the population will occur for everyone with relatively larger impact at the upper end of the distribution. Improved coverage and targeting of social

programs in general, and actions under Pillar III specifically, will be needed to efficiently respond to any adverse social and distributional impacts of reforms. While some measures have no direct gender impacts, reforms to teacher performance appraisal system will positively affect women given that more than 80 percent of teachers are female. Enhanced standards of health services delivery also have the potential to benefit women via improved delivery of antenatal care services. The prior actions in Pillar II improve the overall functioning of the public sector and are expected to be distributionally neutral.

### **Environment Aspects**

Most of the policy reforms under this operation are neutral to the environment with the exception of two prior actions, one on the DCFTA and the other on the electricity transmission grid. Operationalizing the legislative components of the DCFTA would entail adoption of the food safety law and enhancement of sanitary and phytosanitary standards in the field of agro-production. This is likely to lead to the application of cleaner and more responsible technologies of primary production and food processing. Export orientation would mean higher quality standards of produce, which is attainable through better pesticide management, well controlled application of agrochemicals and careful selection of animal feed. The environmental impacts of such improvements are likely to be positive as they are expected to lead to decrease in environmental pollution from poor quality or extensively used inputs. However, in the power sector, the environmental impacts could be negative. The government is undertaking legal and regulatory reforms to stimulate the development of new hydropower generation plants and electricity transmission lines. Expansion of infrastructure can lead to negative environmental impacts, including cumulative impacts of construction and operation of power plants. However, given that the government aims at replacing thermal generation with hydro generation, it will not lead to a considerable increase in carbon emissions. Risk mitigation in this area includes Bank support to the government in carrying out a strategic environmental and social assessment of the power sector development strategy that will be financed from the Transmission Grid Strengthening Project currently under preparation. Diversification of generation sources by exploring the potential for other renewables may also help decrease cumulative risks of constructing new hydropower plants. The EU support to the Government of Georgia in drafting the law on renewables is aimed at removing barriers for developing alternative sources of renewable energy.

### **V. Tentative Financing**

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

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