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# Social-economic Development Strategy of Georgia

“GEORGIA 2020”



Government of Georgia

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## Foreword

The first few years of the formation of an independent, market-based economic system were especially difficult for Georgia: civil unrest, armed conflicts in Abkhazia and South Ossetia, energy and transport blockades, extremely high crime rates, severed economic ties, the loss of old, traditional markets and suppliers and the absence of new connections and suppliers to adequately replace old ones, high rates of workforce migration - this is just a small list of the negative factors which led to unprecedented economic stagnation, hyperinflation and a catastrophic increase in unemployment during the first few years of Georgia's independence.

The country had no choice but to carry out swift and radical economic reforms, the gradual implementation of which significantly improved the situation, but failed to yield desired results, especially in terms of decreasing unemployment and poverty levels. The goals set out in existing strategic and programmatic documents, whose stated aim was to significantly reduce poverty and unemployment, remain largely unachieved.

Despite strong rates of economic growth demonstrated during the previous years, the conditions for the major part of the population remained unchanged. Therefore, Government of Georgia's goal is to create foundations for long-term inclusive economic growth and improve the welfare of the population.

## Vision for Development

Economic policy of the Government of Georgia is based on three main principles. The first principle implies ensuring fast and efficient economic growth driven by development of real (production) sector of the economy, which will resolve economic problems that exist in the country, create jobs and reduce poverty. The second principle implies implementation of economic policies that facilitate inclusive economic growth – it envisages universal involvement of the population in the economic development process (including Diaspora, migrants, ethnic minorities and other groups), prosperity for each member of society through economic growth, their social equality and improvement of the living standards of population. The third main principle is based on rational use of natural resources, ensuring environmental safety and sustainability and avoiding natural disasters during the process of economic development.

Government of Georgia recognizes principles of democratic development, rule of law, efficient administration, respect for human rights and basic freedoms; the Government's policy is based on those principles.

Integration in the European Union is the cornerstone of Georgia's foreign and internal policy. Government of Georgia intends to adhere to democratic development course and ensure firm

support to universal European values, which will be basis for getting closer to the EU. Correspondingly, effective implementation of Association Agreement between EU and Georgia (whose integral part is Deep and Comprehensive Free Trade Area) is very important as it is a precondition for political association and gradual economic integration with the EU. At the present stage of development and in the context of the existing reality, the goal of the Government of Georgia is to implement the economic policies, which will ensure the sustainable development of the country. Economic policy must be based on the principles of economic freedom and respect to and protection of property rights. At the same time, the state will act as a guarantor of justice in economic processes.

In order to facilitate economic development, Government of Georgia will activate economy regulation mechanism and in case of a crisis it will stimulate demand on the market.

The guiding principle of the country's strategy for economic development is establishing the necessary conditions for a free private sector operating under an optimal, efficient and transparent government. This means the establishment of an economy in which the private sector will be free to make its own decisions, in which the supremacy of property rights will be guaranteed, and in which the private sector will be the main driving force behind economic development. Free market relations will be combined with optimal model of state regulations. The state will ensure prosperity of each citizen.

Based on the principles of optimal and efficient governance, the state's involvement in entrepreneurial activities will be minimal, and it will not seek to compete with the private sector: its participation in economic activities will be limited to sectors where the private sector remains weak and inefficient.

The Government's economic policy considers the private sector's competitiveness to be a very significant driver of economic development. The existence of competition in both the internal and external markets is a necessary precondition for a successfully functioning economy.

Mutual openness to international trade must be ensured, and free-trade areas must be expanded.

Ensuring the country's readiness and attractiveness to foreign investments will become possible through implementation of stable and predictable economic policies as well as through integration with international financial markets and the reduction of the country's financial risks.

Besides economic efficiency, the Government's economic policies will be guided by principles of social security and social justice. Reduction of unemployment and provision of dignified labor

conditions to people, orientation towards quality and accessible education, health care and basic social welfare systems are the tools for implementing those principles.

The Government's economic policy will achieve prosperity through reducing unemployment. At the same time, the authorities will provide the population with basic social guarantees and allocate targeted social assistance to the poorest layers of society. Resolving the problems which directly hinder achievement of shared prosperity is the priority for the Government of Georgia.

As a result of analysis, weak competitiveness of the private sector, weak development of human capital and limited access to finances were identified as the critical problems hindering economic development.

In this context, the Government must stimulate private sector, facilitate investments and create fair and protected business environment. Its goal is also to stimulate development of business through developing innovations and entrepreneurial skills and raising access to finances, which leads to economic growth. In order to achieve prosperity, the state plays an important role in terms of creation of a basic social protection system and provision of relevant services to population.

Social-economic Development Strategy "Georgia 2020" (hereinafter referred to as Strategy) reflects the priorities and problems that need to be resolved in order to achieve long-term, sustainable and inclusive economic growth. At the same time, regional development plays a significant role in achieving comprehensive economic development. International experience shows that inclusive economic growth depends on effective planning and implementation of not only national, but also regional development policies, it depends on strong and competitive regions. Regional development is viewed as an important factor for achieving success on a national level.

The advantages of proper planning and implementation of regional development policies include identification and optimal use of concrete regions' comparative advantages, their specific characteristics and existing potential. At the same time, further streamlining and development of the local infrastructure is one of the main preconditions for reducing regional disparities, facilitating and stimulating local economic growth, attracting direct investments and further integration with the EU.

Consistent decentralization and the leading role of sub-national units in stimulating local economic processes are seen as very important factors for achieving general i.e. national development. Correspondingly, during the implementation of policies outlined in the present Strategy, concrete activities must take into consideration the involvement and needs of self-governing bodies in accordance with the development priorities of specific regions.

“Georgia 2020” strives to achieve the following forecast results by 2020:

Indicator	Current rate	Forecast rate
GDP per capita (GEL, nominal)	5811.7	13,000
GDP per capita (GEL, in constant prices)	5811.7	9200
Gini coefficient	0.41	0.35
Inflation (%)	2.4	3.0
Unemployment (%)	15.0	<12
Taxes (% of GDP)	24	25
Exports (goods and services, % of GDP)	45	65
Current account deficit (% of GDP)	>10	6
Public debt to GDP ratio (%)	34	<40

## Goal of the Strategy

The goal of the present Strategy is to identify the main factors hindering inclusive economic growth in Georgia and define relevant priority tasks for their neutralization. The Strategy contains so called “horizontal” actions of economic policy. Correspondingly, the Strategy’s goal is not analysis of separate sectors of economy, evaluation of their competitiveness or identification of the country’s concrete advantages. The Strategy defines priorities for relevant ministries, which will be included in actions plans and other relevant documents together with relevant costs, responsible bodies and monitoring mechanisms.

The actions under this Strategy correspond with the already existing sector strategies. At the same time, it does not reflect all the obligations, which have been assumed by the Government of Georgia.

## Analysis of the current situation

Following the restoration of Georgia's independence, the country experienced two waves of economic reforms. The first wave, which established the institutional foundations for a new economic system, was carried out after the crises of the first half of the 1990s. These policies implemented during this first stage initially succeeded in stimulating economic growth; however, this growth was impeded by the end of the 1990s.

The primary aim of the second wave of reforms launched in 2004 was market liberalization, which, among other issues, was based upon such measures as the reduction of taxation and bureaucratic reform.

One of the main factors behind economic growth during previous years was government investment, a significant part of which was directed towards infrastructure projects. In the meantime, the contribution of workforce to economic growth was actually negative, declining by an average rate of 1.6 percent. During this period, the average yearly growth of total factor productivity (the portion of growth unaccounted for by the growth of labor or capital) was 2.8 percent.

**Figure 1. Gross fixed capital formation and foreign investments**

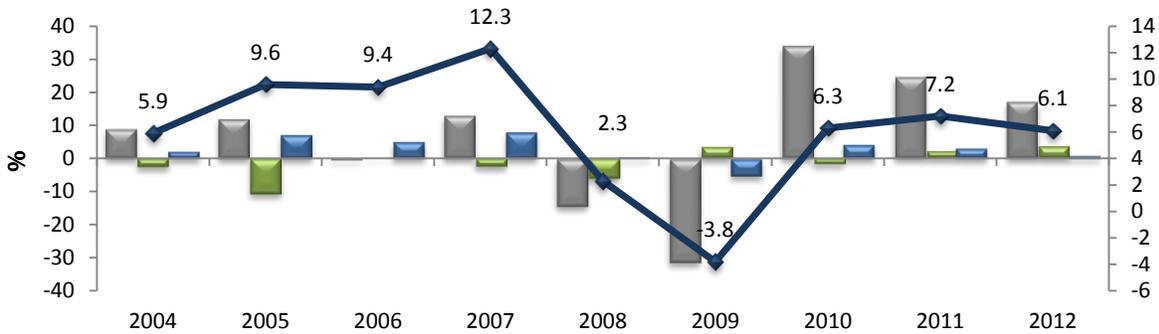


(Green line) Gross Fixed Capital Formation (% of GDP)

(Blue line) FDI, net inflows (% of GDP)

Source: GeoStat

**Figure 2. Factors of production (yearly change, %)**

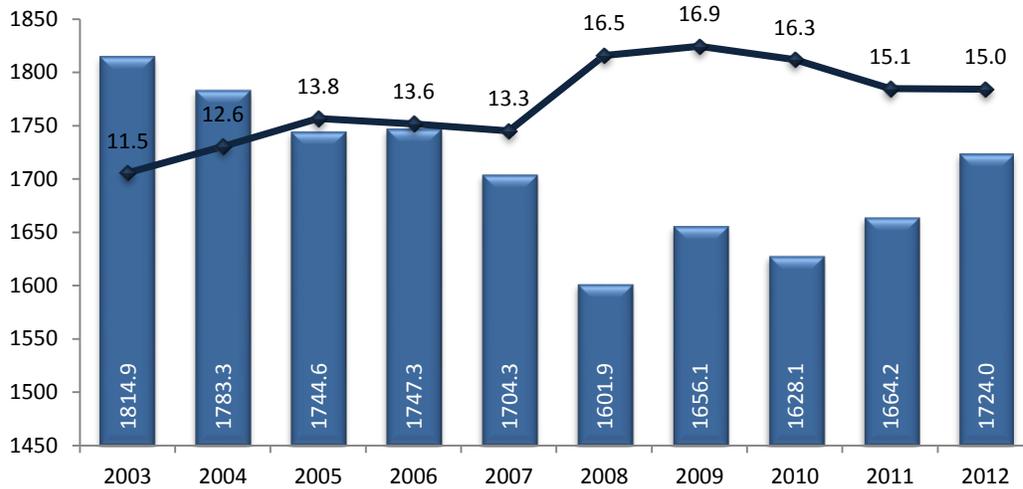


Capital (grey), labor (green), TFP (blue), Output (dark blue line)

*Source: GeoStat, Ministry of Finance*

In previous years many expected that significant inflows of FDI would lead to increased knowledge and transfer of technology - both key to boosting and diversifying exports and creating new jobs. However, neither saw increases on a scale that would have led to long-term economic growth. In particular, a significant proportion of investments were made in capital-intensive sectors, where employment volumes are small. According to official data, Georgia’s unemployment rate peaked at 16.9 percent in 2009, stabilizing later at 15 percent in 2012. Moreover, about two-thirds of the workforce is self-employed—predominantly in the agricultural sector, where most people are engaged in subsistence farming, which is itself largely the result of the government having neglected agriculture for the past decade. On the whole, the unemployed and self-employed account for around 70 percent of the country’s active workforce.

**Figure 3. Employment and unemployment rates**

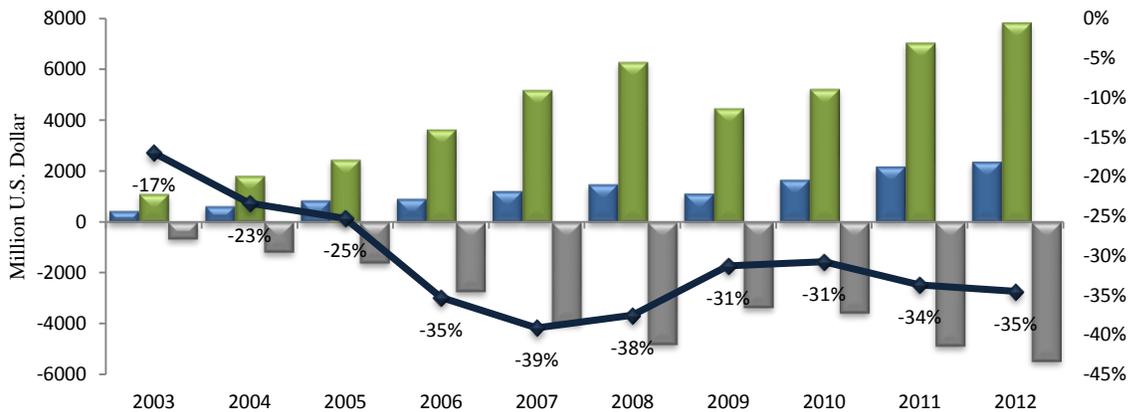


Employed (in thousands) (blue columns), Unemployment rate (%) (black line)

*Source: GeoStat*

Similarly, the Government’s economic policies did not yield the desired results in terms of increasing the competitiveness of Georgia’s exports. Export diversification was insignificant, and the growth of imports significantly outweighed that of exports; this led to an increased negative external trade balance, which poses significant macroeconomic risks to the country.

**Figure 4. External trade**

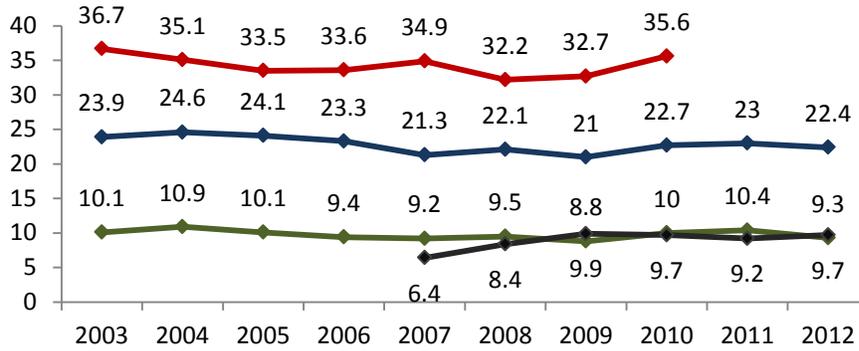


Export (blue), Import (light green), Trade balance (grey), Trade balance (% of GDP) (black line)

*Source: GeoStat*

Besides, economic growth did not tackle poverty rates, which have largely remained unchanged. In terms of inequality, Georgia is one of the most unequal states among ECA countries.

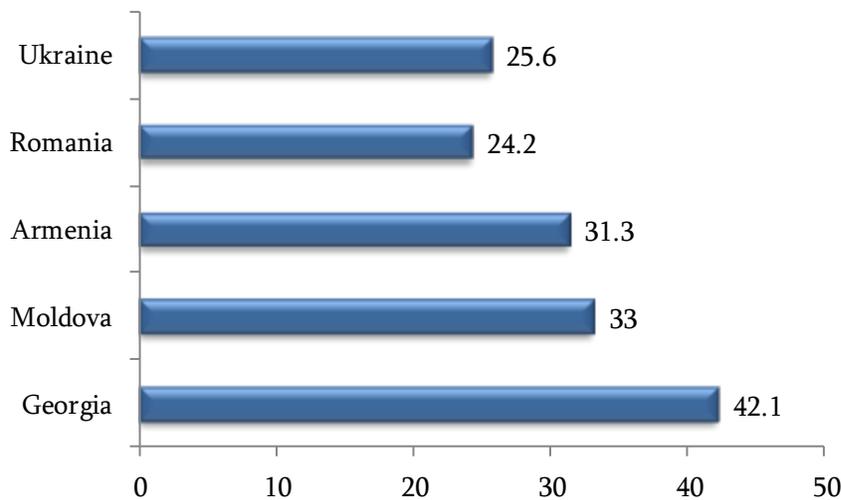
**Figure 5. Poverty indicators**



Poverty headcount ratio at \$2 a day (red)  
 Population under 60% of median consumption (blue)  
 Population under 40% of median consumption (green)  
 Registered poverty rate (black)

Source: GeoStat

**Figure 6. Inequality indicator (Gini coefficient, 2010)**



(From top to bottom: Ukraine, Romania, Armenia, Moldova, Georgia)

Source: World Bank

Taking into consideration the above-mentioned facts, an analysis of Georgia’s economy over the past few years leads us to two main conclusions:

- The economic policies of the last decade were successful in terms of investment and correspondingly increasing short-term economic growth rates, but these policies failed in their attempt to lay foundations for increasing the competitiveness of the Georgian economy and ensuring long-term comprehensive economic growth;
- Results of economic growth did not reach a significant part of the Georgian population and failed to have an impact on reducing unemployment and poverty levels.

New economic policies under the present Strategy will achieve increased prosperity through reducing unemployment, improving labor and living conditions, forming basic social protection system and developing human capital. At the same time, the Government fully intends to fulfil its responsibility to provide targeted social assistance to the poorest layers of society. Given these factors, solving the problems which are impeding efforts to achieve these goals is the main priority of the present Strategy.

In order to achieve comprehensive economic growth, the most important task is to identify and overcome the most critical problems which are hampering the Georgian economy. The Growth-Diagnostics Method (see the Annex) used during the elaboration of the present Strategy enables the identification of these critical problems. The private sector’s low level of competitiveness, insufficiently developed human capital and limited access to financial resources were identified as most pressing problems.

The Strategy defines priority measures for overcoming these three main problems:

<b>1. Private sector competitiveness</b>
Improving the investment and business environment
Innovation and technologies
Facilitating the growth of exports
Developing infrastructure and fully realizing the country’s transit potential
<b>2. Human Capital Development</b>
Developing the country’s workforce that meets labor market requirements
Tightening the social security net
Ensuring the accessible and quality health care
<b>3. Access to finance</b>
Mobilization of investments
Development of financial intermediation

## Necessary preconditions for inclusive economic growth

A number of assumptions must hold true in order to successfully implement the Strategy, in particular, achieving macroeconomic stability and ensuring effective public administration:

- **Macroeconomic stability.** Achieving a stable macroeconomic environment is one of the main preconditions for the successful implementation of the Strategy. Therefore, fiscal discipline, low unemployment levels and price stability, an independent monetary policy, the gradual reduction of the country's current account deficit to moderate levels and preserving the stability of financial sector are important factors for Georgia's long-term economic growth; and
- **Effective public administration.** The successful implementation of the Strategy also requires efforts to increase the potential of Georgia's state agencies to an adequate level.

## Macroeconomic policy framework

Table macroeconomic policy is a necessary precondition for fast and healthy economic growth. If the Government is ever faced with a choice between implementation of Government's other social or economic goals and carrying out the declared policies directed at macroeconomic stability the priority will be given to the latter option.

Georgia's economic growth model is based on the following main concepts:

- Private sector driven growth
- Efficient government
- Equal opportunities for businesses;
- State investment policy facilitating growth;
- Free competition;
- Openness to trade.

Through elaboration of macroeconomic policy framework the Government of Georgia assumes the obligation to implement stable macroeconomic policy in order to overcome external risks; it also undertakes to carry out structural reforms in order to preserve macroeconomic stability and reputation of a government that realizes the need for fiscal responsibility.

## **Stable and sustainable macroeconomic policy**

### **- Fiscal consolidation**

Government of Georgia will ensure medium-term fiscal consolidation. This policy aims at reducing fiscal deficit down to 2.5% by 2017 and to 1.5-2% by 2020. During the medium-term period reduction of fiscal deficit is expected through fast economic growth and limiting the current expenditure growth. Target deficit indicators will be based on the deficit change rates predefined by the Government of Georgia, which must ensure stability of state debt and create corresponding space for countercyclical policy. This, in its turn, will enable fiscal stabilizers to automatically and effectively respond to various shocks.

Government of Georgia undertakes to widen fiscal space in order to make sure that response to shocks is more flexible and that it has more instruments for reacting to fiscal challenges without jeopardizing financial situation or economic stability.

### **- Price stability**

National Bank of Georgia will continue implementing the inflation targeting policy. The main goal of the monetary policy is keeping inflation within planned rates. Government of Georgia realizes that stable prices, which are defined by low, one-digit inflation rates, pave the way for economic growth. Long-term desirable inflation rate is 3%. National Bank of Georgia plans to decrease inflation rate down to 5% by 2015 and by 2017-2018 the National Bank plans to achieve the above-mentioned desirable rate. The independence of Georgia's National Bank and facilitating the improvement of monetary policy transfer mechanisms are necessary factors for successful implementation of inflation targeting policy.

### **- Preserving the sustainability of public debt**

Public debt is not high in Georgia. The medium and long-term goal of the Government of Georgia is to preserve its sustainability at less than 40% of GDP. This can be achieved through reducing fiscal deficit in the medium-term period. The medium-term plan of the Government is to reduce the primary deficit down to 1.5-2% of GDP (the forecast rate for 2014 is 2.7% of GDP).

The major part of the public debt is represented in foreign currency. In order to decrease exchange rate and refinancing risks the debt management policy of the Government of Georgia is directed at increasing the share of national currency in the total amount of public debt. This can be achieved through increasing the validity periods of government bonds and taking into consideration the expenses associated with that change. Government of Georgia will increasingly

rely on internal credit market; however, the growth of credits should not limit private sector financing.

- **Tax policy**

The goal of the Government of Georgia is to create stable tax system, which will facilitate sustainable economic development and reduce the risks of economic shocks to the minimum. In order to ensure that Georgia still enjoys the status of an attractive place for doing business in future the current low tax pressure policy will be preserved going forward. It fully corresponds with Organic Law of Georgia on Economic Freedom, according to which the existing taxes can be raised or new taxes can be introduced only through a referendum.

In this context, the main efforts of the Government of Georgia will be directed towards sustaining the stability of the tax system and strengthening the tax administration.

**External risks**

- **Gradual reduction of Georgia's current-account deficit**

The high rate of current account deficit in Georgia is the potential source of macroeconomic vulnerability. Due to the constant deficit, net external obligations equal almost 100% of GDP. High deficit and need for external refinancing in case of sudden changes in capital inflows increase country's vulnerability. This is partially balanced by the big share of preferential public debt, foreign direct investments and intercompany loans, which are more stable sources of external financing. Government policy will be directed towards reducing the country's current-account deficit to sustainable levels. Strategic goal of Georgian Government's economic policy is the achieve 6% of current account deficit and continuing its further reduction.

At the same time, in order to ensure sustainability of external positions, Government of Georgia will facilitate inflows of such long-term capitals as foreign direct investments and donor financing.

- **Preserving current account deficit at levels that are needed for debt stabilization**

Share of total external debt in GDP is high. The priority of the Government of Georgia is to stabilize and then decrease that rate. To that end, the Government of Georgia will preserve the current account deficit at a level, which will ensure medium-term sustainability and long-term reduction of external debt.

- **Policy directed at reducing current account deficit**

Reduction of current account deficit will be based on three policy directions: medium-term fiscal consolidation with a view to limiting total demand, higher flexibility of exchange rate and reforms directed at strengthening export and competitiveness. Georgia will adhere to the principle of openness to international trade, take steps to efficiently implement free trade agreements with its partners, continue to implement policies directed at development of regional trade and work for eradicating artificial barriers existing for Georgian products in neighboring countries.

- **External buffer**

In order to protect its economy from external shocks (in the context of high current account deficit and high level of dollarization) Georgia will preserve adequate levels of international reserves. Under the inflation targeting and flexible exchange rate policies, the goal of the National Bank of Georgia is to preserve minimal level of the country's international reserves at 3.5-4 month worth of import.

- **Exchange rate**

Georgia pursues free-floating exchange rate policy, which is well suited for Georgian economy with its automatically stabilizing function. Free-floating exchange rate mitigates the impact of external shocks on economic indicators. The Georgian economy is expected to grow more rapidly than the economies of its neighboring countries, which will cause a long-term appreciation of the real exchange rate of the Georgian lari (GEL). In this context, in order to preserve competitiveness, monetary policy must ensure appreciation of real exchange rate in Georgia in comparison with neighboring countries at a slower rate than production growth.

## **Institutional issues**

- **Independence of National Bank of Georgia**

Independence of monetary policy is a fundamental principle of macroeconomic policy, which is strictly upheld by the Government of Georgia. Independence of National Bank of Georgia is guaranteed by Organic Law of Georgia; in particular, Government does not and will not interfere in its activities.

- **Financial stability**

Government of Georgia along with financial supervision institutions will develop an efficient, transparent and sustainable financial sector.

- **Budget comprehensiveness**

In order to better control expenditures and efficiently distribute resources, the budget must be comprehensive. It should encompass all the revenues and expenses of the Government of Georgia, notwithstanding peculiarities of management of certain government programs and legal grounds of expenditures. To that end, Government of Georgia plans to include legal entities of public law and all types of dividends in the budget. Budget comprehensiveness will enhance efficiency of state expenditures and enable the Government to reduce the budget deficit.

- **System of financial risk monitoring**

Achievement of Georgia's long-term goals requires management of fiscal risks. Government will continue the policies under which state guarantees are not issued; at the same time, the Government will elaborate an effective system of financial risk management with a view to identifying, evaluating and mitigating negative effects of risks.

- **Long-term fiscal planning**

Budget policy is based on medium-term strategic planning. Medium-term plans will be used for achieving fiscal sustainability. Government of Georgia will improve the process of adoption of programmatic budget, with which it will ensure its execution.

- **Public-private partnership**

Government of Georgia plans to form an efficient mechanism for public-private partnerships, which is especially important for attracting investments to infrastructure and hydropower sectors. At the same time, Government will thoroughly assess fiscal risks associated with PPPs with a view to better managing them.

- **Donors**

Georgia's economic policy is elaborated in close cooperation with international donors. Georgia is implementing the current program with International Monetary Fund. Government of Georgia plans to request a new program, which will ensure long-term involvement and regular consultations.

- **Fiscal regulations**

The main principle of the Government's strategic vision is creating the image of a reliable and responsible government. Georgia has a self-imposed and long-term limitation on fiscal policy in the form of limited number of budget aggregates. In order to ensure reliability of the regulations, Government has reflected certain fiscal rules in the legislation. 4 fiscal rules of the Georgian fiscal system are clearly defined in legislation:

**Budget balance rules** – Organic Law defines upper limit of total budget deficit at 3% of GDP.

**Debt rules** – Public sector debt as a permanent percentage in relation with GDP.

**Spending rules** – Expenditure part of the budget has an upper limit that equals 30% of GDP.

**Revenue rules** – Organic Law forbids increasing of any type of tax except for excise tax.

Besides, Government of Georgia is guided by other fiscal rules, which are not included in legislation, but are still considered to be main principles of fiscal policy:

1. Decreasing tendency of fiscal deficit;
2. Real increase rate of public investments at more than 10%;
3. Unplanned revenues should not impact structural deficit.

## Efficient public administration

The successful implementation of the “Georgia 2020” Strategy will require coordinated work on behalf of various state agencies as well as co-operation with all stakeholders. Institutional capacities for public policy management—which include policy formulation, strategic planning, and the development of evaluation and monitoring mechanisms—will gradually be strengthened in the public sector. The Government will also facilitate the development of a human resources management system as part of efforts to ensure the stability of public service provision and the recruitment of qualified staff through relevant material and career motivation. Effective public administration also requires improvements to the country's tax systems in order to preserve budgetary stability and simultaneously improve the tax environment for businesses.

### In order to achieve these goals the Government of Georgia will ensure:

- Improvement of mechanisms of public policy management and strengthening their links with the State Budget. Government will actively use policy analysis, strategic planning and policy evaluation instruments, which are associated with the State Budget;

- Use of cost effectiveness analysis during the evaluation of capital projects, which will facilitate improvement of efficiency of state finances;
- Transparency of state policy through involving stakeholders in the process of elaboration and implementation of state policy;
- Facilitating the improvement of institutional capabilities of subnational authorities through more efficient provision of public services, strategic planning and implementing operational costs, attracting investments and introducing innovations.

## 1. Competitiveness of the private sector

Georgia has great potential in terms of development and increased competitiveness—potential which could be achieved by overcoming the barriers which currently hinder the growth of competition and by taking into consideration the country’s current potential for prospective development. The high rates of economic growth which would benefit the wider population will be achieved by competitive private sector.

On average, the Georgian economy grew by 6 percent annually between 2004 and 2012. This rate was the result of a wave of reforms aimed at liberalizing the country’s economy, but these reforms were not, however, sufficient to increase overall productivity along with private sector competitiveness, and were therefore unable to stimulate long-term economic growth.

Compared to other sectors of the economy, Georgia’s industrial sector saw the least growth in terms of productivity, and the latter sector’s level of development and export potential remain low. Exports are not diversified, their added value is low and new market penetration and expansion rates are weak. All these factors have resulted in the very low rates of growth in terms of employment, which clearly illustrate the fact that the competitiveness of the country’s economy and private sector (as its main driving force) remains weak.

The main goal of the “Georgia 2020” Strategy is to remove the barriers which impede the stable growth of productivity and correspondingly, competitiveness of the private sector.

EU-Georgia Association Agreement, whose integral part is Deep and Comprehensive Free Trade Area, aims at gradual economic integration of Georgia into EU’s internal market and creates new prospects for raising Georgia’s private sector competitiveness. This process envisages gradually bringing Georgia’s regulatory legislation and institutions closer to EU’s relevant regulations and systems. Correspondingly, Georgia’s goods and services will be able to enter EU’s internal market, the grounds for maximum realization of the country’s export potential will be formed, Georgia’s investment attractiveness will improve and new opportunities for attracting investments to the country will appear.

## Improvement of investment and business environment

### Current situation

Favorable entrepreneurial and investment environment has a great impact on productivity as it has a direct impact on the efficient distribution of resources in the private sector. Business requirements generally experience rapid change due to fierce global competition and dynamic economic processes and constant work is therefore needed to improve the entrepreneurial and investment environment.

Reforms aimed at liberalizing Georgia's economy were launched in 2004, resulting in the removal of bureaucratic barriers and reductions to the overall tax burden. According to the 2014 edition of the World Bank's *Doing Business* Report, Georgia has been one of the world's leading reformers for the past several years; the country currently holds the 8<sup>th</sup> place out of 185 in the "Doing Business" rating.

Despite this, however, serious problems remain in certain areas, which hinder long-term economic growth and improvement of the private sector's competitiveness. Ensuring free market competition is still a problem, and concerns remain in terms of bankruptcy regulation and the resolution of commercial disputes as well as various other issues relevant to doing business.

Existing difficulties generally worsen the entrepreneurial environment, reduce investor trust, and make effective mechanisms established in other areas less effective: Georgia, for example, holds the 1<sup>st</sup> place in the 2014 edition of the World Bank's *Doing Business* Report in terms of ease of property registration, but this achievement loses its importance if property rights are not properly observed and if disputes concerning property ownership are not resolved quickly.

Various international evaluations and reports indicate problems in the business and investment sectors. Georgia, for example, held the following places in the 2013-2014 edition of the World Economic Forum's *Global Competitiveness Report*:

- Protection of property rights—120<sup>th</sup> place;
- Efficiency of legal framework in settling disputes—92<sup>nd</sup> place;
- Effectiveness of anti-monopoly policy—138<sup>th</sup> place;
- Intensity of local competition—123<sup>rd</sup> place; and
- Extent of market dominance—119<sup>th</sup> place.

Improvements to the regulatory environment are also reflected in the 2014 edition of the World Bank's *Doing Business* Report, according to which Georgia has one of the best performances in the world, but improvements remain to be made in certain areas (e.g. issues concerning

bankruptcy and meeting creditor requirements). These weaknesses are in turn reflected in the *Doing Business* Report, according to which Georgia currently holds the following positions:

- Bankruptcy procedures—88<sup>st</sup> place; and
- Recovery rate—33.6 percent, whereas the average recovery rate in Eastern Europe and Central Asia is 37.1 percent and 70.6 percent in OECD member countries.

The Government of Georgia must take active steps to eradicate existing deficiencies and sustain an attractive business and investment environment over the long term. It should be noted that EU-Georgia Association Agreement opens up new opportunities for Georgia to attract investments.

In order to ensure attractive entrepreneurial and investment environment the implementation of various legislative and institutional changes is required, including efforts to strengthen the judiciary—particularly as a strong and independent judiciary is essential to efforts to improve the country’s business and investment environment, especially in terms of protecting property rights. The Government of Georgia will protect business from illegal interventions; in that regard, the Government’s goal is to eradicate existing deficiencies while preserving achieved results.

## **Policies that are to be implemented in order to improve the investment and business environment**

The Government of Georgia will ensure the transparency of public administration and guarantee equal opportunities in terms of starting and doing business for all; it will be the main guarantor of property rights. At the same time, the Government will support strengthening the role of business ombudsman in terms of property rights protection and resolution of commercial disputes.

The Government of Georgia will also ensure the effective implementation of reforms through the formulation and adoption of relevant legislative initiatives and administrative improvements, which, in its turn, will support efforts to increase private sector’s competitiveness and to support inclusive economic growth.

The Government’s tax policy will further ensure the creation of an attractive and stable tax environment for the private sector and foreign investments as well as for launching and developing businesses. According to the provisions of the EU-Georgia DCFTA, Georgia’s customs legislation will be harmonized with EU regulations. Amendments to the Georgian Tax Code will

be minimized, which is in compliance with the obligations assumed by Georgia under EU-Georgia Association Agreement.

All main taxpayer obligations will be defined only through law. The country's tax administration will be simplified and sanctions will be optimized. Certain categories of economic crime will be decriminalized. Statutes of limitations under the Tax Code will gradually be reduced. Legal relations between the state and the private sector will be based upon principles of equality.

## **Strengthening the protection of property rights**

The protection of property rights is one of the stated priorities of the Government of Georgia. In order to strengthen the protection of these property rights, which is guaranteed under the Georgian Constitution, it is important to ensure the independence of the judiciary and to support the further professional development of judges. Improving existing mechanisms for the protection of intellectual rights is also important within the context of guaranteeing the protection of property rights.

## **Government support for development of entrepreneurship**

Supporting the business sector will facilitate improvement of competitiveness of products and services produced in Georgia. Legislative and institutional harmonization with EU under the EU-Georgian Association Agreement implies meeting EU requirements and norms when carrying out business activities. Therefore, the Government will inform business sector on the steps that are to be taken under the Agreement and on other EU requirements. Besides, the state will elaborate efficient mechanisms for supporting business, especially small and medium businesses, with a view to decreasing costs associated with meeting the regulations and increase their competitiveness.

Strengthening the business competitiveness depends on development/enhancement of entrepreneurial skills. Therefore, one of the main directions of work for legal entity of public law Entrepreneurship Development Agency will be development of entrepreneurial skills of the startup and small businesses' representatives.

Emphasis will be made on enhancing entrepreneurial skills of pupils and students studying in educational institutions, especially in vocational training schools/centers.

## **Strengthening mechanisms for the efficient resolution of commercial disputes**

Strengthening the competences and capabilities of the courts in terms of resolving commercial disputes is important for the efficient functioning of the private sector and its increased competitiveness. The Government will facilitate the development of Alternative Dispute Resolution (ADR) arbitration courts in accordance with international best practices; this will increase the competence of arbitrators and ensure the independence of arbitration courts.

## **Improving investment legislation**

Georgia's current investment legislation is outdated and disconnected from reality; moreover, the existing norms are scattered among several normative acts and they fail to properly reflect investors' rights and guarantees as well as activities that are needed for encouraging investments. The Government will therefore ensure replacement of the existing investment legislation with a new legislation which will correspond with international norms and best practices.

## **Improving legislative and institutional mechanisms for free market competition**

The Government of Georgia will improve legislative and institutional mechanisms for ensuring free trade and competition, and will introduce best European practices in accordance with the provisions of the EU-Georgia Association Agreement. Competition legislation will be based on effective norms and enforcement mechanisms for eradicating cartel transactions, agreements limiting competition and efforts to abuse dominant market positions. Competition legislation must, however, also avoid raising artificial barriers to growth and development of companies.

In order to facilitate creation of competitive environment in the country, Government will encourage further strengthening of the judiciary with a view to improving the knowledge of judges in terms of fair resolution of competition disputes and pertaining issues.

## **Improving mechanisms for the regulation of bankruptcy and the closing of businesses**

The ease with which a business can be closed is as important as that with which it can be opened in terms of facilitating effective functioning and competitiveness of business. The ease with which businesses can be shut down is also very important as it increases the ease with which

companies can move from low productivity areas to more efficient ones, which, in its turn, encourages company growth and increases private sector competitiveness. The Government will ensure the streamlining of legislation and enforcement mechanisms connected with closing businesses as part of efforts to further simplify administrative procedures concerning business activities. Legislation and relevant enforcement mechanisms for raising the recovery rate during bankruptcy procedures will also be improved.

## **Improving public services and enhancing the transparency of public administration**

Improving access to public services as well as reducing the potential amount of time spent during administrative procedures is important for the effective functioning of businesses. To that end, Government will improve services rendered by state institutions, which also implies development of electronic services and expansion of e-governance system. Georgia currently holds the 72<sup>nd</sup> place in the UN “E-Governance Index”.

Access to public information will be improved, and dialogue between the state and the private sector will be intensified with a view to improving transparency—which, in its turn, should ensure the greater involvement of businesses in the formulation of economic policies. In this regard, best practices of co-operation between the state and the business sector will be shared and implemented.

## **Ensuring flexible regulations**

The goal of the state is to create regulations which will facilitate the development of free-market entrepreneurship in the country; current and future regulations should not limit business activities by creating additional burdens, to that end, the Government will improve Regulatory Impact Assessment system, whose goal is to evaluate the impact of existing and new legislative acts on the country’s business environment.

## **Expected results**

Taking the above-mentioned steps should significantly improve the country’s business and investment environment, which will lead to the opening of new businesses, the expansion and diversification of existing enterprises, an increase in foreign investment, increased productivity

rates, and improvements in the country’s standings in relevant international ratings and evaluations.

### Targets for improving Georgia’s investment and business environment

Target	Baseline*	2017	2020
Total investments (% of GDP)	24	30	35
GCR (Georgia’s rank)	72	58	40
Regulatory quality (WGI) (points)	0.68	0.72	0.78

\* Most recent available measure.

## Innovation and technologies

### Current situation

Goods produced in Georgia score low in added value. At this stage, only the processing industry is relatively developed. This is directly linked to the country’s natural resources and local agricultural production. The major reason for these patterns is the low level of technological development and innovation, which, at the same time, causes irrational use of natural resources and jeopardizes the country’s natural wealth.

Both government and private sector spending on research and development remain low, which is reflected in various international evaluations and ratings: the 2013 edition of the Global Innovation Index (GII) ranks Georgia 73<sup>rd</sup>, the 2012 edition of the Innovations Capacity Index (ICI) ranks Georgia 44<sup>th</sup> (out of 131 countries), and the 2013-2014 edition of the World Economic Forum’s “Global Competitiveness Index” (GCI) ranks Georgia in the following positions (out of 148 countries surveyed):

- Capacity for innovation—118<sup>th</sup>; and
- Company spending on R&D—128<sup>th</sup>.

Both Georgia's access to the latest technologies and overall level of technological development remain low: according to the GCI, Georgia holds the following positions:

- Availability of latest technologies—100<sup>th</sup>; and
- Firm-level technology absorption—117<sup>th</sup>.

Levels of protection of intellectual property—a major factor in the implementation of innovations—are also unsatisfactory: Georgia currently holds the 124<sup>th</sup> place in terms of protection of intellectual property.

Despite the fact that significant steps have been taken in recent years to improve access to the internet, the Georgian population's level of use of this means of communication remains unsatisfactory: here Georgia holds relatively better but still unsatisfactory positions in the above-mentioned 2013-2014 edition of the GCI:

- Individuals using the internet (%)—71<sup>st</sup>; and
- Broadband internet subscriptions (per 100 pop.)—65<sup>th</sup>.

Finally, the World Economic Forum's "Networked Readiness Index" (NRI) ranks Georgia in 65<sup>th</sup> place.

## **Policies aimed at raising the level of innovation and technological sophistication**

The main goal of state policies as far as innovation and technological sophistication are concerned is to facilitate the transfer and introduction of innovative activities and modern technologies both at the national and regional levels. The state will facilitate the introduction of environmentally-friendly modern technologies and development of a "green" economy.

The Government will select and support certain innovative industrial projects with special (accompanying) social-economic effects.

During the project implementation the Government of Georgia will be guided by the principles of innovation, experimentation and sustainability, transparency and clear success criteria as well as public and private partnership.

## **Improving access to funding for research and development and the facilitation of its commercialization**

The Government will facilitate research and development with a view to developing the private sector and improve competitiveness; this implies supporting applied research by increasing state funding and introducing various instruments to do so. The Government will also improve access to funding—especially for SMEs, which are the drivers of innovation. To that end, the Government will work on building the capacity of Innovations and Technologies Agency.

In order to commercialize research and development, connections between the private sector and the educational system, science and technologies systems will also be deepened with a view to introducing applied R&D in practice and improve the efficiency of its commercialization.

## **Developing infrastructure needed for innovation**

The Government will facilitate the development of relevant infrastructure such as industrial parks, incubators, regional development agencies and innovation centers; it will also facilitate: the training of workforce that has adequate qualification, improvement of auxiliary infrastructure needed for R&D in tertiary education and scientific establishments as well as research laboratories and integration of R&D processes in tertiary education system. A unified system for monitoring the research activities in tertiary education and scientific-research establishments and result-oriented funding models will be launched.

## **Strengthening the protection of intellectual property**

Protecting intellectual property is especially important for innovation; to that end, the Government of Georgia will strengthen the legislative and institutional framework relevant to the protection of intellectual property and will introduce best practices in accordance with the EU-Georgia Association Agreement.

## **Facilitating the broad use of information and communication technologies in the economy**

Facilitating the broad use of information and communication technologies is important both for the population and for raising private sector competitiveness; in order to achieve this, the

Government will support measures to improve the country’s telecommunications infrastructure. Besides, access to internet and information and communication technologies will be ensured all over the country.

### Attracting Foreign Direct Investments oriented towards modern technologies

With a view to developing innovation and modern technologies, the Government will encourage FDIs oriented towards the introduction of new technologies—especially environmentally-friendly and resource-saving technologies which will encourage the development of a “green” economy.

### Expected results

Some of the most important results of state policy implemented by Government in innovations and technologies area will be improvement of knowledge transfer and technological absorption by Georgian firms, establishment of connections between scientific and business circles, existence of satisfactory level of innovations, which results in improved competitiveness of local production and orienting Georgian exports towards more high-tech products.

#### Targets for the development of innovation and technologies

Target	Baseline	2017	2020
Knowledge Economy Index ranking	68	55	45
Global Innovation Index	73	65	60
TFP (annual, %)	2.70	3.00	3.20
Innovation Capacity Index	44	40	36
Global IT Index	65	58	50

## Supporting the export growth

### Current situation

Georgia's exports increased 4.5 times between 2004 and 2013, yet despite such impressive growth, the diversification of exports remains low both in terms of the countries Georgia exports to as well as in terms of the products it exports. In recent years, Georgian products have penetrated new markets, and the export of services has seen significant growth. Between 2010 and 2013, Georgia's most exported commodities were vehicles (mainly re-exports), Ferro-alloys, copper ore, mineral water, fertilizers and some other agricultural products.

Raw materials currently dominate the country's exports. Both the rate of market diversification and that of new market penetration by concrete products remain low.

The implementation of its obligations under the EU-Georgia Association Agreement by Georgia is important for increasing its export potential and its integration with European markets. This will facilitate penetration of EU markets by Georgian export goods and gaining foothold in those markets. Besides, this will also move trade-economic relations between Georgia and EU to a new level. At the same time, raising private sector's awareness about the actions that are to be taken under the Agreement is also important.

Deepening trade-economic links with the United States under the US-Georgia Charter on Strategic Partnership will be a priority; besides, emphasis will be made on launching negotiations on possible free trade agreement with the USA under the high level talks concerning trade and investments.

Full and effective use of free trade agreements with Georgia's trade partner countries and utilization of regional markets is of utmost importance, reduction of artificial barriers with trade partners is also crucial.

Problems concerning technological sophistication and innovation mentioned above are the main reason for low diversification, and are also partially responsible for existing difficulties in terms of access to new markets. Besides, several other factors are also impeding exports in terms of access to new markets: technical trade barriers render the effective use of existing preferential regimes impossible; the absence of infrastructure necessary for boosting exports causes a lack of awareness of potential export markets on Georgian products; better trade regimes are necessary for accessing certain markets and inadequate trade and logistical infrastructure increases the cost of exports.

## Policies aimed at increasing exports

Ultimately, export expansion and diversification is up to the private sector. Government can be an effective partner for businesses seeking to identify export markets and evaluate existing requirements. Government can deepen and develop international trade relations with existing and potential trade partners, protect the interests of national exporters in international markets, develop national quality infrastructure in accordance with international requirements and seek to reduce technical barriers to international trade. Government can also provide exporters with information on export markets and support the development of transport and logistical infrastructure.

## Reducing technical barriers to trade

The Government of Georgia will work to reduce remaining technical barriers to trade in order to facilitate export development and integration with international and European markets and to increase the competitiveness of Georgian products and services; this will make Georgian legislation more compatible with European norms. In this context, national quality infrastructure will be developed and national quality institutions will be integrated with international and European systems. Georgia will also consistently meet the obligations it assumed under the EU-Georgia Association Agreement including the obligations concerning harmonization of metrology, standardization, accreditation, compliance evaluation, technical regulation and market supervision national systems with European systems.

Besides the above-mentioned actions, Government of Georgia will be actively cooperating with region's other countries and existing trade partners in order to resolve the problems concerning the access to neighboring countries' markets for Georgian entrepreneurs. To that end, a Center for Protecting Exporters' Interests has been formed, which will collect information on the problems that Georgian export-oriented entrepreneurs face in international trade.

## Facilitating agricultural exports

Government of Georgia will facilitate sector modernization and competitiveness. In order to increase the export potential of the country's agricultural products, food safety, the veterinary and phytosanitary systems will be developed in accordance with international and European norms through the gradual implementation of obligations assumed under EU-Georgia Association Agreement obligations.

With a view to meeting the obligations assumed under the EU-Georgia Association Agreement and increase benefits from other preferential trade regimes and to ensure the penetration and establishment of Georgian agricultural products in international markets, the Government of Georgia will introduce measures to increase the awareness of Georgian entrepreneurs of food safety, veterinary and phytosanitary issues; of the steps that are to be taken according to the EU-Georgia Association Agreement; of the requirements of international and European markets; and of relevant export procedures.

A geographical provenance certification scheme will also be expanded, and the further development of Georgian brands will be facilitated.

### **Creation of systems facilitating export development**

In order to increase the competitiveness of Georgian products and services and support their establishment in international markets, the Government of Georgia will support the creation of systems facilitating export development, which will raise entrepreneurs' awareness of Georgia's export products and export markets. In this context, a special role will be played by legal entity of public law – Entrepreneurship Development Agency, which will be working on strengthening the export potential. Legal entity of public law Entrepreneurship Development Agency will inform the entrepreneurs about potential export markets, requirements existing in those markets and supply international markets with information on products and services offered by Georgia.

### **Developing and deepening international trade relations**

In order to increase the export potential and competitiveness of Georgian products and services, the Government of Georgia will deepen co-operation with existing and potential trade partners in order to develop preferential trade regimes.

Besides, intensive work will continue with a view to starting negotiations with the United States on a free trade agreement and deepen trade links existing in the region. Government of Georgia will cooperate with neighboring countries in order to make sure that Georgian products don't encounter artificial barriers in foreign markets.

## Expected results

The main result of these efforts will be the increased role of exports in the process of development of Georgian economy, which means increased exports, greater product diversification and improved penetration and survival rates in new markets. Georgian business' integration in the competitive environment of international markets will increase production stimuli and correspondingly, it will facilitate exports of more value added products.

### Targets for export facilitation

Target	Baseline	2017	2020
Exports (goods and services) as percent of GDP	45	55	65
Share of goods exports in GDP (%)	18	22	30
Enabling Trade Index 2012	38	30	25

## Development of infrastructure and full use of transit potential

### Current situation

In recent years, important investments were directed towards the development of primary infrastructure in Georgia, which improved the country's transport and energy infrastructure as well as other main infrastructure systems. Georgia's infrastructure, however, is still not sufficiently developed to ensure the growth of its private sector's competitiveness and the maximum use of its transit potential. Besides, many capital costs incurred during recent years were not linked to infrastructural projects capable of yielding the best economic results.

Thanks to its geographical position, Georgia can potentially play an important regional role in terms of trade and international cargo shipments. In itself, this is an important and increasing source of revenue and a driver of economic growth, yet because of the small size of the Georgian market, the private sector must be widely involved in regional and international business

activities in order to ensure its competitiveness. A well-developed transport and logistical infrastructure is a very necessary precondition.

Despite Georgia's increasing transit capacity, the country's full potential remains largely untapped: compared to other alternative routes, the road from Europe to Asia and back via Georgia is indeed shorter, but only a small proportion of cargo between the two transits through Georgian territory.

Despite investments in road and railway infrastructure, the current capacity of Georgia's transport infrastructure is unable to handle more cargo; the cost of shipping and logistical services is not competitive, and Georgia has no logistical centers, which would meet modern requirements. Different procedures existing at neighboring countries' border crossings also decrease the Georgian route's competitiveness.

Georgia's export problems are reflected in international evaluations: the 2013-2014 edition of the World Economic Forum's Global Competitiveness Index ranked Georgia 103<sup>rd</sup> in terms of international distribution capacity; and the 2012 edition of the Logistics Performance Index ranked Georgia 77<sup>th</sup> among 155 countries.

In terms of infrastructure development, Georgia's level of agricultural infrastructure development remains a problem, despite the fact that it is of essential importance for increasing the productivity and competitiveness of the country's agricultural sector—both in terms of primary production of agricultural products and in terms of the processing industry associated with that sector. Irrigation and drainage infrastructure is also currently underdeveloped.

A stable and accessible energy supply is an important precondition for the private sector's competitiveness and development. Despite the fact that the current situation of Georgia's energy sector is not a major barrier to economic development, adequate policies are needed in order to ensure that energy does not become a future impediment as demand for electricity increases.

The volume of electricity currently generated in Georgia does not meet local demand, and the country has to import electricity every year. The amount of imported electricity and natural gas is quite significant, which pushes up the price of energy and energy production. Dependency on external sources also endangers the stability of supply.

Without increasing current rates of energy generation, the share of imports will increase along with demand. Meanwhile, the country's rich energy resources remain mostly unexploited. Georgia has around 300 rivers which could be harnessed to generate energy, with a total potential annual capacity of 15,000 megawatts; although the country's average annual energy potential equals 50 billion kilowatts per hour, 80 percent of this potential remains untapped.

Besides its hydro-electric potential, Georgia's potential in terms of wind power and solar energy generation is also quite significant. The country also has geothermal water resources which could decrease imports of expensive energy products; the efficient management of water resources is very important in terms of exploiting hydro-electric resources.

That said, due to its seasonal character, the exploitation of hydro-electric resources requires the maximum development of export markets for the exportation of surplus energy. Export options are, however, currently quite limited.

Besides reducing the amount of imported energy and making better use of local resources, problems of access to energy must also be resolved: technical difficulties in terms of energy distribution infrastructure currently cannot ensure a stable and quality supply of energy. The relatively complicated administrative procedures needed for establishing connections to energy distribution networks makes energy inaccessible. The high capital costs needed for expanding generation capacity are also reflected in end-user energy tariffs, an increase compounded by the lack of competition within the distribution market.

According to the 2013-2014 Global Competitiveness Report, Georgia ranks 52<sup>nd</sup> in terms of quality of energy supply, and according to the 2014 edition of the World Bank's *Doing Business* Report, Georgia ranks 54<sup>th</sup> in terms of access to electricity.

## **Policies aimed at developing infrastructure and the maximum realization of transit potential**

A well-developed transport, energy, logistical and agricultural infrastructure is one of the most important factors capable of increasing the country's competitiveness and realizing its full transit potential. Logistics, as one of the most rapidly developing sectors of the modern world, would enable Georgia to make maximum use of its transit and trade potential. Correspondingly, state policy will be directed towards developing this sector, including through the development of infrastructure, attracting investments to the sector and integrating the country with international and regional transport systems.

The main goal of the state policies implemented in the energy sector will be reducing energy imports and increasing energy independence, improving the investment environment and attracting foreign direct investment. Besides, the further improvement of regulatory mechanisms is also important, as doing so will attract investment to the energy sector and encourage its rapid development.

The importance of carrying out proper environmental impact assessments during the process of building and developing the country's infrastructure should be noted, as the results of such assessments must be taken into consideration in order to avoid damage to the environment.

### **Streamlining transport infrastructure and developing logistical centers**

The Government will facilitate the increasing development of transport system capacity (road, roadside, railway and port infrastructure, the reconstruction of airports and the construction of cargo terminals, logistical centers, etc.) with a view to streamlining transport infrastructure and develop logistical centers. The completion of the East-West Highway and the Baku-Tbilisi-Kars railway line as well as the development of an international airport in Kutaisi (lengthening the runway and building cargo terminals) and the construction of a deep-water port in Anaklia are currently the country's biggest priorities.

The development of relevant infrastructure which will meet international standards as well as that of multimodal and intermodal shipping operations will be facilitated with a view to developing logistical centers.

Equally, the development of national and local road infrastructure is also important as a means of increasing volumes of internal shipping and tourism and stimulating the country's overall economic growth; the network of national and local roads must, however, meet international standards, and maintenance works must be carefully planned in order to ensure their long-term use.

### **Supporting investments in energy, transport and logistics; strengthening public-private partnerships**

The Government will encourage the mobilization of investments in transport and logistics (including through public-private partnerships) in order to develop energy sector, increase the country's transport capacity and to ensure relevant logistical support; the Government will also design and introduce mechanisms for providing financial support to priority energy, transport and logistical projects. Special attention will be paid to the investments, which will encourage production of higher value added products in the country.

## **Fostering a competitive environment and developing information systems**

The Government will facilitate the formation of a competitive transport environment with the aim of developing the country's transport system and increasing private-sector competitiveness; this process will also aim to ensure free market access for companies interested in providing transport services.

The Government will also introduce measures to develop Georgia's information systems and create a united transport statistics database. The development of electronic processing of transportation documentation and the active use of modern information technologies will also be encouraged.

Road infrastructure improved in accordance with international standards makes fast travel on the highways possible. In this context, systemic requirements will be elaborated and implemented, which, in its turn, will lead to elaboration of a new road safety strategy.

## **Integrating Georgia in regional and international transport systems**

The Government will facilitate the country's integration within international transport systems and will deepen regional co-operation in order to increase Georgia's competitiveness as a transit corridor. Maritime routes (including ferry links) will be developed in order to connect Georgian transit corridors with main trans-European transportation routes; the Government will also work on establishing "through" rates with neighboring countries at an intergovernmental level in order to support increased transit movements.

At the same time, measures envisaged by the EU-Georgia Association Agreement will also be carried out, and Georgian legislation will become more compatible with European norms in order to integrate Georgia within international and regional transport systems.

## **Development of agricultural infrastructure**

The Government of Georgia will work to develop the country's agricultural infrastructure, including irrigation and drainage systems, in order to increase the Georgian agricultural sector's competitiveness. Improving irrigation and drainage systems leads to better water use, creation/development of efficient systems (including drip irrigation, sprinkler irrigation, etc.) and farmers' increased access to these systems; besides, as a result of the above-mentioned

improvement, farmers will be supplied with modern technologies in order to increase their productivity and make optimal use of available resources.

The development of infrastructure for the processing and storage of agricultural products will be facilitated in order to increase the productivity and competitiveness of Georgian agriculture; alongside other measures, this will be done by attracting investments in this area, with these efforts being expected to satisfy local demand and increase the country's export potential.

The Government of Georgia will also ensure the development of national and local road networks as well as other transport and communications infrastructure with a view to increasing regional and local development as well as the local competitiveness of the private sector.

### **Developing water supply, drainage and waste management systems**

Fully-functioning water supply and drainage systems and high-quality drinking water are very important in terms of developing basic infrastructure. The Government's goal is to supply the population with water 24 hours a day, to streamline water supply and drainage systems in all urban centers and towns, and to ensure their proper functioning and further improvement; the Government also aims to ensure that the system meets international standards.

In order to achieve the above-mentioned goal, Government of Georgia pays particular attention to the challenge of moving to European integrated water resources management model – River Basin Management Plans; the Government plans to establish adequate mechanisms for implementing consistent water management policies. River Basin Management model introduces a common management system for water resources (rivers, lakes, underground reserves etc.), which apart from streamlining water supply and drainage systems, facilitates efficient distribution of water resources among water users (for energy, irrigation, recreational and other uses).

The introduction of modern systems for solid waste management as well as the construction of new sanitary landfill sites and terminal stations in accordance with the EU's environmental and technical standards is equally important. In this regard, the Government of Georgia is drawing up plans for a number of new regional sanitary landfill sites and transfer stations and is working to identify appropriate sources of funding.

The creation of modern, environmentally-friendly landfill sites and other necessary infrastructure (transfer stations, sites for storing hazardous waste, etc.) is also necessary for the adoption of a national system for the efficient management of domestic waste landfill sites.

## **Improving energy independence**

In order to decrease Georgia's energy imports and increase its energy independence, the Government will facilitate energy projects (including strategic energy projects) through local and foreign investments. The Government will facilitate rational utilization of local energy resources taking into account possible environmental impact of each project.

## **Improving energy efficiency**

Energy efficiency will be enhanced and relevant legislative mechanisms will be drawn up in accordance with international and European norms in order to preserve the country's energy resources. The efficient use of energy is important as a means of increasing the country's energy independence and rational use of resources, and can potentially decrease future costs.

## **Building natural gas infrastructure/metering in regions**

Government of Georgia will continue building natural gas infrastructure in villages, introducing individual meters and building electricity infrastructure in villages that have no electricity. This will lead to lessened consumption of natural resources for heating/fuel and improved social conditions in the regions.

## **Facilitation of electricity exports**

Expanding Georgia's export market requires integrating the country with the European Energy Union and implementing Georgia's 2015 Electricity Market Model, which, in its turn, will create regional trade opportunities and facilitate increased competition.

Obligations assumed under the EU-Georgia Association Agreement will also be consistently implemented in order to carry out the institutional reform of the country's energy sector in accordance with modern European standards and introduce energy efficiency standards.

## Taking into consideration environmental impact of infrastructure projects

The environmental impact and negative impact of global warming on the country's economy must also be taken into consideration during the planning of infrastructure development.

Due to the fact that Georgia is one of the most sensitive places among the world's mountainous regions in terms of natural disasters, it's necessary to decrease the natural disaster risk, avoid loss of lives from such disasters and eradicate their negative results (damage to roads, bridges, industrial or residential premises and other infrastructure). To that end, Government of Georgia plans to introduce modern early warning systems, implement various measures and develop relevant infrastructure.

Besides national efforts, it will be necessary to attract environmental investments from international funds of UN Framework Convention on Climate Change (Green Climate Fund, Global Environment Protection Fund, etc.) in order to meet the requirements of the Convention; this will facilitate the process of introducing energy-saving, environmentally friendly modern technologies in Georgia.

Besides, the protection of forests and the introduction rational practices for their exploitation will significantly improve the population's socio-economic standing, particularly as the development of agriculture, hydro-electric power generation, tourism and other sectors of the economy is directly linked to the health of the country's forest ecosystems. The introduction of modern models of forest management and innovative technologies (taking into consideration the need to preserve forest biodiversity, its recreational, water regulatory and soil protection functions) will reduce the negative consequences of forest degradation and will increase economic benefits through the improvement of forest ecosystem services.

## Expected results

The ultimate goal of the state policy will be the transformation of Georgia into a regional leader in terms of transportation and logistics. Transportation rates and turnover as well as amount of processed cargo will increase, which, in turn, will increase the competitiveness of the private sector.

The implementation of policies aimed at developing Georgia's agricultural infrastructure will increase the productivity of both primary agricultural production and the associated processing industry, as well as that of both farms themselves and agricultural products as a whole.

Modern systems of water supply and solid waste management will be developed throughout Georgia.

As a result of the implementation of these policies, the amount of energy generated in Georgia will increase, which will in turn decrease energy imports and improve the country's energy independence. Environmental impact will be taken into consideration during this process. As the amount of energy generated in Georgia increases, energy exports are expected to rise and export markets to be further diversified. Besides, this will foster a competitive environment and will simplify the process of connecting to energy sources.

### Targets for infrastructure development and maximum utilization of transit potential

Target	Baseline	2017	2020
Total annual production of electricity (in TW* <sup>h</sup> )	9.7	12.0	14.0
Access to electricity ( <i>Doing Business rank</i> )	50	45	35
Logistics Performance Index (score)	2.77	3.1	3.3
Roads, percentage surfaced	39	42	45

## 2. Development of human resources

The development of human resources and the efficient use of existing potential are two of the most important factors contributing to comprehensive economic growth.

Fast economic growth is an important precondition for increasing population's welfare and reducing poverty. At the same time, creation of equal opportunities for developing human capital through provision of quality services, social justice and strengthening the social systems is necessary as it provides access to quality education and healthcare systems.

Inclusive economic growth facilitates creation of employment opportunities. At the same time, important investments in human resources development are necessary. Current unemployment rates demonstrate the necessity of developing the human resources. Policies should be directed

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\*Trillion watts

towards capacity building in human resources, it especially concerns youth, individuals with inadequate qualifications and persons that face the danger of discrimination in the labor market (handicapped people etc.). At the same time, in order to receive qualified academic and technical workforce in the long-term period, it's necessary to improve the quality of education and access to quality education systems.

The present Strategy includes three main directions for developing human resources; they require active reforms from Government. These directions are: Ensuring workforce relevance to labor market requirements, tightening the social security net and ensuring the accessible and quality health care and education systems.

Formation of quality and accessible education system at all levels of education (general, vocational and tertiary) is a priority for the Government of Georgia.

Education is a fundamental factor of development and achieving sustainable economic development is impossible without investments in human capital. Only under strong and socially fair educational system can the existing social, cultural and economic challenges be overcome.

## Development of workforce that meets labor market requirements

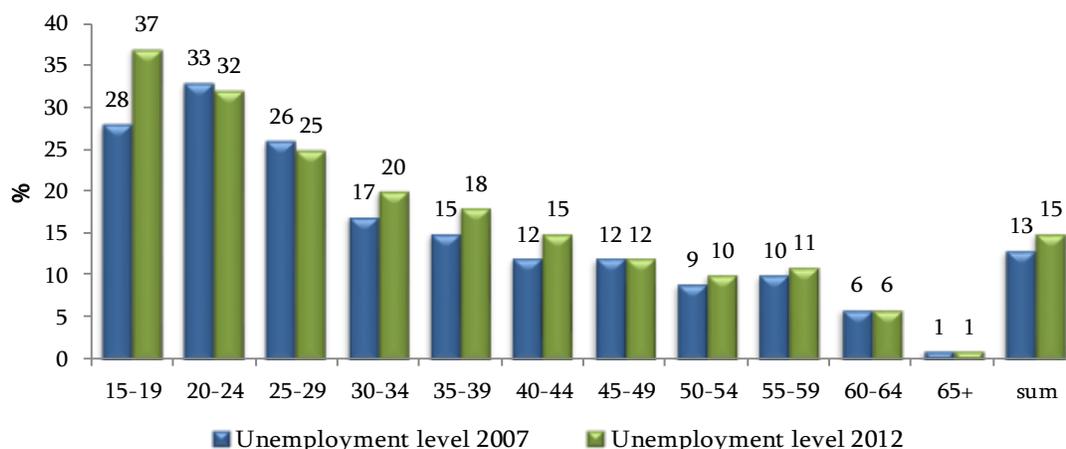
### Current situation

Job creation and measures to increase workforce relevance to labor market requirements are important factors which contribute to comprehensive economic growth. Better employment opportunities will lay a solid foundation for improving the living standards for all Georgians. Job creation and the full involvement of the country's workforce in comprehensive economic growth are much more effective at overcoming poverty than the simple provision of social assistance.

The business environment reforms of the mid-2000s were accompanied by rising investment levels, yet the boom barely affected employment opportunities. Unemployment rates rose from

13.3 percent in 2007 to 16.5 percent in 2008; by 2012, the rate had dropped to 15 percent. Over the same period, however, youth unemployment (15-19 age group) rose from 27.7 (2007) to 36.9 (2012) percent. These rates are higher than those in many of the ECA countries. At 28 percent, unemployment remains high in Georgia's urban areas, and Georgia's workforce lacks employment opportunities, especially in the younger age groups.

**Figure 7. Unemployment rates by age groups (2007-2012)**

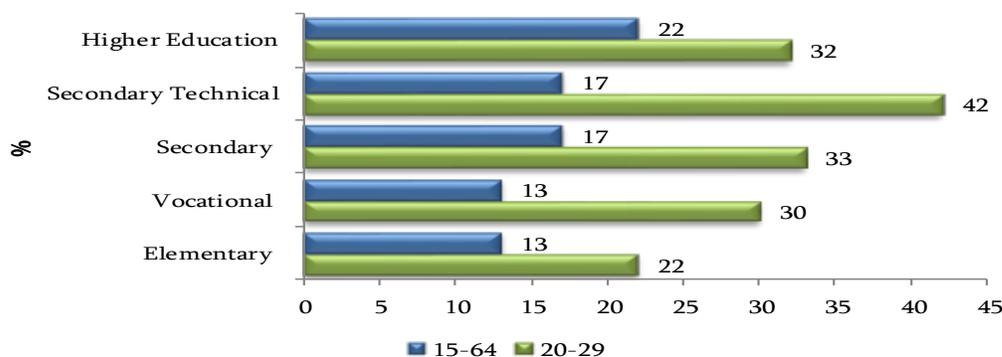


Source: GeoStat

Two-thirds (67.1 percent) of the unemployed in Georgia have been without work for more than a year, which reduces employment opportunities even further. According to the 2013 World Bank Report, employment rates are quite low due to long-term unemployment.<sup>1</sup>

One of the main problems is the mismatch between the skills available and those required by the labor market. There are many people whose qualification is less in demand on the labor market. At the same time, the proportion of the country’s workforce with relevant vocational training is too small to fill positions requiring professional qualifications.

**Figure 8: Unemployment rates by level of education (2010)**



Source: World Bank, based upon the 2010 Household Budget Survey

<sup>1</sup> World Bank, *Georgia: Skills Mismatch and Unemployment, Labor Market Challenges*, March 2013, p. 2.

Unemployment rates by level of education (figure 8) reveal that the higher the education level is the more obvious the unemployment problem becomes. This shows that education system fails to meet the modern challenges. The fact that there is no difference between the unemployment rates among people with vocational and elementary education clearly demonstrates the flaws existing in vocational education system. Moreover, the unemployment rate among young people with vocational training is 8 percent higher than unemployment rate of young people with only elementary education. These data (along with other factors) show that there is no coordination between qualifications required of the workforce and qualifications provided by the educational system.

The quality of education is also a problem in Georgia's general educational system. In the OECD's 2009 Programme for International Student Assessment (PISA), Georgian students scored below the OECD average. Only 38 percent of students are proficient in terms of reading literacy at or above the threshold set for functional illiteracy, and a mere 31 percent are proficient in mathematics at or above the threshold.

According to the 2013-2014 Global Competitiveness Report, Georgia ranks 105<sup>th</sup> in terms of "quality of the educational system", and 130<sup>th</sup> in terms of "availability of research and training services".

The quality of pre-school education also influences the development of human resources: on average, only 46 percent of children go to kindergartens in Georgia; in the country's regions this rate fluctuates between 20 and 58 percent<sup>2</sup>, and is even lower in rural areas. Forming vision and system is very important in preschool education; besides, clear definition of institutional functions and responsibilities and use of comprehensive approach through improvement of standards, development of human resources, quality monitoring and infrastructure is also crucial. Resources used and decisions made in preschool education must ensure observance of principles of equal and even access.

Georgia's vocational training system also faces challenges: vocational training programmes struggle to meet labor market requirements, levels of public awareness of such programmes are low, and vocational training is still not regarded as being an equal or more attractive alternative to straightforward academic education. More specifically, vocational training in Georgia is generally not regarded as an income-generating or career-stimulating option.

Low level of spending on education is also a problem. Despite the fact that education spending has been rising in recent years, it still remains significantly behind average ECA levels. The

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<sup>2</sup> UN Children's Fund, *Comprehensive Strategy of Calculations and Financing of Early Age Education System in Georgia*, 2012.

physical infrastructure of education has suffered from the low levels of spending and individuals working in the system are poorly paid, which reduces motivation.

## **Policies to be implemented in order to develop workforce that meets labor market requirements**

Government policy in this area will be directed towards creating preconditions for the enhancement of employment opportunities in Georgia. The development of labor market infrastructure in particular will raise the awareness of those seeking work of existing and potential employment opportunities. Streamlining the general education system will also ensure the higher qualification of those preparing to enter the labor market. At the same time, improving vocational training programs will increase workforce qualifications, and will lead to the progressive eradication of the mismatch which currently hinders the labor market. Eventually, these actions will facilitate the development of human capital, which will speed up the country's comprehensive economic development.

## **Facilitating labor market development**

The goal of the state policy for labor market development is the eradication of the skills which currently hinders the labor market through the rational use of human resources, the facilitation of efficient employment, and efforts to increase workforce qualifications. The ultimate goal of the policy will be a consistent reduction of the country's rate of unemployment.

Several activities are planned in order to support the effective functioning of the labor market: Labor market research will be institutionalized and a labor market database will be formed/developed; effective communication between employers and jobseekers will be ensured; state and private mediation services will be developed; a streamlined system for training or retraining the unemployed and jobseekers will be created (supporting uninterrupted education); policies corresponding to labor migration processes will be drawn up and implemented, taking into consideration the current situation of the labor market; and programmes for self-employment and entrepreneurial activities will be launched.

In the process of labor market development not only it is important to provide the employed with jobs, but also ensure firm protection of their rights and provision of adequate remuneration for their services in order to ensure their normal living standards.

To that end, Government of Georgia will work on farther improvement and harmonization of labor and employment legislation with European standards. Besides, taking into consideration the existing conditions, the Government will create institutional mechanisms for monitoring the observance of labor rights in accordance with European practices, which will protect the employed individuals' right to have safe and adequate work environment and work conditions; at the same time, the Government will supervise observance of other rights stipulated by law.

Implementing relevant state policies in connection with labor migration processes is also important in terms of labor market development. Government of Georgia will define and protect the labor rights of the migrants.

Government will facilitate social partnership and social dialogue, which implies cooperation between the state, employers and the employed and elaboration of forms of cooperation between the parties through the above-mentioned partnership and dialogue. Each employed will be provided with dignified work conditions while the interests of the employers will be taken into account. Such mutually acceptable cooperation, which will be facilitated and guaranteed by the state, will strengthen social peace and stability of economic processes in the country.

## Improving the quality of general education

Improving accessibility to high-quality general education is one of the Government's main priorities. In order to improve the quality of general education, the education system must be based on modern, scientifically proven vision and concepts. The system's activities will be planned and implemented in accordance with that common vision: education sectors will be harmonized and access to uninterrupted education will be ensured (preschool-general-vocational-tertiary education during the whole life), training programs will be improved and developed, teachers' corps will be strengthened through their professional development, increasing their motivation and attracting new professionals to the system, the physical infrastructure of schools will be upgraded and developed, all of which requires effective financing mechanisms. One of the priorities will be preschool education sector, which will be improved through strengthening preschool children's readiness for school, increasing access to kindergartens and developing their quality.

The activities that the Government intends to carry out include: developing and introducing modern methods for the professional and career development of teachers in accordance with scientifically proven comprehensive vision of the education sector; designing "motivation packages" according to development levels and programmes aimed at raising the qualifications of

teachers; revising the existing national curriculum and introducing relevant amendments with a view to increasing the competitiveness of human resources; taking into consideration labor market requirements during educational process, especially as far as teaching mathematics, natural sciences, information and communication technologies and foreign languages is concerned; monitoring of introduction of national curriculum and carrying out researches in order to strengthen the efficiency of children-oriented system; introduction of teachers' evaluation system and development of quality of teaching with a view to improving transparency and accountability; facilitating the introduction and development of new methods of learning; creating psychological centers in order to increase the safety of schools and provide psychosocial services to pupils with behavioral or emotional problems and their families; introducing career guidance and planning programmes in schools; and improving the inclusiveness of education in order to improve its accessibility for people with special needs and overcome their education and employment problems.

### **Developing vocational education and training**

Vocational training reforms will be carried out in the following ways: the regulatory environment governing the vocational education system will be improved, increasing the capacity of professional training establishments in accordance with the requirements of the labor market and a modern economy; market-oriented professional standards and flexible training programmes will be drawn up; an optimal vocational training network will be established which will be accessible in terms of both geographic location and educational programmes and disciplines; effective financing mechanisms will be established, which will encourage the improvement of the quality of teaching through increases competitiveness; full access to diverse vocational training programmes will be ensured for all social groups; vocational teachers and instructors will be trained or retrained in accordance with modern standards and requirements; mechanisms for supporting the employment of graduates will be reinforced; and high-quality career planning and career-guidance systems will be established.

### **Facilitating the development of tertiary education sector**

Development of a strong tertiary education system and science is one of the priorities for the Government of Georgia. Higher educational institutions form knowledge-based society and facilitate individual and public welfare. Tertiary education system must provide education of European standards, constantly work on improving its quality and obtain international trust,

prepare competitive youth for local and international labor markets. In order to create competitive human capital in the country, expansion of access to higher education and creation of effective financing mechanisms is very important.

The steps that the Government of Georgia plans to take include: ensuring autonomy and academic freedom; creation of transparent mechanisms for improving the efficiency of higher educational institutions' leadership and attracting qualified academic and supporting staff; creation of programs for developing academic personnel and facilitating their educational and scientific activities; equipping higher educational institutions with modern educational and scientific infrastructure and technologies; establishment of relevant (inclusive) learning environment for students with special learning needs in the universities; improvement of external mechanisms, authorization and accreditation that are used for quality assurance in educational institutions; development/introduction of mechanisms for improving internal quality in higher educational institutions; effective integration of learning and research and development of research culture in higher educational institutions.

A common informational-analytical system will be introduced with a view to evaluating the efficiency of tertiary education system.

With a view to improving learning and research quality internationalization component will be strengthened in education management model, legislative barriers will be removed in order to ensure students' and academic personnel's mobility. International involvement in accreditation of curricula will be enhanced, international collegiate evaluation system will be used for evaluating the results of research activities, Georgia will be more involved in relevant instruments and programs under EU-Georgia Association Agreement.

Tertiary education and science funding model will be improved in order to create guarantees for long-term strategic development of higher educational institutions and encourage stable development of certain directions.

The state will facilitate formation of a common space for education and research through improving doctor's degree level and streamlining legislation, which regulates integration of learning and research in tertiary education system.

## Expected results

As a result of the above-mentioned activities, the quality and accessibility of education will be enhanced, and the competitiveness of human resources will be increased. Employment

opportunities will also be improved as a result of the eradication of the skills mismatch which currently hinders the labor market. The development of human resources as a production factor is equally important for achieving the Strategy's targets.

In addition, the creation of employment opportunities for Georgia's labor workforce will encourage comprehensive economic growth. Ensuring better opportunities for every individual is both an economic necessity and the Government's social obligation.

### Targets for developing workforce that meets the labor market requirements

Target	Baseline	2017	2020
Unemployment rate (%)	15	13	<12
Enrollment in pre-school education (%)	46	60	80
Enrollment in vocational education courses (%)	2.5	5	10

## Improving the social assistance system

### Current situation

The further improvement of Georgia's social security net for vulnerable groups is important as a means of increasing the competitiveness of the country's human resources. Currently, Georgia's social protection system combines two components: Targeted Social Assistance (TSA) to help households below the poverty threshold, and a basic pension system.

Georgia's social security net was created in 2004 and the TSA programme was introduced in 2006; it provides financial assistance to poor and vulnerable households, and was designed to replace a range of category-benefits for groups such as single pensioners, orphans, disabled children, the blind, and large families. Despite the reduction of relative poverty between 2009 and 2011, which was partially the result of the introduction of the TSA programme, around a fifth of all Georgian households (21.8 percent) and a quarter of the country's children (25.2

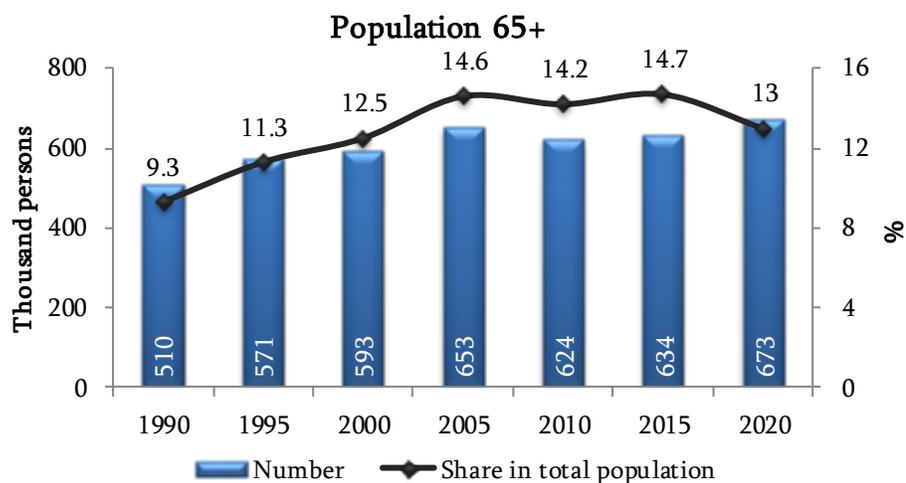
percent) remained below the relative poverty line<sup>3</sup>. At around 0.41 during recent years, Georgia's Gini coefficient is high.

According to 2013 data, around 1.7 million individuals were registered in the TSA database (around 40 percent of the country's population), 443,000 of whom benefited from the TSA programme. TSA coverage extends to around 10 percent of the population. The total 2012 budget outlay for these benefits amounted to roughly GEL 141 million (or 0.7 percent of GDP). Despite measures taken so far, the socio-economic methodology used to evaluate households needs to be improved in order to increase the efficiency of the TSA programme.

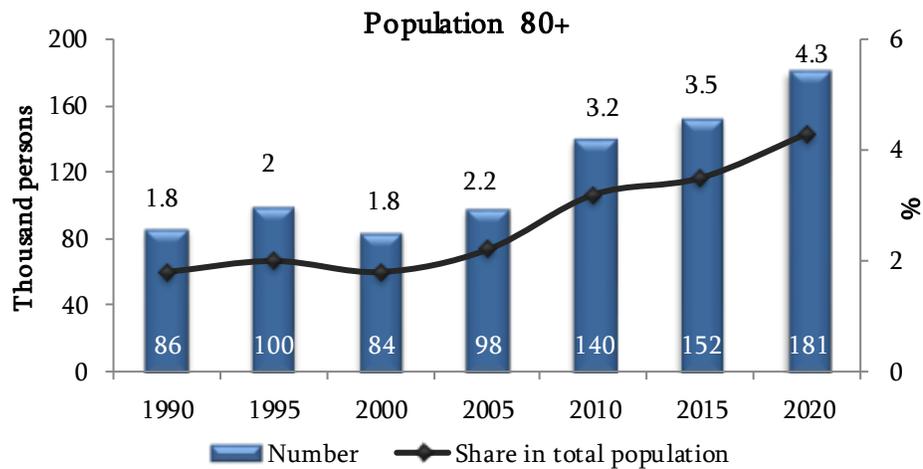
In July 2013, the Government doubled spending on social allowances by increasing benefits from GEL 30 to GEL 60 per month, in addition to GEL 48 for each additional household member (formerly GEL 24 per month). This amounted to an additional GEL 71.5 million in 2013 (full-year cost GEL 213 million or 0.5 percent of GDP).

Old-age pensions are the main form of social protection extended to senior citizens. Once they reach the age of 65 (men) or 60 (women), all Georgian citizens are entitled to receive pensions. Old-age pensions were increased to GEL 150 monthly in September 2013 (compared to GEL 115 in 2010). The total number of beneficiaries is currently around 684,000, or 15 percent of the total population. Yearly expenditures on pensions amount to around GEL 1 billion.

**Figure 9: Projected population of Georgia**



<sup>3</sup> UN Children's Fund, *Georgia: Reduction of Children Poverty*, discussion document, 2012



*Source: UN, Population forecast*

The number of pensioners in Georgia is increasing (according to UN projections, old-age pensioners will represent 25 percent of the Georgian population by 2050); the Government's social expenditures will be constantly increasing. A gradual transition to a pension savings scheme is therefore necessary, as doing so would, in its turn, decrease the financial pressures caused by unsustainable increases in basic pensions.

### **Policies to be implemented with a view to improving the social protection system**

Government's policy in social welfare sector is directed to ensuring dignified living and work conditions for people through creating social protection system, decreasing social risks associated with poverty and old age and enabling the disabled and other vulnerable groups to participate in the country's social and economic life.

## TSA benefits

The methodology by which the socio-economic situation of households is evaluated will be improved with a view to improving the purposefulness of the TSA programme; the administration of TSA will also be streamlined, and social information management systems will be strengthened. These actions will also increase the efficiency of social benefits.

## Future pension benefit increases

Gradual transition to a pension savings scheme will be facilitated with a view to increasing the efficiency of the pension system. In addition, economic growth is a precondition for gradually increasing basic pensions, which will improve the social standing of pensioners.

## Expected results

By taking the above-mentioned steps, the Government will ensure that at least 80 percent of the households in the poorest decile of the population will be covered by the TSA program and that at least half of the households in the second decile will also be included in the program. Besides, universal basic pensions will also be preserved and gradual transition to pension savings system will be effected.

### Targets for the improvement of the social welfare system

Targets	Baseline	2017	2020
Coverage of the poorest decile by TSA	50	60	80
Population below 60% of median consumption	22.4	20	18
Population below 40% of median consumption	9.3	8	5
Population living below the poverty line (percentage)	9.7	8.5	6
Gini coefficient	0.41	0.38	0.35

## Ensuring the accessible and quality healthcare

### Current situation

The accessibility of medical services and the eradication of inequality in terms of the quality of care itself are significant factors in terms of the inclusiveness of the country's development. Morbidity, mortality and disability cause significant losses in terms of productivity and economic development in general.

Despite the fact that the overall health and life expectancy of mothers and children have improved in Georgia over the past two decades, the country's healthcare outcomes remain alarming: both the morbidity and the mortality rates<sup>4</sup> were still much higher than similar rates in developed European countries; these data indicate the presence of systemic problems in the country's healthcare system, and call for immediate Government intervention.

The Government's main priority is to improve the general population's access to as well as the quality of medical care. This was made clear by the fact that the Government almost doubled spending on health care in 2013 compared to the previous year (from GEL 365 million to GEL 635 million)<sup>5</sup>; a universal health insurance scheme was also launched in February 2013. As of April 2014 all of Georgia's citizens are provided with basic medical care, including 560,000 people benefiting from State Medical Insurance. Government of Georgia provides about 3.4 million people with Universal Healthcare Program and up to 546,000 people are covered by private or corporate medical insurance.

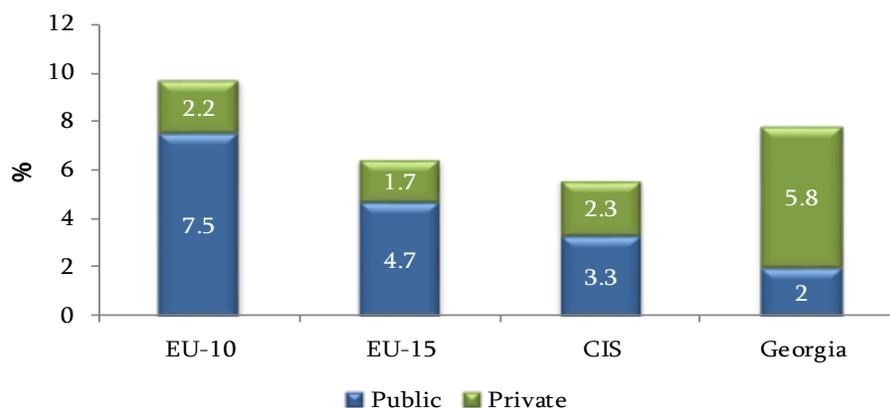
One of the Universal Medical Insurance scheme's main goals was to reduce extremely high out-of-pocket healthcare expenses. According to 2010 data<sup>6</sup>, total public healthcare expenditures amounted to 9 percent of GDP, and out-of-pocket expenditure by households roughly equaled 70 percent of total expenditure on healthcare. At 2.1, the number of outpatient contacts per capita is still low in Georgia (compared to the EU - 7.6 and the CIS - 8.6). Due to high costs, self-treatment is the main option for 44.3 percent of Georgians suffering from an illness. Only 8 percent of Georgians admitted to having visited a family doctor in case of illness, compared to over 40 percent in Moldova, Russia, Tajikistan and Uzbekistan.

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<sup>4</sup> The infantile mortality rate in 2012 (12 per 1,000 live births) was much higher than the rates in developed European countries (7 per 1,000 live births).

<sup>5</sup> Law of Georgia on 2013 State Budget.

<sup>6</sup> Health and Expenditure Survey, 2010

**Figure 10. Public and household spending on healthcare**

*Source: World Health Organization*

It should be noted that households in Georgia spend two-thirds of their out-of-pocket healthcare expenses on purchasing medicines. Georgians spend in excess of 3 percent of GDP on medicines annually, which is twice the OECD average. The contributing factors to such high expenditure on pharmaceutical products include a preference for originator brands (OB) over less onerous generic drugs (GD), the irrational prescription practices of many doctors, and, most importantly, the high prevalence of self-treatment.

Besides high costs, the quality of care is another long-standing concern in Georgia's healthcare system. The mass privatization and marketization of medical establishments (less than 10 percent of all medical establishments remain in public ownership) was not counterbalanced by appropriate regulatory mechanisms designed to protect the patients' right to receive high-quality medical services or efficient systemic measures to monitor the quality of healthcare in clinics.

Georgia has not established well-tested methods of quality assurance such as accreditation, and its current quality assurance mechanisms require serious reform in terms of infrastructure and human resources. The dearth of qualified human resources and their uneven geographic distribution also remains a significant barrier to establishing high-quality medical services.

In conclusion, two major factors responsible for Georgia's low healthcare outcomes, low quality of medical care and 'impoverishing' out-of-pocket payments can be identified:

1. Shortcomings in the country's healthcare funding system; and
2. The incorrect regulation of medical services.

## Policies to be implemented in order to improve the quality and accessibility of healthcare

The aim of policies to be implemented in this area is to increase the population's life expectancy and improve public health by decreasing household expenditure on healthcare (including impoverishing out-of-pocket payments) while preventing the main causes of morbidity and mortality through improving the quality of medical service and streamlining healthcare management system.

### Improving public healthcare spending systems

Household expenditure on medical services and medicines will be decreased by maintaining Universal Medical Insurance coverage and improving public health sector funding systems instead of increasing total public healthcare expenditure (which already accounted for 9 percent of GDP by 2011). This requires changing the ratio between public and private healthcare expenditure by shifting the burden towards the public sector.

In order to increase the efficiency of funding in the healthcare sector, a “united procurement mechanism” for procuring basic medical services will be launched.

Besides, the possibility of introducing an integrated financing system for medical services (diagnosis-linked groups) is also being considered, as this would increase the efficiency of public spending on healthcare. In order to improve the cost-effectiveness of public spending, plans are being drawn up to review vertical (specific disease-oriented) state programmes<sup>7</sup> so as to strengthen their integration within the Universal Healthcare Programme and focus financing on highly-efficient services for the population.

In order to facilitate inclusion, the country's healthcare infrastructure and the provision of existing medical services for particularly vulnerable groups and for people living in mountainous zones and near occupied territories will be further improved.

### Improving the quality of healthcare

Plans are being made to introduce a unified system of quality control in order to improve the quality of medical services rendered to the population, which, in turn, will increase the

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<sup>7</sup> More than 80% of health spending was directed towards Universal Medical Insurance and Medical Insurance Program in 2013. However, 130 million GEL was also allocated for the so called “vertical” state programs that are directed against such specific diseases as diabetes, tuberculosis, AIDS etc.

efficiency of healthcare expenditure. This implies: 1) improving mechanisms to regulate medical establishments, including the development of internal audit, licensing and permit conditions and accreditation mechanisms; 2) introduction of professional development system and relevant incentivizing mechanisms for increasing the motivation and qualification of medical personnel; 3) strengthening mechanisms for the protection of patient safety and rights through the creation of a system for managing medical mistakes and alternative mechanisms for dispute resolution; 4) the introduction and regular updating of clinical practice guidelines and protocols, taking into consideration new research and international practices. The goal of these reforms is to ensure that, by 2020, 70 percent of Georgia's medical institutions will be subject to a national accreditation system, and that the qualification of medical personnel will be raised through the further improvement of medical training and licensing mechanisms in accordance with international standards.

### **Increasing the affordability of pharmaceutical products**

The Government will increase the stringency of drug use regulations through the introduction of evidence-based clinical practice and by gradually limiting the list of over-the-counter medication. This will prevent the misuse of medication, the development of resistance to drugs, and contribute to the increased use of healthcare facilities.

Georgia's Ministry of Labor, Health and Social Affairs currently provides the general public with many free essential drugs (to treat diabetes, tuberculosis and HIV/AIDS, as well as medication used for dialysis, hemophilia and urgent and planned surgeries). The inclusion of essential medication for treating priority diseases (e.g. hypertension) into the basic healthcare package is also planned. Furthermore, the Government will also ensure the uninterrupted provision of essential medication (e.g. antiretroviral and tuberculosis medicines and vaccines) by unifying procurement or by introducing other mechanisms to improve cost-effectiveness.

### **Strengthening primary healthcare**

The Government will consolidate the role of family doctors (first entry-level) for better outpatient management. The establishment of more efficient contacts between primary and other levels of healthcare is also being considered in order to ensure the continuity of services and to eliminate waste in healthcare service provision. The Government will also improve mechanisms for the early detection and effective treatment and management of infectious diseases such as vaccine-resistant infections, tuberculosis, etc., as well as that of non-infectious

diseases (e.g. cardiovascular and oncological diseases) at primary-healthcare levels. Healthcare initiatives will also target alcohol and tobacco use, drug addiction and adynamia among children, young people and adults.

## Expected results

The ultimate aim of steps to be taken to reform Georgia's healthcare sector is to increase the population's life expectancy and improve its overall health. Georgia's population will also be more protected from high out-of-pocket payments and the consequent risk of impoverishment; access to high-quality medical services and medicines will be improved; the efficiency of public spending on healthcare will be increased through improved administration and by placing greater emphasis on preventive measures. These measures will have a positive impact on the country's human capital development, economic growth and poverty rates.

Target	Baseline	2017	2020
Coverage by medical insurance/universal health programme of the population, % (2012)	50	100	100
Share of OPP in total health spending, % (2011)	70	≤50	≤30
Share of pharmaceuticals in total OPP payments, % (2011)	60	≤40	≤20
Accredited in-patient medical facilities, %	0	50	70
Outpatient utilization (visit per person) (2012)	2.3	4	8
Life expectancy	74.7	74	76
Mortality among 0-5 year old children in 1,000 live births (2012)	12.4	10	8
Mortality among mothers per 100,000 live births (2012)	22.8	12.3	8

### 3. Access to finance

In order to achieve the goals set out in the present Strategy, the country's average annual real economic growth rate must equal 7 percent; in order to ensure this as well as growth in productivity, the annual investment growth rate should be 10 percent or more.

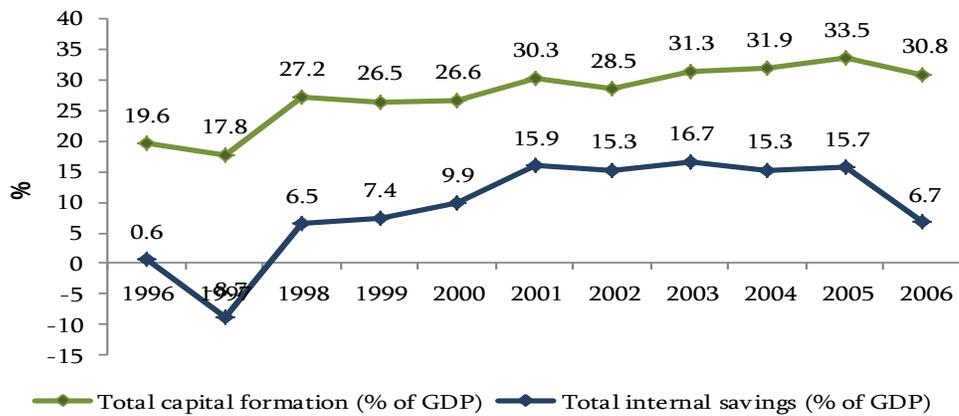
According to Global Competitiveness Report for 2013-2014, one of the factors impeding development of private sector in Georgia is limited access to finances. Similar results were shown in surveys carried out by other organizations (World Bank, International Finance Corporation).

Access to finance is crucial for business development, increased productivity, expansion of export areas and therefore achieving the necessary rate of investments in economy; however, there are two main barriers in this area: 1) National savings are low and insufficient for investments; 2) Financial intermediation is inefficient and despite the extra liquidity often present in the country it still fails to provide resources needed for stimulating the economy. Correspondingly, financial institutions and markets need to be developed taking into consideration legal, regulatory and institutional aspects.

### Mobilization of investment resources

#### Current situation

In order to achieve fast and sustainable economic growth rates, amount of investments made in Georgian economy must equal at least 30 percent of GDP every year; this can be achieved only through mobilizing domestic savings, attracting foreign investments and developing domestic financial markets. However, level of domestic savings and dynamics of total capital formation are not sufficient in terms of achieving the goals set out in the present Strategy. According to Global Competitiveness Report for 2013-2014, Georgia holds 98<sup>th</sup> place in gross national savings category and 126<sup>th</sup> place as far as access to financing through domestic capital markets is concerned. Moreover, according to current statistics, total savings account for about 10-15% of GDP. Bank deposits, which are one of the most important sources of savings, accounted for only 24% of GDP in 2012, whereas this indicator equaled 38% in Latvia, 41% in Moldova, 50% in Turkey, 56% in Estonia and 67% in the Czech Republic.

**Figure 11: Total capital formation and savings**

*Source: World Bank, World Development Indicators*

Besides, the problem is not only the low levels of domestic savings that are needed for investments, but also lack of access to finances available in local currency and lack of long-term credit resources. Access to finances in local currency and enhancing access to financing for small and medium enterprises (so that they can expand their activities) are important factors for developing entrepreneurship. Long-term financing is necessary for investment projects, which are directed at increasing firm productivity and export competitiveness as well as facilitating technological modernization.

Georgian financial markets must make both short and long term financing available and hence respond to the needs of enterprises of various types and development levels. Correspondingly, Social-Economic Development Strategy must facilitate development of relevant financial markets and instruments through strengthening legislation, regulations and institutions. At the same time, the Government will create necessary incentivizing and protection mechanisms for motivating investors and depositors; it will encourage the market development, decrease fiscal costs and avoid draining of private capital out of the country.

### **Policies to be implemented in order to mobilize investments**

The Government needs to implement measures aimed at increasing savings and facilitating the inflow of foreign capital. At the same time, important preconditions for increasing savings are

macroeconomic stability, including measures to sustain the purchasing power of savings and transparent and efficient mechanisms for protecting investments and savings.

Encouraging domestic savings will be critical to efforts to ensure the country's sustainable development and to reduce its international vulnerability. Savings consist of two main elements—public and private; consequently, facilitating the growth of both public and private savings is important.

### **Savings-oriented fiscal policy**

In the mid-term, the Government will carry out policies aimed at ensuring consistent fiscal consolidation with a view to increasing the rate of public savings. By implementing measures to reduce the deficit and increase its sustainability, the Government will increase the volume of savings in the country. Besides, the resources will be spent through public-private partnerships as much as it's possible.

### **Introduction of a deposit insurance scheme**

A transparent and explicit deposit insurance system will be introduced in order to stimulate the rate of private savings, which will in turn decrease risks associated with depositing money in banks. This system should be based upon best international practices, and the Government will work with the National Bank and the country's banking sector in order to develop a viable deposit insurance mechanism.

### **Pension reform**

Pension reform, which calls for the establishment of a mandatory pension savings scheme, will also facilitate the growth of savings in the country, and will create an additional source of investments along with strengthening the country's social security net.

Georgia's capital markets must also be developed in order to enable the future pensions saving scheme to facilitate the growth of investment. It's also important to facilitate improvement of private insurance operations.

## Foreign investments

In order to improve access to long-term investments, attracting foreign direct investments is needed. FDI inflow facilitates increased investments, diversifies financial resources, increases their periods and develops/enhances knowledge and technologies. Therefore, attracting FDIs, especially in export-oriented industries and creation of a favorable investment climate will significantly increase the country's attractiveness.

## Stimulating long-term investments

The existence of long-term domestic and external investments is important. Under domestic savings facilitation policy, the Government will encourage the creation of long-term savings and investment instruments, including issuance of bonds and other securities. Institutions as well as private capital and investment funds will be developed in order to carry out long-term investments. Attracting long-term foreign direct investments is a priority of the Government of Georgia.

## De-dollarization

Currently, households and entrepreneurs prefer keeping their savings in the foreign currency. At the same time, due to the difference between interest rates on credits issued in foreign and domestic currencies the local entrepreneurs (including those who are not export-oriented) prefer receiving credits in foreign currency. As a result, the private sector faces currency risks, which causes high levels of dollarization of loan portfolio (the rate has significantly decreased during the last 4 years, but it still equals 64% of the bank loan portfolio). Extra currency risks raise the credit risks for small and medium enterprises and consequently, it decreases their credit potential. Therefore, Government and National Bank of Georgia will facilitate de-dollarization (or so called "Larization") process using market tools in order to increase the amounts of credits issued in lari and enhance the amounts of lari deposits. This will significantly reduce the risks of small and medium enterprises and increase their access to finances.

## Expected results

As a result of the above-mentioned measures, the volume of loans in Georgia will increase and a long-term and stable basis for access to finance will be created. This will cheapen investment resources and increase their volumes in the economy, which will have a direct impact on the sustainable growth of the country's GDP, employment and general welfare.

### Targets for the mobilization of investments

Target	Baseline	2017	2020
Domestic savings as percent of GDP (%)	10	20-22	25-28
Bank deposits as percent of GDP (%)	25	34	40

## Developing financial intermediation

### Current situation

Financial resources that are available for financial intermediation in Georgia are mainly short-term, which makes short and medium term loans dominant on the market, the loans with maturity periods of more than 5 years are scarce. Bank sector is the most developed sector in financial intermediation, as for non-bank financial intermediates, they account for only 5% of bank sector's assets and less than 4% of GDP. Access to finances is an especially acute problem for small, medium and startup businesses. Access to finances for new, innovative enterprises and farmers is especially problematic due to high interest rates and demanded collateral as new enterprises often don't have sufficient collateral or credit history. Companies that are introducing innovative technologies cannot use their intellectual property and/or it's not enough to fund the launch of the business. Carrying out cadaster reforms in agriculture is important. Strong fragmentation of agriculture market and weak agriculture infrastructure makes attracting investments in that sector difficult. Besides, undeveloped insurance products cannot reduce business (such as crops, weather or natural disaster insurance) and credit (immovable and movable property insurance, payment insurance etc.) risks and improve loan conditions for borrowers (reduction of loan costs).

Streamlining the activities of bank and microfinance institutions is needed for facilitating sectoral diversification of the economy and improvement of access to finances. Besides, development of other forms of long-term financing is necessary especially through development of financial leasing, factoring and capital markets.

Underdeveloped capital markets are also a serious problem. In 2012, the total capitalization of companies listed on the Georgian Stock Exchange equaled 2 percent of GDP, and the volume of transactions corresponded to less than 3 percent of GDP. According to the 2012-2013 edition of the Global Competitiveness Report, Georgia occupies one of the lowest rankings in the Global Competitiveness Report both in terms of attracting finances to the local equity market and in terms of venture capital availability. Besides, Georgia ranks 72<sup>nd</sup> out of 118 countries in the 2013 Venture Capital and Private Equity Country Attractiveness Index.

Underdeveloped stock market are characterized with lack of companies' securities and lack of development of local, especially corporate bond market. There are no bonds supported by collateral or any other guarantee. These problems may be explained by the following main reasons: a) such securities are not yet attractive for securities issuers and investors due to their amount, price and associated costs; b) legal and regulatory mechanisms are not satisfactory and need farther improvement; c) Emission costs may be too high and less attractive compared with bank loans; d) Market is not sufficiently transparent for attracting investors, especially foreign investors and consequently, relevant legislation associated with financial markets needs improvement.

On the one hand, companies prefer not to place their shares or bonds in stock market. Such behavior may be explained by the following circumstances: a) the problem is compliance costs. Many companies historically never prepared regular financial reports. That's why, costs associated with meeting the compliance requirements established for the listed companies may be too high, except for the cases when entry in stock market is associated with clear benefits for the company; b) the value of transactions is higher on the stock market, which makes it less attractive compared to a bank loan; and c) the lack of experience of entrepreneurs and their scarce knowledge of stock market activities place the Georgian stock market in an unfavorable situation.

On the other hand, individuals face risks and its difficult for them to decide to invest their savings in corporate stocks and bonds, mainly because: a) dealing in securities issued by Georgian companies has a bad reputation; b) the private sector's low standard of transparency deters individuals from deciding to invest in the private sector; c) the institutional basis for protecting the rights of minority shareholders is inadequate; d) activities of the Georgian companies lack stability due to low quality management, low level of technological development of business,

skills mismatch in the labor market and market instability e) financial instruments, institutions and capital market infrastructure are not developed (including stock markets, credit rating companies, financial consultation services, investment funds, brokers, dealers etc.).

## **Policies to be implemented in order to develop financial intermediation**

Government policy will be directed towards improving bank and non-bank financial intermediation, as this will direct existing savings towards “real” sectors of the country’s economy.

The credit infrastructure will be strengthened in order to successfully implement reforms directed at improving the access to financing, which implies introduction of legal and institutional regulations, which will improve the activities of Credit Data Bureau and protection of transactions; it will also strengthen bankruptcy and insolvency procedures.

Development of non-bank financial sector (including its legal aspects) requires: 1) Improvement of legal regulations of such non-bank financial institutions as microfinance organizations, leasing companies and factoring; 2) Provision of adequate legislation and infrastructure for capital markets; 3) Encouragement of institutional investors and their operations; 4) Facilitating the development of various forms of risk capital with a view to supporting startup, small and medium businesses; 5) Development of investment products and instruments; 6) Development of trade and asset-based special financing instruments.

## **Deepening financial intermediation in the bank sector**

Development of financial intermediation carried out by the banks is important as the banks are the main source of financing for households and entrepreneurs in Georgia. Currently, loans issued to small and medium entrepreneurs account for 20% of the total amount of loans issued by the banks whereas small and medium entrepreneurs account for 92% of the enterprises registered in Georgia.

Enhanced quality and diversity of the bank products and reduction of interest rates is important in terms of increasing access to finances for small and medium enterprises. Reduction of credit costs also requires improvement of credit instruments.

## Stimulating non-bank credit and investment institutions

Development of non-bank financial institutions (microfinance organizations, financial leasing, factoring), improvement of legislation and its harmonization with international practices are important factors for strengthening customer protection, increasing transparency of nonbank financial organizations and access to information on their part.

Besides, as improvement of financial intermediation is concerned, the development of such financial institutions as: financial leasing, insurance companies and pension funds is also very important. Government of Georgia will facilitate introduction of best international practices and eradication of administrative barriers. These actions will be carried out in accordance with best EU practices.

Currently, there are both legal and administrative barriers in the country, which don't allow those establishments to fully utilize their potential. Country's economic policy will be directed to eradicating those barriers. In particular, the Government will carry out actions, which will improve the qualification of courts and other administrative bodies concerning the leasing operations and strengthen protection of property rights of the leasing companies.

## Facilitating stock market development

The Government will take the following steps with a view to developing the stock market:

**Improving levels of financial education**—The Government will implement measures to improve the financial knowledge of companies potentially able to issue securities; the Government will also provide technical assistance to potential issuers by familiarizing them with successful international practices and by explaining the advantages of attracting investment through the issuing of securities.

Improving the financial literacy of small investors (individuals with savings) is equally important, and the Government plans to work on raising public awareness of both features of securities and the rights of shareholders.

**Increasing transparency**—In order to improve financial transparency, the Government will work to increase the compatibility of company accounting and reporting systems (accounting, audit) and information disclosure processes (including information on shareholders) with international standards. This will be achieved through the relevant reform in financial reporting sphere, which will be implemented in accordance with IFRS. Besides, audit reform will be carried out, which will correspond with ISA standards. Accounting and audit service quality will improve

and development of corresponding financial consultation services will be facilitated as it will help the companies prepare relevant documentation.

**Improving legislation for facilitating capital market development** – The present Strategy implies fast development of state and corporate bond markets with relevant legal reforms.

Development of stock market will take more time. However, these reforms must be launched through developing/streamlining relevant legal acts, including through harmonizing legal norms that regulate securities market with IOSCO (International Organization of Securities Commissions) principles.

Implementation of the above-mentioned actions will increase market transparency and investors' trust; it will strengthen corporate management and protection of investors (including small investors); besides, these actions will reduce the possibility of abusing market positions, the number of speculative and insider transactions will be reduced, as a result, the market will become more compatible with international standards and practices.

**Development of capital market infrastructure** - In order to increase access to finances, the Government will facilitate the development of capital market infrastructure, including the development of trade system (both stock market and over-the-counter (OTC) trading system), credit rating services, regulations and market supervision in accordance with international standards and practices as well as IOSCO principles. This will ensure financial transparency of issuers, minimization of transaction costs and payment risks, eradication of speculative and insider transactions and coordinated activities on the market.

**Development of capital market instruments** – Government of Georgia will review the existing legislation with a view to developing capital markets; it will elaborate new norms and regulations (if necessary). Besides, the Government will ensure development of corporate bonds, other types of securities, private capital instruments and other financial instruments.

## Facilitating venture capital

Development of venture financing is necessary in order to make funding available for startups and high-risk businesses as well as innovation-based enterprises. Venture capital is also important for funding innovative projects. The Government will take steps in order to form relevant legislative and institutional environment.

## Increasing access to finances for startup, small and medium enterprises

A legal entity of public law - Entrepreneurship Development Agency has been formed in order to encourage small, medium and start-up businesses and facilitate exports; the main goals of this Agency is to improve the business skills of small and medium entrepreneurs, to increase their access to financial resources, to strengthen their export potential and to support their access to market.

Besides, with the use of legal entity of public law – Innovations and Technologies Development Agency, the Government will ensure development of entrepreneurial innovations, improvement of innovation ecosystems (formation of relevant infrastructure through public/private partnerships such as business incubators), increased investments in R&D and their commercialization. It's important to support Georgian entrepreneurship, technological modernization of Georgian companies as well as increased competitiveness of exports and facilitation of productivity growth.

## Improving access to investments in the agricultural sector

The current problem with mobilizing investments in Georgia's agricultural sector is mainly the result of the weakness of the country's land market and of available financial instruments (particularly leasing systems) as well as the relative lack of insurance and the absence of modern financial instruments such as warehouse receipts systems. Besides implementing measures which will be aimed at resolving these issues (which also implies streamlining the land cadaster system), the Government will work to design new credit schemes in co-operation with financial institutions, and will seek to create new financial products in order to improve access to finances. The Government will also facilitate the establishment of farmers' groups and farming co-operatives as a means of making agricultural financing easier. The creation of a farmers' register is also seen as a potential way of encouraging investments and ensuring their transparency.

## Expected results

Once implemented, the above measures will encourage the diversification of financing instruments. New financial institutions, together with the banking sector, will increase the efficiency of financial mediators and in doing so they will improve the efficiency of investments. In the long run, this will improve access to finance.

### Targets for the development of financial intermediation

Target	Baseline	2017	2020
Share of private credits in GDP (%)	34.5	45	55
Capitalization of companies listed in stock market; share in GDP (%)	6	10	16

### Implementation framework

The Strategy will be implemented with the use of current or future policy documents of the Government of Georgia, including the State Budget, BDD, strategies and action plans prepared by Georgian ministries, offices of state ministers and relevant agencies subordinated to the Government of Georgia. It should be pointed out that the present Strategy does not include all the actions planned by the Government. It is focused on overcoming the main obstacles hindering inclusive economic growth.

Co-operation between government, the private sector and civil society will guarantee transparency and accountability, which is important for the Strategy's effective implementation. Administration of Government of Georgia will coordinate the activities envisaged under the Strategy and ensure adequate co-operation between the government and stakeholders.

### Monitoring and evaluation

Appropriate monitoring and evaluation mechanisms need to be created for the Strategy to be implemented, whilst taking into the consideration the fact that the Strategy will always be subject to change in order to achieve the Strategy's goals and ensure its achievements are properly evaluated.

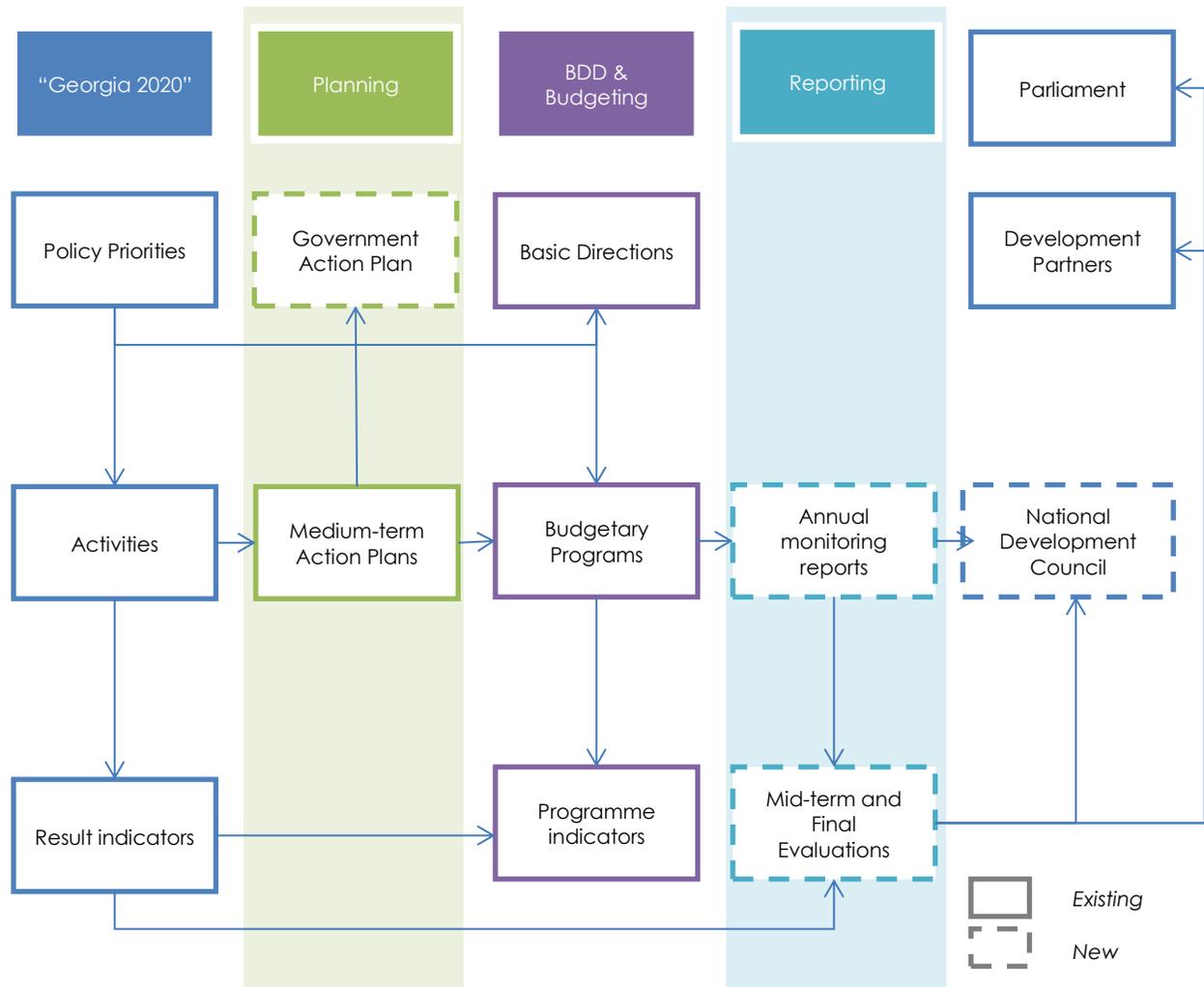
The Government will prepare annual reports on the implementation of the policies included in the Strategy, based on the reports prepared by the line ministries. If needed, public consultations will also be held to adopt corrective measures or exert more efforts in particular areas.

Mid-term and final reports will also be prepared. The interim report will assess mid-term implementation of the Strategy (as of 2017) and the final report will assess the final results achieved under the Strategy (as of 2020).

## Linking the Strategy with the budget

Basic Data and Directions document (BDD) as well as strategy documents and action plans prepared by ministries, offices of state ministers and relevant agencies subordinated to the Government must correspond to the policy priorities defined in the present Strategy.

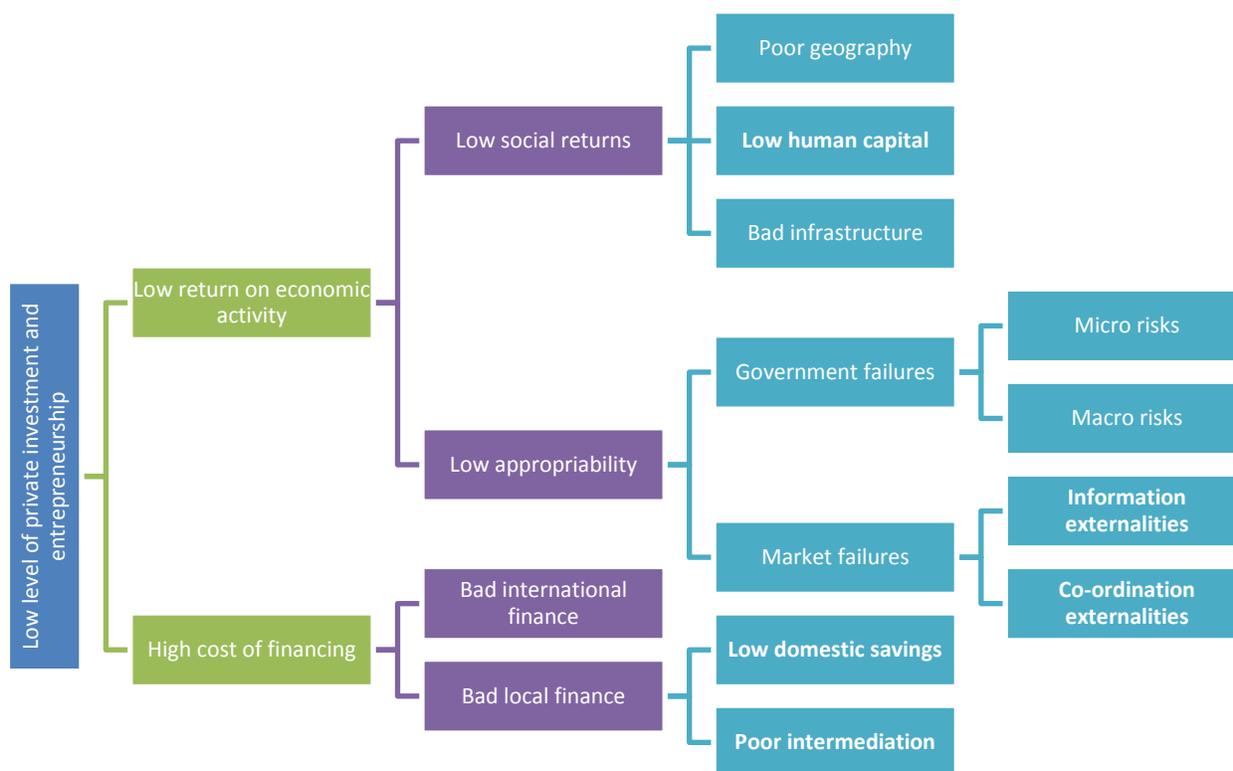
### The overall implementation framework



## Annex. Growth diagnostics methodology

Growth diagnostics method defines factors hindering economic growth with the use of decision-making hierarchy. The figure below reflects the factors hindering economic growth, which were revealed as a result of using decision-making hierarchy.

Growth Diagnostics Decision Tree



In Georgia, this methodology has previously been used on two occasions, leading to different conclusions. Research undertaken by the Government of Georgia in 2011 identified *low human capital* and *underdeveloped road infrastructure* as the binding constraints for economic growth. More recently, a study conducted by an independent think-tank in 2012 came to the conclusion that *weak property rights* are, as a matter of fact, the binding constraint for economic growth.

The conclusions of both studies were relevant for the periods during which those studies were conducted.