

RISK ASSESSMENT AND RISK MANAGEMENT PLAN

1. Since 2004, far-reaching structural reforms have been introduced to strengthen public financial management (PFM) and reduce corruption. Georgia's score on most PFM performance indicators included in the World Bank's Public Expenditure and Financial Accountability assessment reports has increased over time.¹ Radical PFM reforms and aggressive enforcement of anticorruption policies have largely eliminated petty corruption. Georgia's rank in Transparency International's Corruption Perception Index 2014 rose to 50th of 175 countries from 79th of 180 countries in 2007.² However, further reforms are needed to reduce risks to macroeconomic stability and to stimulate economic growth and poverty reduction.

2. **Macroeconomic risks.** Georgia's economy has been hard hit by a combination of severe external shocks: the Russia–Ukraine crisis, the deepening recession in Russia, and currency devaluations in trading partner countries. Because of these shocks, Georgia's exports and remittances from Georgian workers abroad have sharply decreased. The economy is slowing as a result. The lari has depreciated by more than 30% against the US dollar since November 2014. However, Georgia's macroeconomic management is generally sound. Because of its solid fundamentals, reform-minded authorities, and improved market access to the European Union,³ Georgia is well placed to overcome the current challenges.

3. Access to finance is listed as the third main obstacle in the business environment identified by Georgian firms in the Business Environment and Enterprise Performance Survey conducted in 2013–2014. Almost 36% of the firms surveyed had a loan or credit line, and more than 40% of the loans to small and medium-sized enterprises (SMEs) were in US dollars. This poses significant currency risks for those SMEs, especially non-exporters that are not hedged against exchange rate fluctuations. Limited access to finance triggered by the collateral required for financing is a particularly serious problem for firms, especially those who have been in business for less than 5 years.⁴ Georgia's main goods exports are primary products. Product diversification is especially important, and requires investment in export promotion and improved competitiveness of export products. The Asian Development Bank (ADB) program is supporting access to finance and growth in innovation through the newly established Entrepreneurship Development Agency and the Georgia Innovation and Technology Agency.

4. Making growth more inclusive will require investments in human capital. In 2014, the government increased social spending on pensions, health, and education. Despite this increase in social expenditure, the authorities remain committed to fiscal consolidation and to meeting the 30% limit on spending introduced by the Economic Liberty Act from 2014 onward. To keep social expenditure under control, a contributory pension scheme needs to be introduced to supplement and limit growth of the existing tax-financed universal pension scheme. ADB is supporting the reform process through policy-based loans and technical assistance.

5. **Public financial management risks.** The public financial management (PFM) risks in Georgia are manageable for this policy-based loan. The basic set of systems for strategic

¹ World Bank. 2013. *Georgia: Public Expenditure and Financial Accountability Assessment 2012*. Washington, DC.

² Transparency International. 2014. *Corruption Perception Index 2014*. Berlin.

³ On 27 June 2014, Georgia and the European Union signed the Association Agreement, including a deep and comprehensive trade area, leading to increased European integration and providing export and investment opportunities.

⁴ European Bank for Reconstruction and Development. 2015. *Business Environment and Enterprise Performance Survey V*. London.

budget planning, formulation, and execution has been put in place. The integrated PFM system has been fully implemented. All state financial transactions have been unified under a single treasury account. However challenges remain, including inadequate monitoring and analysis of government contingent liabilities, non-inclusion of some legal entities of public law (LEPLs) revenues and expenditure in budget execution reports, and inadequate predictability and transparency of intergovernment transfers.

6. The government's capacity to monitor and manage fiscal risks, including contingent liabilities of state-owned enterprises and public-private partnership projects, is limited. ADB is supporting the Ministry of Finance in the establishment of a dedicated, staffed, and budgeted unit to monitor and manage these risks.

7. LEPLs are entities created under various ministries to provide specific public services, charging fees which they are allowed to retain for their functional needs. LEPL revenues are not integrated with the budget. Such revenues accounted for 10% of the 2012 state budget. As part of the program, efforts are under way to further integrate LEPLs with the budget and to enhance transparency by integrating the financial transactions of LEPLs with the electronic budget system. This will facilitate improved monitoring of LEPL expenditure and revenues.

8. While amendments to the Constitution of Georgia in 2010 increased the independence of local governments, they lack financial resources to fulfill their responsibilities. Under subprogram 1, the Parliament approved the Local Self Governance Code in February 2014, establishing the legal basis for further development of local self-government and paving the way for reforms in intergovernment finances. The Budgetary Code has also been amended to define the separation of revenues among the budgets of the state, autonomous regions, and municipalities.

9. **Procurement risks.** The State Procurement Agency continues to improve transparency in public procurement processes by adopting international standards. The 2009 Law on State Procurement provides a legal framework for second-generation reforms, including the introduction of e-procurement. In 2010, a unified e-procurement system was launched. All documents needed in the process of public procurement are uploaded into the system electronically and are accessible to all interested parties. The system reduced the volume of paperwork and increased transparency. Recently the State Procurement Agency modified the e-procurement system to meet the procurement requirements of multilateral development banks.

10. **Corruption risks.** The country's anticorruption progress is reflected in reports by international observers and public opinion surveys, which indicate the government's success in reducing corruption. However, countries doing business in Georgia still face a number of obstacles, including deficiencies in the judicial system, enforcement of property rights, and high-level corruption. The government has made fighting high-level corruption a priority.

Risk Description	Risk Assessment	Mitigation Measures or Risk Management Plan
Macroeconomic		
Geopolitical tensions in the region could affect the economy and slow down growth.	High	The government's commitment to efficient public financial management while maintaining capital expenditure and diversification of trade partners, including the EU, contributes to greater policy certainty and helps address medium-term growth concerns.
Lack of export sophistication and limited access to finance may affect business environment, especially SMEs.	Medium	ADB's policy-based loan and the TA ^a are supporting MOESD in providing access to finance and in promoting export sophistication through the Entrepreneurship Development Agency and the Georgia Innovation and Technology Agency.
Increased social expenditures and relatively lower revenues may lead to a wider fiscal deficit.	Medium	ADB's policy-based loan and the TA are supporting the introduction of a contributory pension scheme to supplement and limit growth of the existing tax-financed universal pension scheme.
Public financial management		
Lack of assessment and monitoring of contingent liabilities exposes the government to various types of fiscal risks.	High	ADB's policy-based loan and the TA are supporting the establishment of a dedicated unit in MOF to monitor and manage these risks
Limited coverage of public financial management may affect expenditure effectiveness and the fiscal consolidation process.	High	ADB's policy-based loan and the TA are supporting the integration of the LEPLs with the budget, and the financial transactions of LEPLs with the electronic budget system.
Weak local government finances	Medium	ADB's policy-based loan and the TA are supporting the government in establishing the legal framework for improved intergovernmental finances.
Procurement		
Lack of transparency in procurement	Medium	The State Procurement Agency is improving the e-procurement system to strengthen public procurement processes.
Anticorruption		
While corruption has been reduced, some concerns regarding high-level corruption remain.	Medium	The government made fighting high-level corruption a priority with elimination of petty corruption.
Overall	Medium	

ADB = Asian Development Bank, EU = European Union, LEPL = legal entity of public law, MOESD = Ministry of Economy and Sustainable Development, MOF = Ministry of Finance, SMEs = small and medium-sized enterprises, TA = technical assistance.

^a ADB. 2014. *Technical Assistance to Georgia for Strengthening Domestic Resource Mobilization*. Manila (TA 8716-GEO).

Source: Asian Development Bank.