FISCAL IMPACT ASSESSMENT

A. Introduction

1. Economic evaluation reveals that the Government of Georgia (government) requires budget support, which is largely attributable to the negative fiscal impact triggered by the coronavirus disease (COVID-19) pandemic. The government budget has been redirected to support urgent medical and social-economic needs, and development financing needs reflect these. At the same time, the government is committed to the sector reform to improve sector performance and financial sustainability in order to reduce the sector dependence on the state budget. Prevalent under-investment in infrastructure and inadequate operation and maintenance (O&M) are core underlying weaknesses in the sector. The government is aware of the need to complement physical investments with sector reforms to improve service provision. The policy will also encourage the United Water Supply Company of Georgia (UWSCG) to engage the private sector for outsourcing, operations, and plant maintenance. The government has taken the lead in developing the policy action. The size of the policy-based loan (PBL) reflects the government's total financing needs, the strength of the program, and its fiscal impact.

B. Government's Total Financing Needs

2. Georgia's development financing needs in 2020 are expected to be substantial from the COVID-19 impact. Annual fiscal deficits are projected to be 8.5% of gross domestic product (GDP) in 2020. The real GDP is expected to contract by 5% in 2020. In 2020, the development financing needs of the government is expected to reach $1.53 billion, to be financed by domestic and foreign sources.

3. **Fiscal deficit pre-COVID.** Before the outbreak of COVID-19, strong revenues provided fiscal space to meet increased public outlays in the first 2 months of 2020. Fiscal policy was projected to be mildly expansionary.

Table 1. Selected Fiscal Indicators
(in % of GDP unless otherwise indicated)

Fiscal Indicators	2015	2016	2017	2018	2019[a]
Total government revenue	26.4	27.0	26.8	26.5	25.8
Of which tax revenue	23.6	24.5	24.0	23.6	22.8
Of which grants	0.9	0.8	0.7	0.8	0.8
Government expenditure and net lending	27.4	28.3	27.6	27.2	27.9
Current expenditure	24.1	25.5	23.7	21.5	21.7
Of which wages and salaries	4.7	4.9	4.0	3.8	3.6
Capital expenditure and net lending	3.3	2.9	3.9	5.7	6.2
Primary fiscal balance (including grants)[b]	0.0	-0.2	0.4	0.4	-1.2
Fiscal balance (including grants)[b]	-1.0	-1.3	-0.8	-0.7	-2.1

GDP = gross domestic product.
[a] As of 30 June 2020.
[b] Cash basis.
Source: Ministry of Finance of Georgia; Geostat.

4. **Public debt.** Public debt increased from 41.5% of GDP in 2018 to 44.5% in 2019 in part because of currency depreciation. According to the Debt Sustainability Analysis by the International Monetary Fund (IMF), debt levels are expected to remain sustainable in the medium

term.[1]

Table 2. Selected Debt Indicators
(in % of GDP unless otherwise indicated)

	2015	2016	2017	2018	2019[a]
Total external debt[a]	86.1	88.2	91.3	83.2	86.4
Public debt	41.4	44.4	45.1	41.5	44.5
External debt (PPG)	32.5	35.1	35.7	32.7	34.8
Domestic debt	8.9	9.3	9.4	8.8	9.7
Government external debt service payments (% of exports)	4.4	3.9	3.7	4.5	4.8

GDP = gross domestic product, PPG = public and publicly guaranteed.
[a] As of 30 June 2020.
[b] Excluding intercompany loans.
Source: Ministry of Finance of Georgia; International Monetary Fund.

5. **Fiscal impact of coronavirus disease.** The Georgian economy will be heavily impacted by COVID-19, as transport restrictions affect the travel and tourism industry, while containment measures reduce domestic demand. Real GDP growth in Georgia is projected to slow sharply, as the impacts of COVID-19 add to an already challenging external environment.[2] The government has been implementing extensive anti-crisis measures to help mitigate the impacts including a fiscal stimulus response of measures and plans to provide additional liquidity to support the economy. Public social spending in Georgia including public pensions is sizeable at GEL4.2 billion (equivalent to $1.3 billion) and amounted to 38.8% of total current spending in 2019, which is likely to increase going forward. Disease containment spending on creating quarantine zones and securing medical supplies, e.g., masks, gloves, respirators, and other personal protective equipment in line with the requirements of the World Health Organization entail additional expenditure on goods and services in the amount of GEL351 million (or about $110m). Fiscal revenue is expected to significantly decline as businesses beyond the hospitality industry have been affected by the pandemic.

6. The government estimated that a total development financing needs of $1.53 billion for 2020 as the fiscal deficit is expected to widen to 8.5% of GDP and increase of public debt to 62.4% of GDP in 2020. This constitutes a violation of the limits established in the Economic Liberty Act (3% fiscal deficit and 60% public debt) and commit the government to a parliamentary approved two-year plan to bring fiscal deficit and public debt ratios within the specified limits.

7. **Development financing needs.** The government's GEL3.5 billion ($1.1 billion) COVID-19 anti-crisis economic plan includes support to people, businesses, and health system in 2020. About GEL1.0 billion will be channeled to meeting emergency needs of individuals, GEL2.1 billion for the business sector needs and economic activity, and GEL0.4 billion for healthcare costs to fight the pandemic. The government secured about $1.78 billion financing from development partners.[3] Such assistance will help to reduce fiscal gap in 2020 and beyond.

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[1] IMF. 2020. IMF Reaches Staff-Level Agreement on Sixth Review for Georgia's Extended Fund Facility, Request for Augmentation. News Release. 14 April.
[2] World Bank. 2020. Europe and Central Asia Economic Update, Spring 2020: Fighting COVID-19. Washington, DC.
[3] ADB approved COVID-19 Active Response and Expenditure Support ($100 million) in 2020 and is preparing policy-based loans in energy ($100 million), fiscal resilience and social protection ($200 million), WSS ($80 million), and education ($50 million) for an expected total disbursement of $530 million in 2020. In addition, budget support from other development partners in 2020 amounts to $880 million: (i) $205 million from Agence Française de Développement, (ii) $100 million from Asian Infrastructure Investment Bank, (iii) $95 million from the EU, (iv) $100 million from German development cooperation through KfW, (v) $200 million from the IMF, and (vi) $180 million from the World Bank.

8. The development financing will benefit Georgia across the board. The companies most directly affected by the pandemic will benefit from deferrals and installments for the payment of tax obligations for the next 4 months provided they maintain their existing workforce intact. Impacted small and medium enterprises (SMEs) will be able to obtain loans secured by the government and the Credit Guarantee Fund will be put in charge of helping SMEs receive loans. The government is planning to extend targeted cash assistance and wage subsidies to individuals and families that lost all of their income sources. The government is considering other social programs to provide a critical lifeline to the poor. The pandemic posed an increased burden on its hospital system which entails additional social spending. The government will also be able to carry out ongoing WSS works.[4]

C. Strengths of the Program

9. The economic downturn associated with COVID-19 will reduce commercial water use—an essential revenue stream for WSS operators—resulting in significant revenue loss to WSS operators and further burden on the state budget.

10. **Proposed reforms.** The sector development program (SDP) will support both infrastructure needs and the government's reform program focusing on strengthening governance and institutions, legal and regulatory frameworks, financial sustainability, and private sector participation in Georgia WSS sector. These are significant, impactful actions usually brought through PBL. The UWSCG components—corporate governance, restructuring, human resource realignment, public–private partnership—require a strong political commitment and ownership, and presented as a comprehensive corporate reforms package for maximum benefits. These reforms will improve revenue and operational efficiency to facilitate investments in economic and social infrastructure and enable overall sustainability and inclusivity in the sector. It will further minimize risks of debt restructuring and refinancing loans of UWSCG. Benefits of the SDP can be partially quantified based on the financial impact on UWSCG in section D.

11. **Government capacity.** The Ministry of Regional Development and Infrastructure is experienced, capable, and firmly in the lead to issue and implement policies. UWSCG capacity to implement the corporate restructuring program is relatively weak. A human resources committee and change management committee will be set up as policy actions to improve performance, foster performance culture, and support change management. An advisory team will be established in UWSCG to support the management.

12. **Beneficiaries.** Policy actions will be applied nationally, while near 1 million population serviced by UWSCG would benefit from improved services from the combined policy and project assistance. UWSCG will benefit from reduced redundant costs and more efficient operations and work processes. The government will have more fiscal space to extend resources to the poor and the vulnerable population beyond the urban centers. The investment project in Telavi water supply will contribute to local employment and support economy.

D. Fiscal Impacts of the Sector Reform

13. Expected fiscal impact of the sector development program reforms can be assessed by comparing two scenarios: (i) "no reforms" scenario where UWSCG continues to receive government subsidies to support UWSCG operations and debt service obligations, and (ii) reforms scenario supported by the program with improvements in financial performance of

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[4] The government has more than 200 ongoing WSS works contracts that risk either cancellation or termination.

UWSCG and reduced subsidies and financial burden for the government.

14. **No-reforms scenario.** Fiscal implications of a “no reforms” scenario on UWSCG future financial performance can be estimated if current company performance is extrapolated assuming unchanged operational parameters and performance of the company in the future. As a result, it can be expected that UWSCG will continue to generate operational losses and will require considerable government subsidies and other forms of support to continue provision of WSS services, to maintain and replace assets, and to service debt obligations.

15. Primarily, the following inputs and operational performance drivers are assumed to remain unchanged: constantly high level of nonrevenue water (NRW) at about 77% with about 30% of the total NRW attributed to commercial losses, no tariff increase given that it would not be justifiable given deficient services provided, inefficient operations, and unoptimized operational costs. There will be still some increase in the number of customers driven by expected population growth in Georgia, but UWSCG would be expected to continue generating operational losses with no ability to service its debt obligations. The “no reforms” scenario also assumes that the government would not receive $130 million ($80 million in 2020 and 50 million in 2021 as PBL and $20 million as project loan) during the period fiscal year (FY) 2020–2024 for the fiscal impact analysis.

16. Expected fiscal impact under the “no reforms” scenario is summarized in Table 3. Overall, aggregated operational loss is expected to total $482 million and total aggregate government subsidies over FY2020–2049 period to support company operations including assets maintenance and repairs, and to cover debt service obligations could be as much as $1.2 billion.

17. **Reforms scenario.** Operational performance of UWSCG under the “reforms scenario” was forecasted with considerable improvements expected in terms of NRW reduction, including relatively quick minimization of commercial losses, service quality improvements, and related gradual tariff increase by 10% every 3 years after one-time tariff adjustment by 50% in 2024. Future debt service obligations in this scenario were adjusted to include the assumption that the government would receive $130 million ($80 million in 2020 and 50 million in 2021 as PBL) and $20 million as project loan during the period FY2020–2024.

18. Expected fiscal impact under a “reform” scenario is summarized in Table 4. Overall, UWSCG is expected to start generating operational profits[5] from 2024 with the total aggregate profits of over $630 million generated over 2020–2049 period. Total aggregate government subsidies over 2020–2049 period to support company operations and to cover debt service are expected to reduce to $541 million with no subsidies required after 2039.

Table 3: Sector Reform Fiscal Impact – "No Reforms" Scenario

	Item	Total 2020–2049	2020	2025	2030	2035	2040	2045	2049
A.	**Water Balance, million m^3**								
	1. Billed authorized consumption	1,968	58	62	64	66	68	70	71
	2. Commercial losses	1,800	60	60	60	60	60	60	60
	3. Physical losses	3,696	123	123	123	123	123	123	123
	4. Total NRW	-	183	183	183	183	183	183	183
	5. Water produced and supplied	7,614	246	250	252	254	256	258	260
	NRW, %	**74%**	**76%**	**75%**	**75%**	**74%**	**73%**	**73%**	**73%**
B.	**Selected P&L Figures, $ million**								
	1. Revenue	688	14	19	21	23	26	28	30

[5] Total operating revenue minus total operating expenses.

Item	Total 2020–2049	2020	2025	2030	2035	2040	2045	2049
2. Operating expenses	1,169	24	28	33	38	44	52	59
Operational profit (loss)	**(482)**	**(10)**	**(10)**	**(12)**	**(15)**	**(19)**	**(24)**	**(29)**
C. Debt Service and Government Subsidies, $ million								
1. Debt service (no SDP loan)	759	15	40	50	32	22	-	-
2. Government subsidy	**1,241**	**25**	**50**	**62**	**47**	**41**	**24**	**29**

NRW = nonrevenue water, P&L = profit and loss, SDP = sector development program.
Source: ADB staff estimates.

Table 4: Sector Reform Fiscal Impact – "Reforms Scenario"

Item	Total 2020–2049	2020	2025	2030	2035	2040	2045	2049
A. Water Balance, million m^3								
1. Billed authorized consumption	2,450	55	76	82	84	87	90	91
2. Commercial losses	489	55	16	12	12	12	12	12
3. Physical losses	1,615	111	76	41	41	41	41	41
4. Total NRW	2,104	166	92	53	53	53	53	53
5. Water produced and supplied	4,594	226	169	136	138	141	144	145
NRW, %	**47%**	**76%**	**55%**	**40%**	**39%**	**38%**	**38%**	**37%**
B. Selected P&L Figures, $ million								
1. Revenue	1,612	14	33	44	51	66	84	95
2. Operating expenses	982	24	24	27	32	37	43	49
Operational profit (loss)	630	(9)	8	16	20	29	42	47
C. Debt Service and Government Subsidies, $ million								
1. Debt service including SDP loan repayment	922	15	40	58	40	30	8	-
2. Government subsidy	**541**	**25**	**32**	**42**	**20**	**1**	**-**	**-**

NRW = nonrevenue water, P&L = profit and loss, SDP = sector development program.
Source: ADB staff estimates.

19. It is estimated that the PBL-linked reforms will generate total government budget savings of $104 million in 2020–2029 period given that under "No Reforms" scenario total government subsidies to UWSCG are estimated at $439 million versus $335 million of total government subsidies to UWSCG under "Reforms Scenario".

20. In summary, the expected fiscal implications of the proposed sector reforms are as follows:
- (i) UWSCG is expected to become operationally sustainable in 2023 with operating ratio of 1 or less;[6]
- (ii) UWSCG is expected to become financially sustainable in 2039;
- (iii) the fiscal impact of the reform is expected to be net positive, and more significant over time; and
- (iv) total amount of government subsidies under the reform scenario is expected to be $700 million less compared with a "no reforms" scenario to offset the reform related costs of about $130 million.

[6] Operating expenses, excluding noncash expenses (depreciation and amortization), divided by operating revenue.