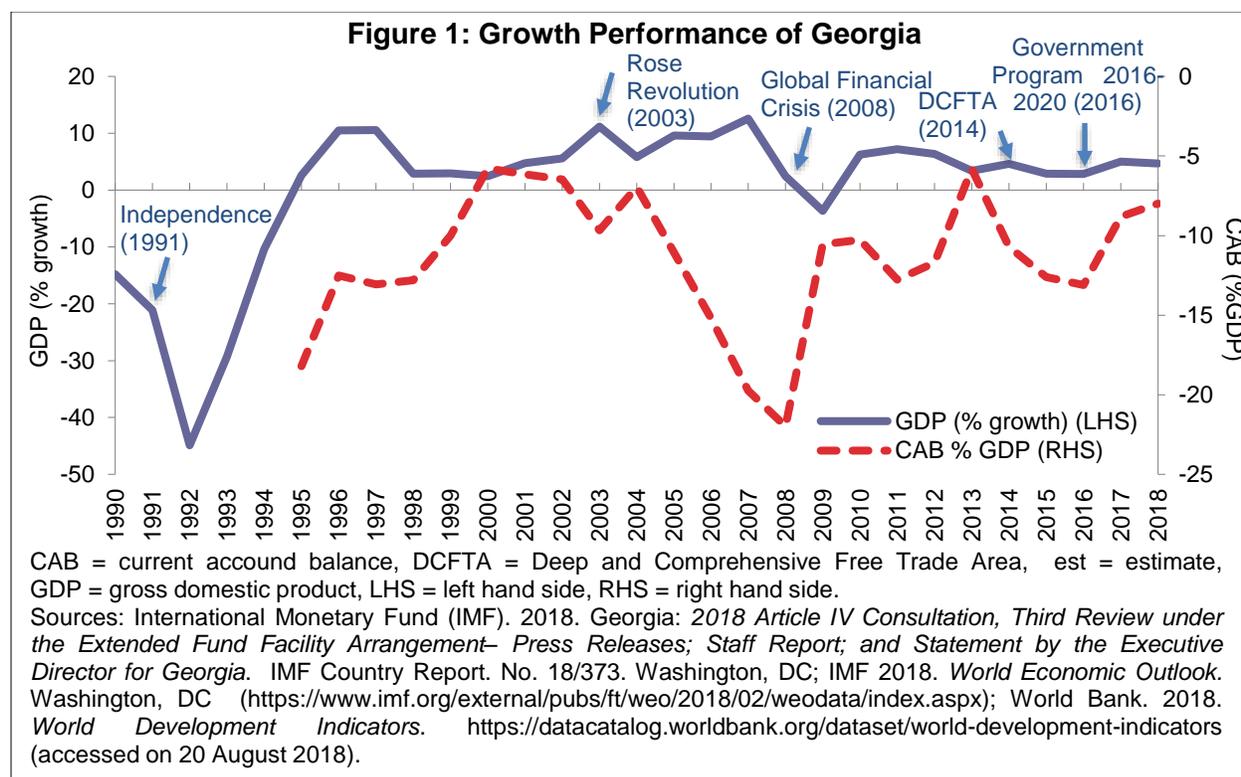


## INCLUSIVE AND SUSTAINABLE GROWTH ASSESSMENT

### A. Overview of Growth Performance

1. Georgia's growth performance to date since its independence from the Soviet Union may be best described in relation to the major historical milestone events (Figure 1). The collapse of the Soviet Union in 1991 led to a serious destabilization of Georgia's economy and, by 1992, the rate of real gross domestic product (GDP) growth had declined to about  $-45\%$ . While growth subsequently recovered under adjustment programs for macroeconomic stabilization and structural reforms by international financial institutions, to reach more than  $10\%$  in 1996–1997, a period of stagnation followed thereafter. However, the economy regained its growth momentum in the wake of the country's Rose Revolution in 2003, which brought a peaceful change of government. The new government undertook structural reforms to minimize discretionary state interventions through trade liberalization, privatization, and deregulation, and fought corruption.<sup>1</sup> The dramatic pace of post-revolution reforms is probably best expressed in the World Bank's ease-of-doing-business ranking. In 2005, the first year when the ranking was released, Georgia was placed 100th among 155 economies. It then quickly moved up to 37th position a year later, and kept doing so every year until it was ranked 11th in 2009.<sup>2</sup> During 2003–2007, the growth rate averaged nearly  $10\%$ . While it slowed substantially in 2008–2009, partly as a result of the global financial crisis, it somewhat recovered to average  $6.6\%$  in 2010–2012.

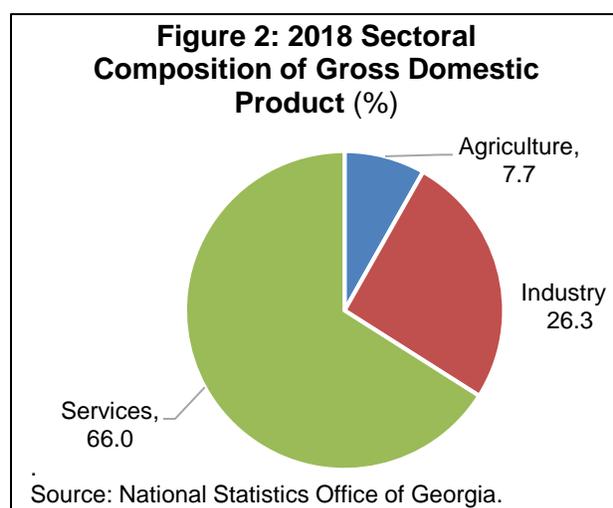


<sup>1</sup> World Bank. 2012. *Fighting Corruption in Public Services: Chronicling Georgia's Reforms*. Washington, DC.

<sup>2</sup> World Bank. 2005. *Doing Business 2006: Creating Jobs*. Washington, DC; World Bank. 2006. *Doing Business 2007. How to Reform*. Washington, DC; World Bank. 2009. *Doing Business 2010: Reforming through Difficult Times*. Washington, DC. It should be noted that, from time to time, the World Bank refines its methodology to work out the ease-of-doing-business rankings and ratings, making a strict comparison across years difficult. However, these values still serve as good references to assess the broad trend of a country's reform orientation toward the business environment.

2. The average growth rate declined to 3.4% in 2013–2016. By 2015, the pace of reforms had somewhat slowed and Georgia’s ease-of-doing-business ranking was down to 24th. In this period, the high-profile Deep and Comprehensive Free Trade Area was established with the European Union (EU), Georgia’s largest trading partner, but its primary focus on Georgia’s side was to raise product standards and regulations in conformity with the EU’s. To start meeting large unmet social needs, the government introduced the Universal Health Care Program. It boosted social sector funding sizably, while making spending transparency a key priority. It also put in place a more balanced labor code, in closer compliance with international standards.

3. In November 2016, the government launched the next phase of major reforms (succeeding those implemented after the Rose Revolution) under its overall development strategy titled “Freedom, Rapid Development, Prosperity: Government Platform 2016–2020” (hereafter, “Government Program 2016–2020”), which prioritizes economic reform, education reform, infrastructure development through spatial planning, and public governance reform. Economic growth recovered to 4.8% in 2017. As of 2018, the real GDP growth recorded 4.7%. Services accounted for 66.0%, industry for 26.3%, and agriculture for 7.7% of GDP (Figure 2).



4. As regards Sustainable Development Goal (SDG) 1 (no poverty), in the long run, the share of population below the \$1.9 per day threshold has been reduced from 19.4% in 2000 to 5.0% by 2017.<sup>3</sup> However, it is substantially higher than the 1.5% average of regional comparators where data is available for 2017 (Table 1). The percentage of the population living below the national poverty line also declined from 34.3% in 2004 to 20.1% in 2018.<sup>4</sup> The growth rate of household income per capita among the bottom 40% of the population was 6.4% in 2011–2016, higher than the 4.3% for the population at large that SDG 10 (reduced inequalities) calls for.<sup>5</sup>

**Table 1: Poverty**

	Georgia			Other CCA
	2000	2010	2017	2017
Poverty headcount ratio at \$3.20 a day (% , 2011 PPP) <sup>a</sup>	44.8	31.1	16.3	10.8
Poverty headcount ratio at \$1.90 a day (% , 2011 PPP) <sup>b</sup>	19.4	12.2	5.0	1.5
Maternal mortality ratio (per 100,000 live births)	37.0	40.0	36.0 <sup>c</sup>	35.4 <sup>c</sup>
Under-5 mortality rate (per 1,000 births)	35.4	16.6	10.8	24.1

CCA = Central Asia and Caucasus, PPP = purchasing power parity.

<sup>a</sup> CCA represents 2017 averages of Armenia, Kazakhstan, and the Kyrgyz Republic. 2017 data for Azerbaijan, Tajikistan, Turkmenistan, and Uzbekistan were not available.

<sup>b</sup> CCA represents 2017 averages of Armenia and the Kyrgyz Republic. 2017 data for Azerbaijan, Kazakhstan, Tajikistan, Turkmenistan, and Uzbekistan were not available.

<sup>c</sup> Latest available data is 2015.

Source: World Bank. World Development Indicators. <https://data.worldbank.org> (accessed on 12 July 2019).

<sup>3</sup> However, the number of households below the extreme poverty line of \$1.25 per day increased by 2.6 percentage points from 2015 to 2017. United Nations Children’s Fund. 2018. *The Welfare Monitoring Survey 2017*. Tbilisi.

<sup>4</sup> National Statistics Office of Georgia (GeoStat). <https://www.geostat.ge/en/modules/categories/192/living-conditions> (accessed 10 July 2019).

<sup>5</sup> ADB. 2018. *Key Indicators for Asia and the Pacific 2018*. Manila.

5. A close look at Georgia's growth path reveals that it is closely linked to movements in the external balance. As shown in Figure 1, Georgia's current account deficit has had a tendency to widen when growth accelerated and shrink when growth decelerated. For instance, the current account deficit rose rapidly while the economy was booming after the Rose Revolution, until reaching its peak at more than 20% of GDP in 2008. The observed correlation between growth and current account deficit implies that growth has been driven by domestic demand, rather than net exports (which ultimately reflects the country's overall investment–savings balance). In 2017, domestic demand (consumption, investment, and government expenditures combined) accounted for 115.6% of GDP, while net exports accounted for –15.6%. The persistent deficit necessitated external balance-of-payments support, and the country has been under several International Monetary Fund (IMF) programs to date, the latest of which is ongoing (Box 1). The existence of a large current account deficit, which averaged 11.6% during 1995–2017, implies that domestic demand far exceeded supply. Thus, an analysis of Georgia's long-term growth performance requires careful assessment of developments in the country's productive capacity—productivity, in particular.<sup>6</sup>

#### **Box 1: Ongoing International Monetary Fund Program for Georgia**

Since independence in 1991, Georgia has implemented several International Monetary Fund (IMF) programs in support of its balance of payments. The IMF's current 3-year arrangement in the amount of SDR210.4 million (about \$285.3 million) under the Extended Fund Facility (EFF) was originally approved on 12 April 2017. The EFF program calls for reducing economic vulnerability, pursuing well-coordinated policies, and promoting economic growth. Apart from macroeconomic policies, it involves structural reforms with an emphasis on investment in both physical and human capital, public administration reforms, and further improvement of the business environment for private sector development. The original approval of the EFF arrangement allowed for immediate disbursement of SDR30 million (then about \$40.7 million).

The first review of the program was completed on 6 December 2017, allowing for the immediate purchase of SDR30 million (then about \$42.4 million). Despite earlier concerns about Georgia's fiscal discipline, the authorities demonstrated the pursuit of prudent public financial management. The IMF commented: "The program is on track with all end-June 2017 performance criteria and structural benchmarks met. Economic activity has strengthened on the back of stronger growth in main trading partners. Fiscal overperformance and efforts to address structural weaknesses have helped boost confidence." It is noteworthy that the government introduced various measures to keep public finances sound in 2017, and even outperformed the IMF program targets.

The second review of the program was completed on 27 June 2018, allowing for an immediate purchase of SDR30 million (then about \$42.25 million). Again, Georgia's performance exceeded the IMF's earlier expectation. Tao Zhang, the IMF's Deputy Managing Director, commented: "Georgia has made notable progress under the IMF-supported program. All end-December quantitative performance criteria were met, most with significant margins, while most structural benchmarks have been implemented. Economic growth has been stronger than initially envisaged, inflation has declined, the fiscal and external positions have improved, and public debt continues to decline. Important progress has also been made in implementing the structural reform agenda."

On 20 September 2018, Georgia's Prime Minister, Mamuka Bakhtadze, and the IMF's Managing Director, Christine Lagarde, met in Washington, DC. After the meeting, Christine Lagarde stated that "Prime Minister Bakhtadze and I discussed the good progress under Georgia's economic reform program supported by the IMF's \$285 million Extended Fund Facility. The Georgian economy is showing strong signs of recovery, supported by prudent macroeconomic policies... I reiterated the Fund's commitment to support Georgia and its people."

The third review of the program was completed on 19 December 2018 for the release of SDR30 million (about \$41.6 million), bringing total disbursements under the arrangement to SDR120 million (about \$166.3 million). The IMF stated that "program implementation through end-June 2018 was satisfactory. All end-June 2018 performance criteria were met—some with significant margin. All structural benchmarks but one were observed, and the missed one was completed with a two-week delay."

<sup>6</sup> For the purpose of a long-term growth assessment, this document looks primarily into the supply side of the economy. For the demand-side analysis of short-term business cycles by the Asian Development Bank, see the Georgia country chapters in the annual *Asian Development Outlook* and its *Update*: <https://www.adb.org/publications/series/asian-development-outlook>.

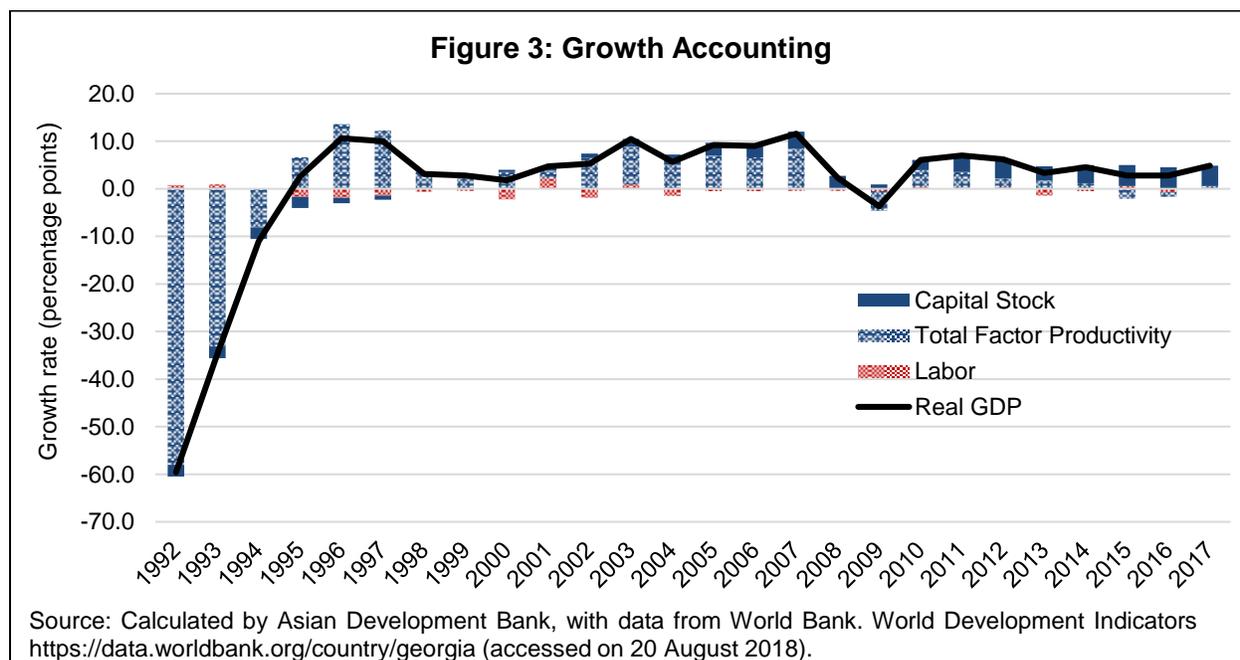
The fourth review of the program was completed on 19 June 2019 for the release SDR 30 million (about \$41.4 million), bringing total disbursements under the arrangement to SDR 150 million (about \$207.2 million). David Lipton, the IMF's First Deputy Managing Director, commented: "Georgia's economic performance remains robust with resilient growth, inflation under control, and reduced external vulnerabilities."

Source: IMF website (<https://www.imf.org/en/Countries/GEO>).

## B. Driver of Long-Term Growth

### 1. Growth Accounting

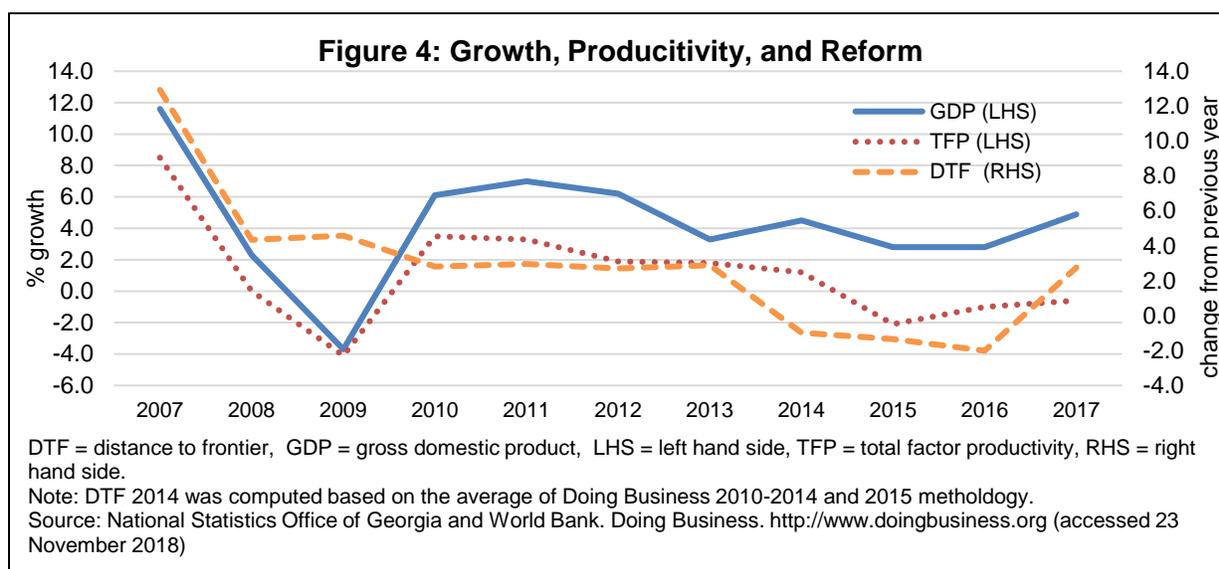
6. The long-term growth of an economy is driven by the enhancement of a country's productive capacity, comprising growth in labor, capital, and the residual known as total factor productivity. Growth accounting that decomposes these three elements reveals that Georgia's GDP growth on its supply side has been driven mainly by productivity growth (Figure 3).<sup>7</sup> Since independence in 1991, periods of high GDP growth tended to coincide with high productivity growth, whereas those of low or negative GDP growth reflected stagnant productivity growth; this pattern is still observable. In 2011, GDP growth began to slow and productivity growth also came down until both bottomed out in 2015 (GDP at 2.9% and productivity at -2.1%).<sup>8</sup> Interestingly, in 2017, both GDP and productivity growth improved—GDP to 4.8% and productivity to a positive 0.6%. In the same year, the current account deficit narrowed to 8.8% of GDP, implying that the growth of Georgia's aggregate supply exceeded that of domestic demand, possibly thanks to stronger productive capacity.



<sup>7</sup> Growth accounting as presented here follows the Solow model. Productivity-led growth is a common feature observed in countries in Eastern Europe and the former Soviet Union in their transition to market economies. A. Alam et al. 2008. *Unleashing Prosperity: Productivity Growth in Eastern Europe and the Former Soviet Union*. World Bank: Washington, DC.

<sup>8</sup> The IMF and the World Bank also ran growth accounting for Georgia. Both came up with the similar conclusion that productivity growth had stagnated since 2011. IMF. 2018. *Assessing Macroeconomic and Structural Reforms in Georgia*. In IMF. *Georgia: Selected Issues*. Washington, DC; and World Bank. 2018. *Georgia – From Reformer to Performer: A Systematic Country Diagnostic*. Washington, DC.

7. While it is hard to identify what really drives productivity growth, improvement in allocative efficiency through structural reforms may explain part of past growth performance.<sup>9</sup> Reforms to enhance market disciplines should facilitate the allocation of capital and labor to segments of the economy that show higher productivity, i.e., they potentially serve as a stimulus to growth. A review of changes in the distance to frontier (DTF) score<sup>10</sup> of the World Bank’s Doing Business reports reveals that, as a broad trend, the period of smaller improvements or deterioration in the DTF score tended to be accompanied by lower growth in total factor productivity (TFP) and GDP (Figure 4). For instance, the DTF scores deteriorated during 2014–2016, and this was the period when both TFP and GDP growth were particularly stagnant. On the other hand, the DTF score improved in 2017, after the commitment to market-oriented reforms was renewed under the Government Program 2016–2020. Georgia climbed up in the ease-of-doing-business ranking from 16th in 2016 to 9th in 2017, and 6th in 2018, and TFP and GDP growth performance improved.<sup>11</sup>



<sup>9</sup> TFP is often described as representing quality of science and technology in the broad sense of the term, and economists generally agree on its importance. However, we know little about what it is exactly and what drives its growth. Paul Krugman wrote that “*productivity growth is the single most important factor affecting our economic well-being*” but “*we don’t know why productivity growth ground to a near halt. That makes it hard to answer the other question: What can we do to speed it up?*” The assessment presented here should be read with this important qualification in mind. P. Krugman. 1994. *The Age of Diminishing Expectations*. Cambridge, Massachusetts: MIT Press. However, it should be noted that not all structural reforms add to growth. For instance, cuts of production subsidies may disrupt growth at least in the short run. Partly for this reason, this assessment focuses on improvements in the business environment as a subject of analysis.

<sup>10</sup> The DTF score captures the gap between an economy’s performance and a measure of best practice across the entire sample of indicators for Doing Business topics. The best performer scores 100.

<sup>11</sup> World Bank. 2017. *Doing Business 2018: Reforming to Create Jobs*. Washington, DC; and World Bank. 2018. *Doing Business 2019: Training for Reform*. Washington, DC.

8. Thanks to the reforms pursued to date, the quality of Georgia's investment climate stands out among the transition economies in Caucasus and Central Asia, but the country can aim even higher. Georgia scored 83.28 in the recent overall ease of doing business for 2018, substantially higher than the average of other Caucasus and Central Asian economies (70.79). In fact, Georgia ranked higher than any actively borrowing developing member countries of the Asian Development Bank (ADB). However, it is still ranked below several developing member economies that have already graduated from regular ADB assistance, such as Singapore and Hong Kong, China.<sup>12</sup> Room exists for further improvement, and for catching up in the areas of dealing with construction permits, getting electricity, paying taxes, trading across borders, enforcing contracts, and resolving insolvency (Table 2). Access to finance is one of the areas where Georgia's performance stands out, but financial intermediation still relies primarily on banking and the country's capital market remains underdeveloped and shallow.

**Table 2: Doing Business**

	Georgia	Other CCA	Singapore	Hong Kong, China
Overall ease of doing business	83.28	70.79	85.24	84.22
Starting a business	99.34	94.13	98.23	98.15
Dealing with construction permits	77.61	69.45	84.73	88.24
Getting electricity	84.38	68.61	91.33	99.34
Registering property	92.86	79.49	83.14	73.55
Getting credit	85.00	65.83	75.00	75.00
Protecting minority investors	81.67	70.56	80.00	78.33
Paying taxes	89.03	72.30	91.58	99.71
Trading across borders	90.03	71.04	89.57	95.04
Enforcing contracts	76.90	66.61	84.53	69.13
Resolving insolvency	56.03	49.89	74.33	65.69

CCA = Central Asia and Caucasus.

Notes:

1. The ease of doing business score (formerly, the distance to frontier score) presented in this table captures the gap between an economy's current performance and a measure of best regulatory practice. Higher scores show absolute better ease of doing business (the best score is set at 100), while lower scores show absolute poorer ease of doing business (the worst performance is set at 0).
2. The ease of doing business score for "Other CCA" represents average of Armenia, Azerbaijan, the Kyrgyz Republic, Tajikistan, and Uzbekistan. The ease of doing business score for Turkmenistan is not available.

Source: World Bank. 2018. *Doing Business 2019: Training for Reform*. Washington, DC.

9. Trade policy—both market access and trade facilitation<sup>13</sup>—and the expansion of trade-related infrastructure are of particular importance when it comes to taking advantage of Georgia's unique geographical position at the crossroads of Europe and Asia. Aside from the Deep and Comprehensive Free Trade Area with the EU, Georgia has free trade agreements with several other trading partners, including countries in the Commonwealth of Independent States and Eastern Europe; Turkey; the European Free Trade Association; the People's Republic of China; and Hong Kong, China. Georgia's average most-favored nation tariff rate came down to 1.5% by 2018, only slightly above the 0.0% rate of Singapore and Hong Kong, China, both of which virtually adopt free trade. However, the agriculture sector still retains an average tariff rate of 6.5%. The

<sup>12</sup> This document singles out Singapore and Hong Kong, China among the graduate developing member economies for comparisons with Georgia. This is because both of these economies have a strong policy orientation as a free trader, backed by an enabling domestic business environment, which Georgia has been thriving at since the Rose Revolution in 2003.

<sup>13</sup> According to the trade facilitation indicators of the Organisation for Economic Co-operation and Development (OECD), Georgia performed better than the average of Europe (excluding OECD countries) and Central Asia, but there is substantial room for improvement in advance ruling: [http://www.oecd.org/tad/facilitation/Georgia\\_OECD-Trade-Facilitation-Indicators.pdf](http://www.oecd.org/tad/facilitation/Georgia_OECD-Trade-Facilitation-Indicators.pdf).

sector accounts for 43.1% of total employment but for only 8.2% of GDP, reflecting low labor productivity. In the area of trade facilitation, Georgia's ease-of-doing-business ranking for trading across borders (43rd) is lower than the country's own record in most of the other areas covered in the World Bank's report, and still lower than that of Hong Kong, China. The World Bank's logistics performance indicators show that Georgia could enhance trade-related infrastructure to relieve supply-side constraints on trade and further advance customs efficiency (Table 3). Similarly, the World Economic Forum's Global Competitiveness Report ranks the state of Georgia's infrastructure in 72nd place (with a score of 66.7), far below Singapore (1st, with a score of 95.7) and Hong Kong, China (2nd, with a score of 94.0).<sup>14</sup>

**Table 3: Logistics Performance Index**

	LPI Rank	LPI Score	Customs Score	Infrastructure Score
Europe and Central Asia	...	3.24	3.04	3.13
Georgia	119	2.44	2.42	2.38
Hong Kong, China	12	3.92	3.81	3.97
Singapore	7	4.00	3.89	4.06

... = not available, LPI = logistics performance index.

Note: The LPI is an interactive benchmarking tool created to help countries identify the challenges and opportunities they face in their performance on trade logistics and what they can do to improve their performance. Performance is evaluated using a 5-point scale (1 for the lowest score, 5 for the highest), and the ranking among 160 countries (the higher, the better) is provided.

Source: World Bank. Logistics Performance Index. <https://lpi.worldbank.org/> (accessed on 21 September 2018).

10. Georgia also has substantial scope for boosting the efficiency of human capital allocation by making the country's labor market more inclusive. While the unemployment rate in Georgia has gradually declined, it remains high at 12.7% in 2018 (Table 4). Unemployment is particularly high in the age group 20–24,<sup>15</sup> at 30.8% in 2018.<sup>16</sup> In Tbilisi, the unemployment rate reached 18.8%, higher than in the rest of the country. Underemployment is also significant, particularly in rural areas. The unemployed or underemployed face a higher risk of poverty.

**Table 4: Employment**  
(% of total)

	2011	2012	2013	2014	2015	2016	2017	2018
Employed	82.7	82.8	83.1	85.4	85.9	86.0	86.1	87.3
<i>of which:</i>								
Hired	34.4	35.7	35.1	37.5	39.6	40.1	41.6	44.3
Self-employed	47.9	46.7	47.5	47.6	46.0	45.6	44.5	43.0
Not stated	0.4	0.4	0.5	0.3	0.4	0.3	0.0	0.0
Unemployed	17.3	17.2	16.9	14.6	14.1	14.0	13.9	12.7

Source: National Statistics Office of Georgia (GeoStat). 2019. *Statistical Yearbook of Georgia 2018*. Tbilisi.

11. According to a study conducted jointly by ADB, the IMF, and the World Bank, the skills mismatch in Georgia's labor market is significant (Box 2). More than 50% of the unemployed have a secondary school diploma and 40% have a higher education degree. However, they lack the skills actually required in the labor market, i.e., low- and mid-level technical skills, and soft skills

<sup>14</sup> Klaus Schwab. 2018. *The World Competitiveness Report 2018*. Geneva: World Economic Forum.

<sup>15</sup> United Nations Development Programme website on the Sustainable Development Goals in Eastern Europe and Central Asia (<http://www.ge.undp.org/content/dam/rbec/docs/undp-rbec-goal-1-no-poverty-infographic.pdf>).

<sup>16</sup> National Statistic Office of Georgia (GeoStat). <http://www.geostat.ge/index.php?lang=eng> (accessed 20 May 2019).

such as creative and critical thinking, problem solving, teamwork, leadership, and decision making.<sup>17</sup> The problem is not a shortage of college graduates, but the poor quality of education.

*“Georgians with advanced education account for a large share of the labor force but also constitute a significant percentage of the unemployed, suggesting an oversupply of educated labor and/or a weak education system. Over 50% of all unemployed Georgians have a secondary school diploma and as many as 40% have a higher education degree. In urban areas, the proportion of unemployed with higher education is even higher at 46%. Significant unemployment among highly educated workers carries considerable individual and social costs, leading to a paradoxical situation of simultaneous high unemployment and a shortage of qualified labor and a loss of human capital investment in Georgia.” (footnote 17)*

In fact, the quality of education is poor at the lower levels as well. This brings ill-prepared entrants to universities, which further compounds the poor quality of tertiary education. Thus, all levels of education, including vocational education and training, are in dire need of reforms that enable them to cater to the labor market’s needs.

#### **Box 2: Joint ADB–International Monetary Fund–World Bank Study on Labor Market and Education**

In 2018, ADB, the IMF, and the World Bank completed a joint study on Georgia’s labor market and education. The research found that the country’s economic reforms had led to robust growth, but the benefits were not broadly shared. Georgia’s growth resulted in meager employment gains; and unemployment, underemployment, poverty, and income inequalities remain high. Poverty incidence and inequality, mostly concentrated in rural areas, also remain high compared with regional comparators. Most of Georgia’s labor resources are locked in low productivity jobs, while a large share of the young population with higher education is unemployed. Business surveys indicate that the mismatch in labor skills has increasingly become an obstacle to growth.

Comprehensive education reforms—including improvements to early childhood, general, and higher education; better vocational training; and upgrades to sector management—that are well integrated into the government’s reform agenda would help produce a better-skilled workforce and support more robust and inclusive growth. More supportive labor market policies, including better labor-matching services and more flexible employment options, would enhance job creation.

Source: F. Painchaud, L. Ersado, and J. Sarvi. 2018. Georgia’s Labor Market and Education System. In IMF. *Georgia: Selected Issues*. Washington, DC.

12. In the long run, Georgia is expected to suffer from a shrinking labor force because of an aging population. This makes the participation of women in the labor market all the more important.<sup>18</sup> The difference in unemployment between men and women is not significant in Georgia, but a gap still exists. While the unemployment rate of women is lower than that of men (or equal, as far as youth unemployment is concerned), women’s share in nonagricultural employment was 46.4% in 2017, less than 50% (Table 5). ADB’s 2019 gender assessment found that although Georgia achieved near gender parity in educational attainment, women account for a significant proportion of the poorest—they figure in the bottom 40% of income distribution, and households headed by women are overrepresented among the poor (Box 3).<sup>19</sup>

<sup>17</sup> F. Painchaud, L. Ersado, and J. Sarvi. 2018. Georgia’s Labor Market and Education System. In IMF. *Georgia: Selected Issues*. Washington, DC.

<sup>18</sup> Women’s labor force participation rate was 57.3%, compared with 78.4% for men. ADB. 2018. *Country Gender Assessment*. Manila.

<sup>19</sup> ADB. 2018. *Country Gender Assessment*. Manila.

**Table 5: Gender in Georgia's Labor Market**

	2013	2014	2015	2016	2017
Share of nonagricultural employment, women (% of total nonagricultural employment)	46.0	45.7	46.4	46.7	46.4
Total unemployment rate (ratio of women to men)	0.8	0.7	0.8	0.6	0.7
Youth unemployment rate (ratio of women to men)	1.0	1.0	1.1	1.0	1.0

Source: United Nations Development Programme. Global Human Development Indicators. <http://hdr.undp.org/en/countries> (accessed on 26 September 2018)

**Box 3: ADB's Country Gender Assessment**

The country gender assessment was prepared under technical assistance funded by the Asian Development Bank (ADB).<sup>a</sup> Its major findings in relation to inclusive and sustainable growth are as follows.

**International ranking and indicators on gender.** Georgia made significant strides in creating an enabling environment for gender equality in the past 30 years. The recognition of equal rights for all is a cornerstone of its constitution, and dedicated legislation has been put in place to promote nondiscrimination and women's rights. However, these measures have not translated into overall progress against regionally and globally comparable gender equality outcomes. Over the past 10 years, Georgia's ranking in the World Economic Forum Global Gender Gap Index (WEF GGI) has steadily deteriorated. In 2017, Georgia ranked 94th of 144 countries, compared with 90th in 2016, 88th in 2010, and 54th in 2006. This puts Georgia among the lowest five countries for gender equality within the Eastern Europe and Central Asia region, just above Tajikistan, Armenia, Azerbaijan, and Hungary.

**Institutional mechanisms on gender equality.** The National Gender Equality Council (GEC) was established within Georgia's Parliament in 2004, initially as an advisory body. The primary objective of the GEC is to ensure systematic and coordinated government processes on gender equality issues, including overseeing the implementation and monitoring of the Gender Equality (GE) Law and liaising with local representations across the country. The GEC became a permanent body after the adoption of the GE Law, with members appointed every 4 years when a new Parliament is elected. It comprises 17 members of Parliament, whose composition depends on the proportion of party members elected to Parliament. The vice-speaker of the Parliament is the GEC's chair. In addition, amendments to the GE Law in 2016 now require all municipal parliaments (*Sakrebulo*s) to appoint a gender advisor and to create a local GEC. The process of putting these measures in place is still underway in many municipalities.

**Women's economic empowerment.** Although Georgia achieved near gender parity in educational attainment, the country needs further improvements on key global indicators of economic status and political voice. According to the most recent United Nations Development Programme (UNDP) Global Gender Index figures, women's labor force participation rate was 57.3%, compared with 78.4% for men. Even though the number of female parliamentarians has been rising in the last few years, women still held only 16% of seats in the Parliament in 2017. Georgia ranked 114th of 144 countries for women's political empowerment in the 2017 WEF GGI. Georgia also has skewed female-to-male sex ratios at birth.

**Mainstreaming gender in ADB operations.** ADB is committed to promoting gender equality through a twin-track strategy that promotes gender mainstreaming in all areas of its operation, while retaining a specific focus on women and girls in projects where special assistance is needed to ensure their full participation in mainstream activities. ADB's priority sectors and subsectors in Georgia are transport, urban transport, water and other urban infrastructure and services, energy, public sector management, and finance.

<sup>a</sup> ADB. 2016. *Regional Technical Assistance for Strengthening Gender-Inclusive Growth in Central and West Asia*. Manila (RETA 9088).

Source: ADB. 2018. *Georgia: Country Gender Assessment*. Manila.

13. As in many other countries, substantial regional disparities exist in Georgia. The regional GDP per capita of the capital, Tbilisi, is \$6,556.1—more than twice that of most other regions (Table 6). The average remuneration of employees is also substantially higher in Tbilisi. Unemployment rates in the areas surrounding the capital (3.9% in Kakheti, 15.3% in Kvemo Kartli, 9.7% in Mtskheta-Mtianeti, and 14.5% in Shida Kartli) tend to be lower than in Tbilisi itself (18.8%).<sup>20</sup>

<sup>20</sup> World Bank. 2018. *Georgia – From Reformer to Performer: A Systematic Country Diagnostic*. Washington, DC.

**Table 6: Regional Disparities**

Region	Gross Domestic Product Per Capita (\$)	Unemployment Rate (%)	Average Monthly Remuneration (GEL)
Abkhazia	...	...	...
Adjara	3,894.1	9.1	848.5
Guria	2,736.2	1.8	596.1
Kakheti	2,711.8	3.9	593.9
Kvemo Kartli	2,853.6	15.3	817.3
Mtskheta-Mtianeti	2,853.0	9.7	950.0
Racha-Lechkhumi and Kvemo Svaneti	2,516.8	12.4	509.6
Samegrelo-Zemo Svaneti	3,013.9	11.9	758.2
Samtskhe-Javakheti	2,851.2	6.8	664.7
Shida Kartli	2,033.0	14.5	564.4
Tbilisi	6,556.1	18.8	1,167.60

... = not available, GEL = lari (Georgia's currency).

Source: National Statistics Office of Georgia (GeoStat). <http://www.geostat.ge/index.php?action=0&lang=eng> (accessed on 20 May 2019).

14. Whereas structural reforms improve the allocative efficiency within a country's production frontier, progress in science and technology has the potential to expand the production frontier itself, by stimulating innovations. Thus, maximizing Georgia's growth performance requires not only reforms but also investments in science and technology. The share of research and development expenditures in Georgia's GDP has increased from 0.22% in 2000 to 0.30% in 2016, reaching a level substantially higher than the average of other economies in Caucasus and Central Asia, but much lower than that of ADB's graduate developing member economies such as Singapore and Hong Kong, China. Likewise, the share of researchers among inhabitants in Georgia is higher than the average of regional comparators, but lower than that of Singapore and Hong Kong, China. Georgia has ample room for further enhancement of research and development capacity to brighten Georgia's prospects as a growth performer.

**Table 7: Research and Development**

	Georgia		Other CCA	Singapore <sup>a</sup>	Hong Kong, China
	2000	2016	2016	2016	2016
Research and development expenditure as a proportion of GDP <sup>b</sup> (%)	0.22	0.30	0.17 <sup>c</sup>	2.18	0.79
Researchers, full-time equivalent <sup>d</sup> (per million inhabitants)	...	1,718	796 <sup>e</sup>	7,808	3,977

... = not available, CCA = Central Asia and Caucasus, GDP = gross domestic product.

<sup>a</sup> 2014 for Singapore.

<sup>b</sup> Refers to the amount of research and development expenditure.

<sup>c</sup> Average of Armenia, Azerbaijan, Kazakhstan, the Kyrgyz Republic, Tajikistan, and Uzbekistan. Data not available for Turkmenistan.

<sup>d</sup> Direct measure of the number of research and development workers per 1 million people.

<sup>e</sup> Average of Kazakhstan and Uzbekistan. Data not available for Armenia, Azerbaijan, the Kyrgyz Republic, Tajikistan, and Turkmenistan.

Source: Asian Development Bank. 2018. *Key Indicators for Asia and the Pacific*. Manila.

## 2. Sustainability – Fiscal, External, and Environmental

15. While improved productivity creates growth momentum, its sustainability needs to be safeguarded by sound and well-governed public finance, external balances, and natural resource management. By and large, Georgia has maintained a prudent fiscal policy since the Rose

Revolution. With the successful introduction of the Universal Health Care Program, the government moved to improve the administrative efficiency of targeted medical insurance programs in 2016, so as to enhance the effectiveness of social spending. In recent years, the size of the augmented fiscal deficit, which reflects both capital and recurrent expenditures, has not exceeded 3% of GDP (even when it expanded to cater for social policy needs in 2016). Georgia's fiscal performance even exceeded the target set under the ongoing Extended Fund Facility (EFF) program by the IMF, which highly commended the achievements by Georgia's authorities.<sup>21</sup> Fiscal prudence should be continuously pursued to ensure macroeconomic stability in the future.

**Table 8: Public Finance**  
(% of gross domestic product)

	2015	2016	2017	2018
General government total revenue, excluding grants	27.1	27.5	28.3	26.9
General government total expenditure and net lending	30.8	31.3	32.0	30.6
Fiscal balance <sup>a</sup>	(1.1)	(1.4)	(0.9)	(0.8)
Augmented fiscal balance <sup>b</sup>	(2.7)	(3.0)	(2.9)	(2.4)

( ) = negative.

<sup>a</sup> Fiscal balance reported according to the Government Finance Statistics Manual (GFSM) 2001 of the International Monetary Fund (IMF).

<sup>b</sup> Augmented fiscal balance reported according to the IMF's GFSM 1986, which reflects both capital and recurrent expenditures.

Sources: Asian Development Bank. 2019. *Asian Development Outlook*. Manila; IMF. 2018. *Regional Economic Outlook Update: Middle East and Central Asia (November 2018)*. Washington, DC; Ministry of Finance of Georgia.

16. The 2018 public expenditure and financial accountability (PEFA) assessment concluded that Georgia's public financial management systems are strong, and the budget documents present most of the basic and much of the supplementary information required to support a transparent budgetary process.<sup>22</sup> The current and earlier PEFA assessments also report that Georgia has made good progress toward a comprehensive medium-term expenditure framework based on the "program budgeting for results" approach. However, Georgia ranked 41st (out of 180 countries) and scored 58 (out of 100) in the 2018 corruption perception index of Transparency International, implying the scope for further improvement in governance.<sup>23</sup>

17. While the current account deficit has narrowed to 7.7% of GDP in 2018, it is still high. It is noteworthy that the current account deficit was more than fully financed by foreign direct investment (FDI) in 2017,<sup>24</sup> while its share declined in 2018. Compared with portfolio investment, FDI is less likely to be withdrawn over short-term speculation by investors, and more likely to add to the country's long-term productive capacity. Georgia maintains a flexible exchange rate regime, which not only helps adjustments in external balances but also prevents sudden currency crashes that typically occur when currency pegging is perceived to be unsustainable in the eyes of investors (or by their self-fulfilling speculation). Nonetheless, the imports cover of Georgia's gross international reserves is 3.3 months, hardly a high figure, and careful attention should be paid to boost the reserve buffer in the future.

<sup>21</sup> IMF. 2018. *Press Release No. 18/132 (16 April 2018): IMF Staff Completes Mission for the 2018 Article IV Consultation and Second Review of Georgia's Extended Fund Facility* (<http://www.imf.org/en/News/Articles/2018/04/16/pr18132-imf-staff-completes-mission-for-the-2018-article-iv-consultation-for-georgia>).

<sup>22</sup> World Bank et al. 2018. *Georgia: Public Expenditure and Financial Accountability (PEFA) Assessment*. Washington, DC.

<sup>23</sup> Transparency International website (<https://www.transparency.org/country/GEO>).

<sup>24</sup> The World Bank's Doing Business 2013 report presented a cross-country study that confirmed the positive correlation between Doing Business indicators and FDI inflow. World Bank. 2013. *Doing Business 2013. Smarter Regulations for Small and Medium-Size Enterprises*. Washington, DC. Georgia's enabling business environment might have worked favorably to attract FDI.

**Table 9: Balance of Payments**

	2015	2016	2017	2018
Current account balance (% of GDP) <sup>a</sup>	(12.6)	(13.1)	(8.8)	(7.7)
Merchandise trade balance (% of GDP)	(36.4)	(36.0)	(34.5)	(38.2)
Financial account (% of GDP)	12.1	12.3	8.7	8.7
Foreign direct investment [net] (% of GDP)	9.6	8.3	10.8	5.1
Gross international reserves (months of imports)	2.5	2.8	3.1	3.3

( ) = negative, GDP = gross domestic product.

<sup>a</sup> Current account includes official transfers.

Source: Ministry of Finance of Georgia; National Bank of Georgia.

18. Apart from the physical and human capital, the preservation of natural capital<sup>25</sup> is of critical importance for Georgia's growth. The 2017 uptick in economic growth reflects a sharp increase of tourists who typically visit the country partly to enjoy its natural scenery. From this perspective, it is encouraging that Georgia's annual average rate of deforestation was negative during 2000–2015. However, the share of nationally protected areas accounted for only 6.5% in 2014, much smaller than that in other Caucasus countries. Georgia's carbon dioxide emissions totaled about 9 million metric tons in 2014, higher than those of Armenia but lower than Azerbaijan's. Georgia has much richer water resources than other Caucasus countries (Table 10). This variable natural capital has critical importance for irrigation, hydropower plants, and personal consumption, and has to be protected as an important element in the country's economic development, energy security, and export revenue. Under the United Nations Framework Convention on Climate Change (UNFCCC) Paris Agreement, Georgia committed to (i) reduce its annual greenhouse gas emissions in 2030 by up to 25% compared with business as usual, particularly in the sectors of agriculture, energy, and industry and trade; and (ii) strengthen the resilience of infrastructure and agriculture to climate change and disaster impacts.<sup>26</sup>

**Table 10: Natural Capital**

	Armenia	Azerbaijan	Georgia
Deforestation (2000–2015, annual average %)	0.02	(1.80)	(0.15)
Nationally protected areas (2014, terrestrial and marine areas, % of total territorial area)	24.80	14.00	6.50
Carbon dioxide emissions (2014, million metric tons)	5.53	37.49	8.99
Internal renewable freshwater resources (2014, per capita cubic meters)	2,282	851	15,597

( ) = negative.

Sources: World Bank. 2017. *World Development Indicators 2017*. Washington, DC.; World Bank. World Development Indicators. <https://data.worldbank.org> (accessed on 12 July 2019).

### 3. Government's Reform Agenda

19. The Government Program 2016–2020 appropriately tackles the aforementioned challenges to Georgia's growth performance. Apart from emphasizing the importance of infrastructure development to take advantage of Georgia's geographical location, the plan calls for further improving the country's business environment and supporting public administration by building on the remarkable achievements to date. The objective is to provide a fully enabling business environment for private sector entities, including through less distortive taxation. For

<sup>25</sup> "Natural capital" is a concept that regards natural resources as a factor of production, such as capital (physical capital) and labor (human capital). D. Helm, 2016. *Natural Capital: Valuing the Planet*. New Haven: Yale University Press.

<sup>26</sup> Government of Georgia. 2015. *Georgia's Intended Nationally Determined Contribution Submission to the UNFCCC*. Tbilisi.

instance, the government introduced the “Estonian model” of taxation in 2017, granting companies domiciled in Georgia tax exemption for retained or reinvested earnings. While Georgia’s business environment is already one of the best in the world, there is still scope to aim for the best among the best. At the same time, the Government Program 2016–2020 correctly identifies the importance of education in catering to the needs of the labor market, and the government announced a new education reform agenda in 2018. Its aim is to pursue comprehensive reforms at all levels of the education system. The newly formed government also accords priority to progress in science and technology, with an aim to further brighten Georgia’s prospects as a growth performer.

20. In the IMF’s estimates, the government’s reform agenda will have significant positive economic impacts.<sup>27</sup> The overall reform package—comprising improvements in the business environment, public investment, and education spending—is estimated to raise the real GDP by 5% in the long run and, in the process to reach the post-reform steady state,<sup>28</sup> the annual growth by about 0.7 percentage points over the medium term. A better business environment is expected to raise TFP by 1% over a 10-year period. Scaled-up public investment and less distorting taxation would increase real GDP by 3% in the new steady state, and the growth by about 0.4 percentage points in the medium term. The additional productivity impact of the education reform is envisaged to take effect after 12 years, with a progressive increase in TFP growth by half a percentage point, which would boost the level of output by between 5% and 10% in the long run. The IMF projects that the current account will turn into a small surplus in the steady state.

### **C. Implications for ADB’s Engagement**

21. Under the country partnership strategy for 2014–2018, ADB’s operations primarily focused on the formulation of physical capital through infrastructure development (transport, urban, and energy), as well as public financial management, and private and finance sector development. These efforts continue to be central for fostering development at the national, local, and regional levels, with particular emphasis on enhancing the country’s connectivity and trade-related infrastructure. At the same time, this document highlights the development of human capital to respond to the needs of the labor market as equally important. Thus, education, including vocational education and training, is added as an additional new sector priority under the country partnership strategy for 2019–2023. Structural reforms to improve the business environment for private-sector-led growth—a primary driver of growth to date—should be continuously supported. In particular, Georgia has substantial scope for easing trade across borders, and specific attention should be paid to enhancing the country’s investment climate with the objective of furthering integration into the global economy. Opportunities to advance growth and economic development through innovations should also be explored.

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<sup>27</sup> IMF. 2018. Assessing Macroeconomic and Structural Reforms in Georgia. In IMF. *Georgia: Selected Issues*. Washington, DC. A steady state refers to the state of the economy where all aggregates are constant.

<sup>28</sup> The IMF’s projection does not specify when growth reaches its steady state.