



## Concept Paper

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Project Number: 52161-001  
October 2018

# Proposed Programmatic Approach and Policy- Based Loan for Subprogram 1 Georgia: Second Domestic Resource Mobilization Program

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**Asian Development Bank**

## CURRENCY EQUIVALENTS

(as of 14 September 2018)

Currency unit	–	lari (GEL)
GEL1.00	=	\$0.3846
\$1.00	=	GEL2.6000

## ABBREVIATIONS

ADB	–	Asian Development Bank
PPP	–	public–private partnership
SMEs	–	small and medium-sized enterprises
TA	–	technical assistance

## NOTE

In this report, “\$” refers to United States dollars.

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## PROGRAM AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number:</b> 52161-001	
<b>Project Name</b>	Second Domestic Resource Mobilization Program (Subprogram 1)	<b>Department/Division</b>	CWRD/CWPF
<b>Country Borrower</b>	Georgia Georgia	<b>Executing Agency</b>	Ministry of Finance
<b>2. Sector</b>	<b>Subsector(s)</b>	<b>ADB Financing (\$ million)</b>	
✓ <b>Public sector management</b>	Public expenditure and fiscal management		10.00
	Reforms of state owned enterprises		5.00
<b>Finance</b>	Finance sector development		10.00
	Infrastructure finance and investment funds		5.00
	Money and capital markets		10.00
	Small and medium enterprise finance and leasing		10.00
	<b>Total</b>		<b>50.00</b>
<b>3. Strategic Agenda</b>	<b>Subcomponents</b>	<b>Climate Change Information</b>	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low
<b>4. Drivers of Change</b>	<b>Components</b>	<b>Gender Equity and Mainstreaming</b>	
Governance and capacity development (GCD)	Institutional systems and political economy	Effective gender mainstreaming (EGM)	✓
Knowledge solutions (KNS)	Public financial governance		
Partnerships (PAR)	Application and use of new knowledge solutions in key operational areas		
Private sector development (PSD)	Implementation Private Sector Conducive policy and institutional environment Promotion of private sector investment Public sector goods and services essential for private sector development		
<b>5. Poverty and SDG Targeting</b>		<b>Location Impact</b>	
Geographic Targeting	No	Nation-wide	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG8		
<b>6. Risk Categorization:</b>	Low		
<b>7. Safeguard Categorization</b>	<b>Environment: C Involuntary Resettlement: C Indigenous Peoples: C</b>		
<b>8. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>50.00</b>	
Sovereign Programmatic Approach Policy-Based Lending (Regular Loan): Ordinary capital resources		50.00	
<b>Cofinancing</b>		<b>0.00</b>	
None		0.00	
<b>Counterpart</b>		<b>0.00</b>	
None		0.00	
<b>Total</b>		<b>50.00</b>	
<b>Currency of ADB Financing: USD</b>			

## I. THE PROPOSAL

1. The proposed Second Domestic Resource Mobilization Program will support the Government of Georgia in sustaining medium-term growth by mobilizing domestic resources for private sector development and economic diversification. The program is consistent with the Government Platform, 2016–2020;<sup>1</sup> and the Asian Development Bank (ADB) country partnership strategy, 2014–2018 for Georgia.<sup>2</sup> It is also included in ADB’s country operations business plan, 2019–2021 for Georgia.<sup>3</sup>

2. ADB chose the programmatic approach as it will allow for effective implementation and monitoring of reforms over the program period i.e., 2020–2022, as well as flexibility to incorporate changes if warranted by changes in the country’s economic situation. The government has asked ADB to provide support through a policy-based lending modality to be disbursed over two subprograms.<sup>4</sup>

## II. PROGRAM AND RATIONALE

### A. Background and Development Constraints

3. Despite numerous shocks—2008 global financial crisis, conflict with the Russian Federation, and the 2014 regional economic headwinds—Georgia’s economy has grown at an average annual rate of 5% since 2008. In 2017, the economy grew at 5% based on remittance-driven consumption growth and rapid growth in exports and tourism. A recovery of consumption, investment in infrastructure, and continued development of the tourism sector are key factors that will fuel growth in the coming years. The growth momentum is expected to continue in 2018 and 2019. These positive economic trends have been reflected in the upgrade in September 2017 of Georgia’s sovereign rating from Ba3 to Ba2 (Moody’s Investors Service). The private sector has led this growth based on an improved business climate. However, inadequate mobilization and ineffective deployment of domestic resources for developing and financing key infrastructure and services (including transport, logistics, and energy) and for small and medium-sized enterprises (SMEs) continue to constrain private sector development.<sup>5</sup>

4. ADB has supported the government in addressing constraints to more and effective domestic resource mobilization and private sector development. During 2014–2016, the Improving Domestic Resource Mobilization Program and attached technical assistance (TA) supported the government’s reforms geared toward (i) stronger debt and fiscal risk management, (ii) more robust revenue and public expenditure management, (iii) generation of domestic savings, and (iv) mobilization of private resources for investment.<sup>6</sup> The support helped create more fiscal space through better revenue and public expenditure management to enable higher social expenditures and public investment; enhanced capacity of the Ministry of Finance to manage fiscal risks, including contingent liabilities of public–private partnership (PPP) projects; improved access of SMEs to financial and business development services; development of a road map for

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<sup>1</sup> Government of Georgia. 2016. *Freedom, Rapid Development, Prosperity—Government Program, 2016–2020*. Tbilisi.

<sup>2</sup> ADB. 2014. *Country Partnership Strategy: Georgia, 2014–2018*. Manila.

<sup>3</sup> ADB. 2018. *Country Operations Business Plan: Georgia, 2019–2021*. Manila. The preliminary design and monitoring framework are in Appendix 1.

<sup>4</sup> ADB will provide transaction technical assistance (TA) for program preparation and implementation. Technical Assistance for Program Preparation (accessible from the list of linked documents in Appendix 3).

<sup>5</sup> Domestic resource mobilization refers to public and private sector activities. The public sector mobilizes resources through public revenue generation, for social services and infrastructure investment. The private sector mobilizes the savings of households and firms through financial intermediaries, for investment in productive activities.

<sup>6</sup> ADB. [Georgia: Improving Domestic Resource Mobilization for Inclusive Growth](#).

a sustainable pension system; and the issue of lari bonds to promote local currency bond market development. ADB's support and the recent rebound in growth offers an opportunity to advance the progress made under the previous program and catalyze public sector resources more effectively for private sector-led economic growth, as enunciated in Government Program 2016–2020 (footnote 1).

**5. Public investment management and infrastructure development.** The government has begun an ambitious infrastructure development program and has identified PPPs as a key mechanism under this program. However, the economic and social impact of public investment depends critically on its efficiency, which is contingent on robust public investment planning and management—including managing public investments in a fiscally sustainable way. Georgia is among the most reformed economies in the subregion, but lags almost every country in the region on Infrascope's PPP environment indicators.<sup>7 8</sup> ADB has provided support for developing PPP legislation and related implementing (secondary) regulations and guidelines.<sup>9</sup> Support needs to continue for developing a comprehensive framework for PPPs and building the operational knowledge and technical capacity of key government ministries and agencies (health, roads, and energy) that select, develop, coordinate, and promote PPP, anchored in robust public investment programming. Guidelines and tools for assessing and managing fiscal risks and contingent liabilities, affordability analyses, and value for money need to be developed. Standardized PPP documentation (e.g., concession agreements) needs to be developed to reduce transaction costs.<sup>10</sup> The banking sector and capital markets are not yet able to provide long-term finance for infrastructure. Government financial support mechanisms (e.g., guarantees, viability gap funds, and mechanisms facilitating long-term debt) are needed in the early stages of PPP market development.

**6. Access to financial services for small and medium-sized enterprises.** The government is keen for the private sector, driven by increased competitiveness of SMEs, to become the key pillar of economic growth. This has assumed high importance in the context of the European Union–Georgia Association Agreement, including the Deep and Comprehensive Free Trade Agreement (ratified by the Parliament of Georgia in July 2014), which offers an opportunity for businesses to maximize their export potential, achieve deeper integration with the European Union market, and increase the potential to attract foreign direct investment. Reforms related to improving the business and investment climate have resulted in improved ratings across multiple indicators.<sup>11</sup> However, despite constituting the largest share of operating enterprises (52% in the first quarter of 2018), SMEs' contribution to gross domestic product is still very low (18% in 2014). SMEs remain concentrated in low value-added sectors and hence low paying jobs. They are constrained by high bank lending interest rates (16.0% in local currency loans and 8.4% in foreign currency loans as of March 2018) and high collateral requirements (up to 90% of the loan amount). Access to finance is often limited to foreign currencies, exposing SMEs to currency reduced risks.<sup>12</sup> No mechanisms are in place to reduce the perceived risk of lending to SMEs under low collateral conditions.

<sup>7</sup> European Bank for Reconstruction and Development. 2017. *Transition Report 2017–18: Sustaining Growth*. London.

<sup>8</sup> The Economist Intelligence Unit. 2017. [Evaluating the environment for public–private partnerships in Eastern Europe, Central Asia and the Southern and Eastern Mediterranean: The 2017 Infrascope](#). London.

<sup>9</sup> The Law on Public-Private Partnership was approved in May 2018 and secondary legislation was approved in July 2018.

<sup>10</sup> ADB. 2015. *Technical Assistance to Georgia for Development of Public–Private Partnerships*. Manila.

<sup>11</sup> Georgia has climbed from 16th position in 2008 to 9th position in 2017 in the Ease of Doing Business ranking and from 130th place in 2005 to 44th place in 2016 on Transparency International's Corruption Perceptions Index.

<sup>12</sup> World Economic Forum. 2017. [The Global Competitiveness Report, 2017–2018](#). Geneva.

7. **Pensions.** ADB has been supporting the government in the development of a multi-pillar pension system since 2014 under the previous program.<sup>13</sup> A pension reform policy was prepared by government, with a rules-based indexation mechanism approved for the universal pension, replacing ad hoc adjustments of the pension amount. Parliament approved the law on mandatory private pension in July 2018 through adoption of the draft Law of Georgia on Accumulative Pension. A road map for the establishment of the private pension system has also been prepared by government; and the government provisionally earmarked funds in 2018 to finance the Pension Agency that will manage the private pension and to pay the government share of the contributions. The proposed Pension Agency will need to be established and the government will need to introduce a rules-based mechanism to maintain, and possibly increase, the purchasing power of the universal pension. In the longer term, the private sector pension savings will provide long-term resources for infrastructure and SMEs, among others, through capital market intermediation.

8. **Capital markets.** The government views limited access to domestic long-term financial resources as a critical obstacle to the country's economic development, since it constrains savings and limits long-term funding for investments. Georgia has a highly concentrated banking industry characterized by banks' dominance as investors in the domestic securities market. Capital market development can contribute to meeting the increasing financing requirements of a growing economy by diversifying a predominantly bank-based system of financial intermediation. This would expand alternative sources of credit, limit the systemic impacts of economic shocks, and reduce financing costs to borrowers by stimulating healthy competition with the banking sector. The formulation of a national capital market master plan is critical as an anchor and to form the basis of Georgia's capital market development. The structural reforms of the pension system, including the development of private pension funds, will support their investment in domestic debt and help develop secondary markets for fixed-income securities.

## B. Policy Reform and ADB's Value Addition

9. ADB's long-term partnership with the government in the design and implementation of the programmatic policy-based Improving Domestic Resource Mobilization Program and lessons learned, as well as extensive experience with similar reform programs in other countries in the region, make ADB well suited to design the proposed program.<sup>14</sup> Sustained engagement under the previous program enabled ADB to motivate the government to undertake reforms that might not have been addressed otherwise, such as pensions, revenue and public expenditure management, debt and cash management, fiscal risk management, which are complex and require gradual implementation. The proposed program would be an extension of that engagement to catalyze further reforms. ADB's related investment and TA interventions in the country will complement the proposed program and help strengthen its design through necessary diagnostics as well as implementation support where suitable.<sup>15</sup> The programmatic approach will allow the program to take a medium- to long-term view, and design and sequence the envisaged reforms accordingly. It will also allow for recalibrating reforms, particularly when warranted by unavoidable political realities and /or exogenous economic shocks. The proposed program responds to key government requests and its design is being closely coordinated with other

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<sup>13</sup> The aim of the multi-pillar pension system is to prevent old-age poverty through a universal pension, providing a flat-rate pension to women from the age of 60 and men from 65 onward, and to provide sufficient income replacement during retirement through an additional private pension.

<sup>14</sup> ADB. 2017. *Completion Report: Improving Domestic Resource Mobilization for Inclusive Growth Program in Georgia*. Manila.

<sup>15</sup> Lessons from ADB's PPP advisory experience in Bangladesh, India, Indonesia, Pakistan, the Kyrgyz Republic, and the Philippines are helping shape Georgia's PPP enabling environment and program in line with international good practices.

development partners' interventions such as the International Monetary Fund in public investment management, Agence Française de Développement in pension reforms, and the European Bank for Reconstruction and Development in the PPP legal and regulatory framework.

### C. Impacts of the Reform

10. The overarching development objective and program impact is inclusive economic growth sustained. The effect of the reforms will be effective mobilization of domestic resources for public and private investment increased. The reform areas are (i) generation of domestic savings enhanced, (ii) comprehensive PPP program operational, (iii) access to financial services for SMEs increased, and (iv) mobilization of private resources for long-term investment enhanced.

### D. Development Financing Needs and Budget Support

11. To support the government's development financing needs, including the cost of mobilizing domestic resources effectively for private sector development, the government has requested policy-based loans totaling \$100 million from ADB's ordinary capital resources. The loans will be disbursed as single-tranche policy-based loans of \$50 million each for subprogram 1 and subprogram 2 in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time). The amounts will be confirmed during the fact-finding mission. Subprogram 1 is on standby in 2019 and firm for 2020, while subprogram 2 is on standby in 2020 and firm for 2021.

### E. Implementation Arrangements

12. The Ministry of Finance will be the executing agency. The Ministry of Economy and Sustainable Development, Central Bank, and Ministry of Finance are the proposed primary implementing agencies. The indicative implementation periods are December 2018 to August 2019 for subprogram 1 and October 2019 to July 2020 for subprogram 2.

## III. TECHNICAL ASSISTANCE

13. Transaction TA in the amount of \$750,000 is required to support the diagnostics to identify key policy reforms and implement the reforms under the areas described in paras 5 to 8.<sup>16</sup> The TA will be financed from ADB's Technical Assistance Special Fund (TASF-other sources).

## IV. DUE DILIGENCE REQUIRED

14. Due diligence to be carried out during the program preparation is summarized as follows:
- (i) **Safeguards.** The direct and indirect impacts of the proposed policy actions on the environment, involuntary resettlement, and indigenous peoples, if any, will be assessed.
  - (ii) **Economic.** The economic viability and sustainability of the program will be assessed, and the economic benefits of the proposed policy reforms evaluated and where possible quantified.
  - (iii) **Governance.** Public financial management, procurement, anticorruption, and capacity development issues will be agreed with the government as part of the program design.
  - (iv) **Poverty and social.** No adverse poverty, social, or gender issues requiring

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<sup>16</sup> Approval on October 2018.

specific attention were identified. A gender impact assessment will be undertaken during due diligence to support gender mainstreaming under the proposed reforms.

15. Subprogram 1 is expected to be classified *category C* for all safeguard aspects.<sup>17</sup> The program design benefited from the explicit commitment of the government and incorporates knowledge gained from sustained ADB policy dialogue and ongoing TA implementation.

## V. PROCESSING PLAN

### A. Risk Categorization

16. The program is categorized *low* because the loan size for subprogram 1 does not exceed \$50 million.

### B. Resource Requirements

17. Program preparation and implementation will require ADB staff with expertise in key areas of the program i.e., public financial management, including PPPs, the private sector, and financial sector development. An estimated 10 person-months of staff time are estimated for processing the program. Transaction TA with six international experts (19 person-months) and three national experts (12 person-months) is required to undertake diagnostic work, support policy dialogue, and assist in the preparation of the subprograms. TA for \$750,000 is included to support the implementation of policy actions under the two subprograms and related capacity building of concerned ministries and/or agencies.

### C. Processing Schedule

18. The proposed processing schedule is in Table 2.

**Table 2: Proposed Processing Schedule**

Milestones	Expected Completion Date
Concept paper and Technical Assistance approval	September 2018
Technical Assistance inception mission	November 2018
Loan fact-finding mission	February 2019
Staff review meeting	March 2019
Loan negotiations	April 2019
Board consideration	June 2019 <sup>a</sup>
Loan signing	July 2019
Loan effectiveness	July 2019

<sup>a</sup> Approval is dependent on government confirmation. Program is listed as standby for 2019 and firm for 2020 in ADB. 2018. *Country Operations Business Plan: Georgia, 2019–2021*. Manila.  
Source: Asian Development Bank

## VI. KEY ISSUES

19. The private pension law was approved on 21 July 2018. The timeline for operationalization of the private pension scheme included in the legislation is very tight and may need extensions over time. This would have implications for the implementation of the pensions reform action plan, including establishing and operationalizing the Pension Agency and implementing formula-based adjustments to the universal pension.

<sup>17</sup> Initial Poverty and Social Analysis (accessible from the list of linked documents in Appendix 3).

## DESIGN AND MONITORING FRAMEWORK

<b>Country's Overarching Development Objective</b> Inclusive economic growth sustained <sup>a</sup>			
<b>Results Chain</b>	<b>Performance Indicators with Targets and Baselines</b>	<b>Data Sources and Reporting Mechanisms</b>	<b>Risks</b>
<b>Effect of the Reform</b> Effective mobilization of domestic resources for public and private investment increased	<p>By December 2021, private investment as a percentage of GDP increased to at least 30% (2018 baseline: 26%)</p> <p>By December 2021, SME lending as a percentage of total bank lending increased to at least 30% (2018 baseline: 25%)</p> <p>By December 2021, 3% increase in the level of pension fund investment in capital markets (2018 baseline: not formulated)</p> <p>By December 2021, \$100 million contributed to mandatory private pension fund (2018 baseline: not formulated)</p>	National Statistics Office of Georgia	Government commitment to reforms is not sustained, causing delays in implementing critical reforms
<b>Reform Areas under Subprogram 1</b> 1. Generation of domestic savings enhanced	<b>Indicative Policy Actions</b> <p>1.1 Pension Agency established by June 2019 (2018 baseline: none)</p> <p>1.2 Rules-based mechanism to retain purchasing power of the universal pension approved by Parliament by June 2019 (2018 baseline: not approved) and supplementary pension savings legislation approved by Parliament by June 2020 (2019: not approved)</p> <p>1.3 Order increasing universal pension amount toward subsistence level approved by government by June 2020 (2019 baseline: GEL200 per month per recipient, not approved)</p> <p>1.4 Charter of Pension Agency, with at least 20% female technical staff, approved and</p>	1.1–1.4. MOF and MOESD annual reports	Delays caused by sudden changes in administrative procedures, ministry leadership, and/ or major staff turnover

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
2. Comprehensive PPP program operational	<p>Board of Directors appointed by June 2020 (2018 baseline: not approved and appointed)</p> <p>2.1 PPP unit established and capacity building plan approved, with at least 30% female technical staff trained by June 2019 (2018 baseline: not established)</p> <p>2.2 Project development fund established by June 2019 (2018 baseline: not formulated)</p> <p>2.3 At least five PPP project concept notes prepared and at least two feasibility studies commissioned by June 2020, with at least one project directly benefiting women (2018 baseline: none)</p>	2.1–2.3. MOESD annual reports	
3. Access to financial services for SMEs increased	<p>3.1 Government creation of an SME finance risk-sharing facility by June 2019 (2018 baseline: not formulated)</p> <p>3.2 SME risk-sharing facility, with at least 25% female technical staff (baseline: 0), issued at least 20 guarantees for SMEs, at least 20% of which are owned and/or managed by women by June 2020 (2018baseline: not formulated)</p>	3.1–3.2. MOF and MOESD annual reports	
4. Mobilization of private resources for long-term investment enhanced	<p>4.1 MOF and NBG approved the long-term national capital market master plan by June 2019 (2018 baseline: not approved)</p> <p>4.2 NBG issued government bonds of tenors beyond 10 years by June 2020 (2018 baseline: not issued)</p>	4.1–4.2.MOF and NBG annual reports	

**Budget Support**

ADB: \$100 million (regular ordinary capital resources loan)

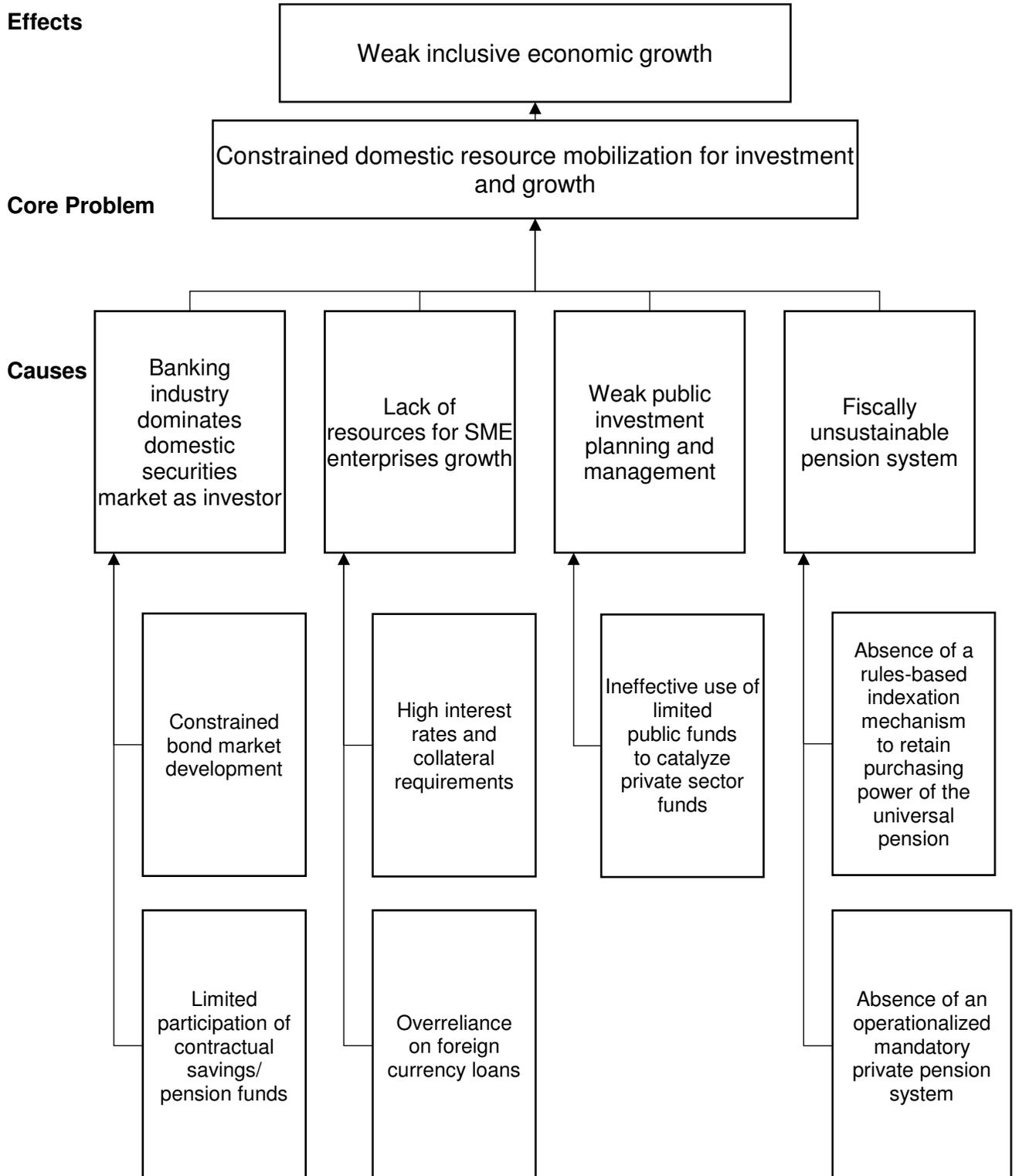
TA: \$750,000

ADB = Asian Development Bank, GDP = gross domestic product, MOESD = Ministry of Economy and Sustainable Development, MOF = Ministry of Finance, NBG = National Bank of Georgia, PPP = public-private partnership, SMEs = small and medium-sized enterprises, TA = technical assistance.

<sup>a</sup> Government of Georgia. 2013. *Socio-Economic Development Strategy of Georgia: Georgia 2020*. Tbilisi.

Source: Asian Development Bank.

## PROBLEM TREE



SME = small and medium-sized enterprise

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/LinkedDocs/?id=52161-001-ConceptPaper>

1. Initial Poverty and Social Analysis
2. Technical Assistance for Program Preparation