ADB

Report and Recommendation of the President to the Board of Directors

Project Number: 54271-001
October 2020

Proposed Programmatic Approach and Policy-Based Loan for Subprogram 1
Georgia: Fiscal Resilience and Social Protection Support Program

Asian Development Bank

CURRENCY EQUIVALENTS
(as of 13 August 2020)

Currency unit	–	lari (GEL)
GEL1.00	=	$0.3248
$1.00	=	3.0785 lari

ABBREVIATIONS

ADB	–	Asian Development Bank
COVID-19	–	coronavirus disease
GDP	–	gross domestic product
IMF	–	International Monetary Fund
MEL	–	Monitoring, Evaluation and Learning
MOESD	–	Ministry of Economy and Sustainable Development
MOF	–	Ministry of Finance
MOILHSA	–	Ministry of Internally Displaced Persons from the Occupied Territories, Labour, Health and Social Affairs
NBG	–	National Bank of Georgia
PFM	–	public financial management
PPA	–	power purchase agreement
PPP	–	public-private partnership
SME	–	small and medium-sized enterprise
SOE	–	state-owned enterprise
TA	–	technical assistance
TSA	–	Targeted Social Assistance

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

Vice-President	Shixin Chen, Operations 1
Director General	Werner E. Liepach, Central and West Asia Department (CWRD),
Director	Tariq H. Niazi, Public Management, Financial Sector, and Trade Division (CWPF), CWRD
Team leader	Rogerio de Almeida Vieira de Sa, Young Professional, CWPF, CWRD
Team members	Tatiana Golubko, Counsel, Office of the General Counsel Elinor Piano, Project Analyst, CWPF, CWRD Kristian Rosbach, Economist, Regional Cooperation and Operations Coordination Division, CWRD Mariane Sual, Senior Operations Assistant, CWPF, CWRD Tamar Tsiklauri, Project Analyst, GRM, CWRD Michiel Van der Auwera, Senior Financial Sector Specialist (Social Security), SDCC
One ADB team[a]	Zehra Abbas, Principal Environment Specialist, Safeguards Division (SDSS), Sustainable Development and Climate Change Department (SDCC) Mary Margareth Bernus, Associate Financial Management Officer, CWOD-PSG, CWRD Haidy Ear-Dupuy, Senior Social Development Specialist (Core Labor Standards), SDSS, SDCC Kaukab Naqvi, Senior Economist, Economic Analysis and Operational Support Division, Economic Research and Regional Cooperation Department Akmal Nartayev, Senior Financial Management Specialist, Public Financial Management Division, Procurement, Portfolio and Financial Management Department Irina Novikova, Senior Social Development Specialist (Safeguards), SDSS, SDCC David Robinett, Senior Public Management Specialist (State Owned Enterprise Reforms), Governance Thematic Group, SDCC Mary Alice Rosero, Social Development Specialist (Gender and Development), Portfolio, Results, Safeguards and Gender Unit (CWOD-PSG), CWRD Malika Shagazatova, Social Development Specialist (Gender and Development), Gender Equity Thematic Group, SDCC Agnes Surry, Senior Planning and Policy Specialist, Operations Planning and Coordination Division, Strategy, Policy and Partnerships Department Deepak Taneja, Principal Treasury Specialist, Treasury Client Solutions Unit, Treasury Department

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PROGRAM AT A GLANCE

Project Classification Information Status: Complete

PROGRAM AT A GLANCE

1. Basic Data — **Project Number:** 54271-001

Project Name	Fiscal Resilience and Social Protection Support Program, Subprogram 1	**Department/Division**	CWRD/CWPF
Country	Georgia	**Executing Agency**	Ministry of Finance
Borrower	Government of Georgia		
Country Economic Indicators	https://www.adb.org/Documents/LinkedDocs/?id=54271-001-CEI		
Portfolio at a Glance	https://www.adb.org/Documents/LinkedDocs/?id=54271-001-PortAtaGlance		

2. Sector	**Subsector(s)**	**ADB Financing ($ million)**
✓ **Public sector management**	Public expenditure and fiscal management	90.00
	Reforms of state owned enterprises	10.00
	Social protection initiatives	75.00
Finance	Money and capital markets	25.00
	Total	**200.00**

3. Operational Priorities

- ✓ Addressing remaining poverty and reducing inequalities
- ✓ Accelerating progress in gender equality
- ✓ Strengthening governance and institutional capacity

Climate Change Information

GHG reductions (tons per annum)	0
Climate Change impact on the Project	Low
ADB Financing	
Adaptation ($ million)	0.00
Mitigation ($ million)	0.00
Cofinancing	
Adaptation ($ million)	0.00
Mitigation ($ million)	0.00

Sustainable Development Goals

SDG 1.1, 1.4, 1.b
SDG 5.1, 5.4, 5.5
SDG 8.1
SDG 10.1, 10.4
SDG 16.6

Gender Equity and Mainstreaming

Effective gender mainstreaming (EGM) ✓

Poverty Targeting

General Intervention on Poverty ✓

4. Risk Categorization: Complex

5. Safeguard Categorization — **Environment:** C **Involuntary Resettlement:** C **Indigenous Peoples:** C

6. Financing

Modality and Sources	**Amount ($ million)**
ADB	**200.00**
Sovereign Programmatic Approach Policy-Based Lending (Regular Loan): Ordinary capital resources	200.00
Cofinancing	**0.00**
None	0.00
Counterpart	**0.00**
None	0.00
Total	**200.00**

Currency of ADB Financing: US Dollar

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a (i) proposed programmatic approach for the Fiscal Resilience and Social Protection Program, and (ii) a proposed policy-based loan to Georgia for subprogram 1 of the the Fiscal Resilience and Social Protection Support Program (program).[1]

2. The proposed program is part of a comprehensive and integrated package of support from the Asian Development Bank (ADB) to the Government of Georgia (the government) to help address adverse health, social, and economic impacts of the coronavirus disease (COVID-19) pandemic.[2] The program supports Georgia's return to inclusive economic growth by addressing longstanding institutional fragilities in social protection, fiscal, and debt management that were exacerabted by the COVID-19 crisis and require immediate response. The policy actions proposed under the program are critical to address the economic impact of COVID-19, ensuring macroeconomic stability in the medium to long term whilst continuing to protect the livelihoods of those most affected by the COVID-19 crisis. Delaying the policy actions of the program would expose the government to unplanned increases in the fiscal deficit due to fiscal risks which are more likely to materialize during the ongoing crisis and continued accumulation of foreign-currency denominated debt and higher exposure to currency and refinancing risks. At the same time, immediate reforms are needed to safeguard the well being of older adults, many of whom have lost some of their supplementary sources of income due to the COVID-19 crisis. The program is aligned with ADB's Strategy 2030, including operational priorities on addressing remaining poverty and reducing inequalities, accelerating progress in gender equality, strengthening governance and institutional capacity. The program is also aligned with the ADB Country Partnership Strategy 2019-2023 for Georgia.

II. PROGRAM AND RATIONALE

A. Background and Development Constraints

3. **Georgia's early adoption of effective public health measures have been largely effective at containing the spread of COVID-19.** As of the 23 August 2020, Georgia counted 1,411 confirmed cases since the start of the pandemic, 1,132 of which have recovered and with 17 fatalities.[3] From the outset the country imposed health checks on incoming air passengers and ramped up restrictions on movement as the first cases emerged. The government's clear and consistent communications were instrumental to avoid widespread contagion. The gradual and phased lifting of lockdown measures was accompanied by a clear communication strategy identifying recommendations by health professionals to help prevent a resurgence in incidence.[4] Public compliance with these recommendations has kept incidence low. As a result, Georgia has managed to achieve one of the lowest case-mortality rates among Organisation for Economic Co-operation and Development (OECD) countries.

4. **The COVID-19 pandemic has had a significant negative impact on Georgia's economy.** While the drop in remittances and exports was less severe than initially envisioned, it did not offset the adverse impact of a marked slowdown in economic activity in the tourism sector and foreign direct investment, leading to a downward revision in forecasts for gross domestic

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[1] Asian Development Bank (ADB). 2020. *ADB's Comprehensive Response to the COVID-19 Pandemic*. Manila.

[2] A comprehensive package of support was put together in response to the Government of Georgia's official request for assistance by ADB submitted on 26 March 2020.

[3] Government of Georgia. StopCov Prevention of Coronavirus in Georgia. (accessed 23 August 2020).

[4] Government of Georgia. 2020. *Measures Implemented by Gerogia Against COVID-19: Report*. Tbilisi.

product (GDP) growth to decelerate by 5.0% in 2020.[5] These revised forecasts are based on recent data indicating a contraction of 12.6% in growth year-over-year (y-o-y) for the second quarter of 2020 and an overall 5.8% contraction for the first half of 2020. In the second quarter of 2020, tourism revenues reduced by $849 million y-o-y. The impact of a drop in tourism revenues on Georgia's external balance was partly offset by a reduced trade balance (-$497 million y-o-y) as imports fell sharper than exports (down 31.8% y-o-y and 24.7% y-o-y, respectively). [6] Further, incoming remittances rebounded in June 2020, increasing by 17.8% y-o-y for that month, following a very significant drop experienced in April due to economic lockdowns globally. After the GEL hit a record low level in March 2020, it appreciated by 6.9% quarter on quarter against the US Dollar (USD), reflecting adequate monetary policy responses by the National Bank of Georgia (NBG), as well as external funding support and resilient remittances. Annual inflation in June 2020 was 6.1%, driven by food price increases, due to disruption to supply chains and strengthened influence of foreign exchange pass-through.[7]

5. **Impact of COVID-19 on public finances is more severe than expected**. The COVID-19 pandemic significantly weakened Georgia's fiscal position.[8] Revenue and grants are expected to decline by 10.5% in the revised budget compared to the original budget for 2020, led by a 12.1% drop in tax revenues, while expenditure is expected to increase by 10.2%.[9] In order to accommodate for the significant increase in public expenditure needed to finance the Anti-Crisis Plan, authorities actively sought to create fiscal space under the revised budget 2020.[10] Recurrent expenditure on wages and salaries and on goods and services have been lowered by 2.7% and 1.6% respectively, compared to the original 2020 State Budget. But despite these efforts, the financing gap for 2020 widened to $1.6 billion, compared to $1.5 billion estimated in May 2020 (footnote 8). To bridge this financing gap, external borrowing is expected to increase by an additional GEL6.2 billion, and domestic debt is set to rise by GEL1.8 billion compared with 2019. Despite GEL's continued depreciation during 2014–2019, Georgia's general government debt-to-GDP ratio has been below 42% of GDP between 2017-2019. However, general government debt will increase sharply to 54.4% of GDP in 2020 from 41.2% in 2019. While the authorities have a medium term plan to gradually reduce government debt as a share of GDP to 51.9% in 2024[11], there are rollover, currency and contingency risks that may disrupt this trajectory (footnote 6). The fiscal deficit has increased significantly to -8.5% in 2020, from -2.2% in 2019, well above the 3.0% ceiling of the Economic Liberty Act.[12]

6. **The increasing share of external public debt exposes Georgia's vulnerabilities to economic shocks.** Domestic markets in Georgia are not sufficiently liquid to finance public financing needs in their totality. To address this shortcoming, the government is seeking foreign currency financing from development partners to finance its ambitious countercyclical development expenditure program. As a result, the share of foreign currency denominated government debt as a share of GDP in Georgia is expected to increase from 31.5% in 2019 to

[5] ADB. 2020. Asian Development Outlook Update: Wellness in Worrying Times. Manila
[6] NBG. 2020. Monetary Policy Report: August 2020. Tbilisi.
[7] NBG. 2020. Monthly Review: July. Tbilisi.
[8] Government of Georgia. 2020. Revised State Budget. Tbilisi.
[9] The tax-to-GDP ratio will drop from 23% in the original 2020 budget to 21.4% in the revised budget.
[10] Increase in expenditure was primarily led by a 28.6% increase in social benefits spending.
[11] Government plans to reduce government debt as a share of GDP to 52.2% in 2021; 53.9% in 2022; 53% in 2023; and 51.9% in 2024. MOF. 2020. Basic Economic and Financial Indicators. (accessed on 15 August 2020)
[12] The Economic Liberty Act, adopted in 2011 and effective since 2014, established numerical upper limits for public debt (60% of GDP), the budget balance (3% of GDP), and expenditures (30% of GDP). Public debt and budget balance rules have been adhered to since their introduction. The ceiling on expenditure was breached in 2014–2015 but only marginally and this trend has since been reversed.

42.5% in 2020.[13] This, in turn, increases public exposure to foreign currency and refinancing risks, threatening economic recovery in the medium term.[14] Despite efforts to diversify the currency composition of government debt portfolio and maintain a minimum of 20%, external debt accounts for roughly 80% of general government debt from which dollar-denominated debt prevails.[15] Continued reliance on external and foreign currency denominated finance counter efforts to deepen domestic debt markets and increase public exposure to external risks, while limiting the effectiveness of countercyclical monetary and fiscal policies.

7. **In the medium-term, the authorities plan to narrow the fiscal deficit to reduce the need to borrow externally**. As a response to the sharp increase in the fiscal deficit in 2020, the authorities have adopted a medium term plan to gradually bring the fiscal deficit under the 3% by 2024.[16] However, the risk of a protracted crisis could require the extension of the temporary social protection measures as well as lower growth and revenues in 2021 (footnote 7). This could create a need for higher expenditure going into 2021, and depending on how global, regional and domestic economic dynamics unfold, a slower than expected rebound in economic activity with lower than expected revenues in the coming years. Higher than planned fiscal deficits in the medium-term could frustrate the government's plan to minimize borrowing needs and, in the absence of deeper domestic markets, contribute to further exposure to refinancing and currency risks.[17] It is, therefore, critical that the government continues to deepen money markets for government securities, thereby increasing liquidity and predictability in the market, whilst further creating an enabling policy and legislative environment for capital market development.[18]

8. **Government supports domestic capital market development to increase the share of lari denominated public debt.** Between 2017 and 2019, the government began to gradually reduce its reliance on external debt. Domestic debt as a share of GDP increased from 7% in 2017 to 9.5% in 2019, whereas external debt as a share of GDP declined from 32.5% to 31.5% in the same period. Likewise, domestic debt as a share of total government debt has increased from 17.8% in 2017 to 23.5% in 2019. While the COVID-19 pandemic partly disrupted this balance—with the share of domestic debt as a share of total government debt declining from 23.5% in 2019 to 21.9% in 2020—government remains committed to this policy objective. In the period 2020-2024, the authorities plans to gradually increase domestic debt as a share of government debt from 21.9% to 32.0%. The program promotes supports the government in this endeavour by promoting institutional reforms which help further deepen the domestic debt market for government securities.[19] This will help minimize public exposure to refinancing and currency risks that threaten macroeconomic stability, an essential precondition for economic recovery.[20] To this end, the proposed program supports policy actions which further strengthen money market infrastructure for government securities on the one hand, while simultaneously supporting the development of capital markets. Deepening the market for treasury securities is an essential precondition for the good functioning of other components of the capital market, as treasury yield curve plays an important role in the pricing of the other securities (footnote 17). The program

[13] MOF. 2020. Basic Economic and Financial Indicators. (accessed on 15 August 2020)
[14] Rising costs of foreign currency-denominated debt due to depreciation of the GEL may impose additional challenges to economic recovery.
[15] IMF. 2020. Technical Assistance Report – The Public Sector Balance Sheet and State Owned Enterprises. IMF Country Report No. 20/223. Washington D.C.
[16] In the revised 2020 State Budget, the authorities announce a gradual reduction in the fiscal deficit to 5.1% in 2021, 4.3% in 2022, 3.2% in 2023 and 2.6% in 2024. MOF. 2020. Basic Economic and Financial Indicators. (accessed on 15 August 2020)
[17] Ministry of Finance of Georgia. 2019. General Government Debt Management Strategy 2019-2021. Tbilisi.
[18] NBG. 2016. Recommendations for Development of Capital Market in Georgia. Tbilisi.
[19] Share of domestic debt which stood at 8.3% of GDP in 2019 and is expected to exceed 10% of GDP in 2020.
[20] IMF. 2020. Debt Management Responses to the Pandemic. Washington D.C.

supports continued and enhanced collaboration between MOF and the NBG to expand issuance of benchmark bonds, which contribute to higher liquidity, transparency, and predictability of the market. This will increase investors' interest towards domestic government securities, and correspondingly expand the investor base. In turn, the development of capital markets will accelerate the de-dollarization process and improve monetary policy transmission on aggregate demand and, eventually, on price level.[21] More developed capital market infrastructure will also help deepen the secondary market for government securities, creating additional lari denominated financial resources available for market participants, including the public sector (footnote 17).

9. **Contingent liabilities threaten fiscal stability and debt sustainability in the short to medium term.** Although Georgia's public sector balance sheet is in a relatively healthy shape,[22] increased exposure to fiscal risks stemming from power purchase agreements (PPA) and state-owned enterprises (SOE) threaten fiscal sustainability in the short- to medium-term, amidst the crisis.[23] The large and risky SOE sector, with high exposure to foreign exchange risks, impose a net draw on the budget, with imminent SOE financing needs of around 18% of GDP[24] posing a significant challenge to fiscal stability which underpin economic recovery.[25] A reclassification of SOEs confirmed 196 SOEs within the general government sector—highlighting the dependence of many SOEs on government funding as well as the role of government in management decisions. Further, from the six largest SOEs, only one generates sufficient operating profits to cover its capital costs while all others make significant losses. Overall, the SOE sector has drawn 6% of GDP from the government budget between 2015 and 2020, cumulatively. By IMF estimates, a 30% depreciation of the lari from August 2020 rate would reduce the net worth of the largest SOEs by about 4% of GDP, severely impacting the health of the government's fiscal position (footnote 23). A number of major SOEs are also exposed to significant foreign exchange mismatches on their assets and liabilities.[26]

10. **Existing guarantees under PPAs are set to increase fiscal pressures, threatening the path to macroeconomic stability and inclusive economic recovery**. Although payment of guarantees under PPAs are to be met largely through user fees, residual payments are worth 22% of GDP over 40 years.[27] These payments could double under plausible scenarios, highlighting the need for effective management of these risks. Recent fiscal projections on the long-term implications of over 150 PPAs commit the government to ensuring minimum revenues—or in some cases returns—to power generators over a 50-year plus period worth

[21] Abuselidze, G. 2018. Georgia's Capital Market: Functioning problems and development directions in association with European Union. Journal of Applied Economic Sciences, 13(7):1929-1938.

[22] Total assets across all government-controlled entities amount to 149% of GDP while liabilities are worth 81% of GDP, leaving a positive net worth of 68% of GDP. IMF. 2020. Technical Assistance Report – The Public Sector Balance Sheet and State Owned Enterprises. *IMF Country Report No. 20/223.* Washington D.C

[23] IMF. 2020. Georgia: Technical Assistance Report—Public Sector Balance Sheet and State Owned Enterprises. *IMF Country Report No. 20/223.* Washington D.C.

[24] It is estimated that the Gross Financing Requirements of the six major SOEs total around GEL 7.6b (18 percent of GDP) during the 2021-2024 period with around. This includes around $350 million and EUR150 million by Georgian Oil and Gas Corporation (GOGC) and $400 million by Georgia Rail (footnote 23).

[25] SOEs have been a large financial drain on government finances with little contribution to public revenues. During the 2014–2018 period, net flows to SOEs amounted to GEL2.6 billion, while the government's GEL4.6 billion equity investment generated very little or no dividends. The costs of SOE financing could place addition strains on the fiscal balance going forward, widening the fiscal deficit and, as a result, the public debt to GDP ratio. Moreover, SOEs require GEL7.6 billion gross financing over 2020–2022 partly for refinancing and new financing (footnote 23).

[26] Some SOEs, such as Georgia Rail do receive revenues in foreign currencies, providing a partial hedge against currency fluctuations, but overall the major SOEs are heavily exposed to depreciations – particularly against the USD and euro – due to the large majority of their debt being in foreign currency (footnote 23).

[27] Annual payments for existing guarantees under PPAs are set to peak in 2024 at 0.6% of GDP under a favorable scenario (footnote 23).

around 65% GDP. The major challenge posed by fiscal risks stemming from PPAs and SOEs is the lack of data and difficulty of incorporating it into the budgeting process. Failure to properly reflect contingent liabilities in the budget framework, especially during a crisis, can lead to expenditure overruns and fiscal pressures. Such a risk would further jeopardize an inclusive and sustainable recovery in the country and require immediate actions.

11. **To maximize the chances of a fast recovery, the government aims to strengthen management of fiscal risks.** The government's ability to gradually narrow the fiscal deficit towards the 3% ceiling specified in the Economic Liberty Act, hinges on its capacity to avert unplanned fiscal expenditures that may arise from the materialization of fiscal risks. These risks include: (i) materialization of obligations to provide minimum guarantees under some PPAs agreements described in para. 9; (ii) exposure to natural disaster risks; and (iii) the foreign exchange exposure and potential recapitalization requirements of the large SOE sector.[28] Institutional reforms, which support adequate identification, disclosure, and preparation for such risks, can help avert unplanned fiscal pressures and associated impact on the fiscal deficit and—as a consequence—general government debt. Based on international experience, materialization of contingent liabilities, especially when coupled with exchange rate depreciation, have been found to be one of the most common causes of unexpected increases in the public debt-to-GDP ratio between 2007-2019.[29] Contingent liabilities stemming from natural disasters, from example, have historically been as high as 10% of GDP in some countries.[30]

12. **Strengthen the government's capacity to report and manage fiscal risks from public-private partnerships, PPAs, and SOEs will create fiscal space for social protection.** Experience from the Global Financial Crisis of 2008 and the numerous episodes of SOE and bank recapitalization and materialization of obligations to provide minimum guarantees under public-private partnerships (PPP) and PPAs served to remind us how disruptive such risks can become to fiscal and debt stability.[31] This includes fiscal risks from unfunded or underfunded policy mandates executed by SOEs. In addition to proving a more stable macroeconomic environment, insulating public exposure to these unplanned fiscal pressures, helps minimize opportunity costs on scarce public resources, effectively creating additional fiscal space for key social spending and public investment priorities.

13. **The COVID-19 crisis adversely impacted social welfare indicators**. Preliminary estimates carried out by the Monitoring, Evaluation and Learning (MEL) Lab suggest that the Anti-Crisis plan will mitigate a significant surge in poverty incidence and reduction in incomes across the income groups. While the impact of the COVID-19 crisis would have certainly been significantly worse if there were no Anti-Crisis Plan in place, both poverty rates are expected to increase in 2020 across the income distribution curve (Table 1).

Table 1: Impact of COVID-19 on Poverty Incidence Under Different Scenarios

	National Poverty Line	$1.9 PPP	$3.2 PPP	$5.5 PPP	$10 PPP
Baseline	19.5	4.5	15.7	42.9	77.9
Lockdown	43.3	19.9	37.5	63.0	87.7
Anti-Crisis Plan	28.5	8.6	23	49.7	80.1
Mitigating impact	**14.8**	**11.3**	**14.5**	**13.3**	**7.6**

[28] IMF. 2020. Technical Assistance Report – The Public Sector Balance Sheet and State Owned Enterprises. *IMF Country Report No. 20/223.* Washington D.C.

[29] IMF. 2020. Managing Fiscal Risks Under Fiscal Stress. Washington D.C. For example, contingent liabilities stemming from natural disasters have historically been as high as 10% of GDP in some countries. IMF. 2003. *"Dealing with Increased Risk of Natural Disasters: Challenges and Options".* Washington D.C.

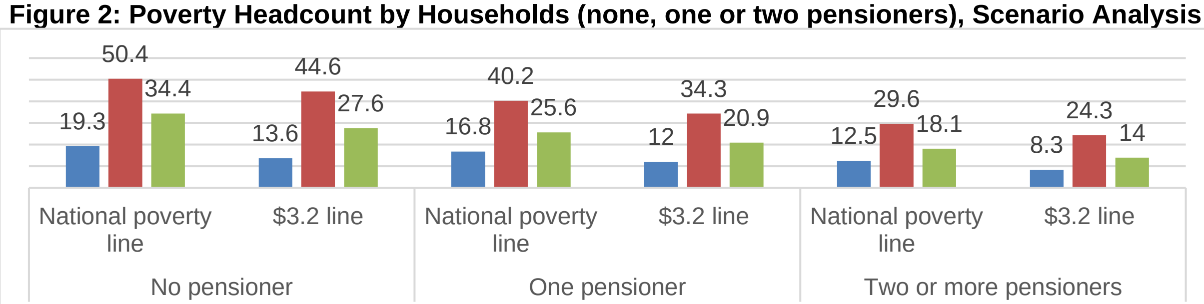
[30] IMF. 2003. *"Dealing with Increased Risk of Natural Disasters: Challenges and Options".* Washington D.C.

[31] IMF. 2015. From Systemic Banking Crises to Fiscal Costs: Risk Factors. Washington D.C.

COVID-19 = coronavirus disease, PPP = power purchasasing parity.
Source: ADB estimates.

14. **Structural and institutional reforms to the pension system are needed to protect the livelihoods of older adults, who are disproportionately exposed to the adverse health and socioeconomic impacts of COVID-19.**[32] Senior citizens are more vulnerable than the general population to the COVID-19 crisis in two important ways. First, older adults are at a significantly increased risk of severe disease following infection from COVID-19. This is compounded by the fact that senior citizens have less access to household assets and dwelling facilities, such as a a bath or shower water supply and sewage, needed to minimize risk of contagion.[33] Second, older adults are disproportionately affected by physical distancing measures as they typically rely on multiple income sources, including informal labor income, savings, and financial support from family members—all of which suffered as a result of COVID-19 lockdowns.[34] The pandemic significantly impacted most sources of income of senior citizens with the exception of pension payouts. This highlights the importance of an adequate and reliable social pension system to avoid a sharp increase in old-age poverty incidence. This is particularly important for women, who constitute 71% of all universal pension beneficiaries in August 2020 and rely on pension payouts for their livelihoods. Life expectancy is higher for women than it is for men, at 78.2 years compared with 69.7—suggesting that reliance on a pension system is higher for women, who spend, on average, 17.2 years on a pension as opposed to men who spend an average of 3.6 years on a pension. Further, and in addition to providing a financial lifeline to the elderly, the COVID-19 crisis highlighted the importance of the pension system in mitigating a steeper resurgence in poverty levels across households with at least one pension recipient. As Figure 2 illustrates, households with one or more pensioners witnessed a proportionally smaller increase in poverty incidence. Overall, the COVID-19 crisis shed light on how critical reforms to the pension systems are to ensure the social wellbeing of the largest share of vulnerable population in Georgia which include not only older adults, but also households with at least one pension beneficiary.[35]

Figure 2: Poverty Headcount by Households (none, one or two pensioners), Scenario Analysis



Source: ADB staff estimates.

15. **Reforms to mitigate old-age poverty and improve fiscal sustainability of pension system began in early 2014 but require further steps.** Reform of the pension system began with an assessment of the existing system in 2014–15, after which the Cabinet adopted a pension reform policy proposing to (i) link future increases of the universal basic pension to inflation and (ii) introduce an additional contributory (Pillar II). The initial diagnostic, undertaken by the Ministry

[32] ADB. 2016. Georgia Social Protection Index 2015. Manila.
[33] United National Population Fund (UNFPA). 2014. General Population Census in Georgia. Tbilisi.
[34] Geostat. Living Conditions. (accessed 14 July 2020)
[35] In addition to generalized lack of access to labor income sources, adults aged 60 are also much more likely to live with disabilities than young adults. Around 20.5% of old-age pensioners are classified as disabled (58.6 percent of the total number of disabled in the country.). Moreover, a majority (57.6 percent) of persons aged 65 and over consider themselves unhealthy (in bad or very bad health). Geostat. Living Conditions. (accessed 14 July 2020)

of Economy and Sustainable Development (MOESD) supported by an ADB technical assistance (TA), concluded that while the universal pension system did have a significant effect in reducing poverty, it did not provide for a decent standard of living to its beneficiaries.[36] Projections on future liabilities taking into account demographic trends[37] suggested that the universal pension system was not fiscally sustainable, given that it was to be financed exclusively from the State Budget.[38] Specifically, the practice of ad-hoc indexation of the universal basic pension was resulting in unplanned fiscal pressures, thwarting efforts towards strenghtened budget predictability. The report recommended that (i) universal pension payouts be raised to susbsistence levels to avoid rises in old-age poverty; (ii) government adopt a mechanisms for indexation of universal penion to maintain their purchasing value; (iii) government establish and operationlise a contributory pension savings scheme (Pillar II); (iv) government complement the universal pension scheme and contributory pension scheme with a fully private pension scheme (Pillar III).[39] In line with these policy recommendations, the GoG has (i) gradually increased universal pension payouts to a pre-determined subsistence level and provided an additional increase for those aged 75 and above; and (ii) effectively established and operationalized the contributiory pension scheme (Pillar II), which is administered by a Legal Entity of Public Law—the Pension Agency. These measures are particularly beneficial for women who constitute 71% of all universal pension beneficiaries and 66% of universal pension beneficiaries over 75 years of age. Further, to ensure fiscal sustainability of the pension system more broadly, an indexation mechanism has been recently approved and the operationalization of the contributory pension scheme was completed. This way, Georgia's pension scheme can maintain its role of poverty alleviation at fiscally affordable levels. The purchasing power of pensioners will remain stable, as ad-hoc increases in the pension amount will no longer be common practice.[40] Going forward, government remains committed to establishing a fully private pension scheme whilst continuing to improve efficiency of the Pillar II pension scheme.

16. **The Government's Anti Crisis Plan is expected to mitigate the rise in unemployment due to COVID-19, but not completely.** Formal unemployment rose from 11.6% at the end of 2019 to 12.3% in the second quarter of 2020.[41] The full impact of COVID-19 on unemployment will not be evident until end-2020. That said, preliminary estimates suggests that in 2020 roughly 385,000 people, or about 23.4% of the employed, face a high risk of job displacement.[42] The impact on the self-employed might be milder comparative to hired workers since roughly 75% of self-employed workers in Georgia work in agriculture, which was less affected during the lock-down period.[43] At the same time, less than average baseline earnings of the self-employed, may require special policy emphasis.[44] To try and mitigate mass retrenchment and loss of income, the government adopted ambitious employment preservation measures: (i) the Unemployment Assistance Benefit (direct transfer of GEL1,200 over six months); (ii) the Income Tax Waiver for Low-Income Citizens (exempting firms from income tax for citizens with monthly income less than GEL750, provided workers are kept on payroll); and (iii) the Informal Sector Assistance (one-time

[36] Sector Assessment (Summary): Social Protection (accessible from the list of linked documents in Appendix 2)
[37] UNFPA projections, based on the 2014 Census, suggest that the share of persons 65 and older will reach 18.9 percent in 2030 (732 thousand persons) and will further increase to 25.3 percent – to one in four persons – in 2050 (880 thousand persons). UNFPA. 2017. Ageing and Older Persons in Georgia. Tbilisi.
[38] MOESD. 2016. Sustainability of the Pension System and recommendations for Reform. Tbilisi.
[39] These policy recommendations were accepted and adopted by Cabinet on 21 March 2016
[40] ADB. 2016. *Social Protection Index 2015*. Manila
[41] Geostat. Employment and Unemployment (accessed 27 August 2020)
[42] L. Pavlenishvili. 2020. *The Social Impacts of COVID-19—Case for a Universal Support Scheme?* Tbilisi: International School of Economics at TSU Policy Institute.
[43] Geostat. Employment and Unemployment. (accessed 20 August 2020).
[44] Geostat. Wages. (accessed 20 August 2020).

GEL300).[45] As the economy begins to recover and these benefits are gradually lifted, it is expected that significant parts of the population will not have job opportunities and the unemployment rate widen. Employment preservation and cash transfer measures targeting the poorest members of society are expected to limit the increase in poverty incidence. Table 1 shows that even the government's Anti Crisis Plan is expected to mitigate the growth in the poverty headcount index across the income distribution curve, the poverty headcount index is nonetheless expected to increase significantly. Government is acutely aware of the need to reform existing social protection systems to mitigate the medium-term impact of COVID-19 on unemployment and poverty ina fiscally sustainable and gender sensitive fashion. As of 2018, 24% of Georgians were beneficiaries of at least one social protection scheme with women constituting 64.9% of all recipients highlighting the need for a gender-sensitive approach to social protection reform. The MEL Lab, set up with ADB support under the COVID-19 Active Response and Expenditure Support Program (CARES) Program, will help provide the necessary sex-disaggregate data to inform policy design aiming to avoid rising unemployment and provide adequate cash transfer support to the poorest members of society.

B. Policy Reform and ADB's Value Addition

17. The proposed programmatic Policy Based Loan supports the government's efforts to ensure macroeconomic stability without compromising key social spending that supports the livelihoods of those most affected by the COVID-19 crisis. To this end, the Program is composed of two subprograms that support the governments reform efforts across three main areas: (i) strengthening public management of fiscal risk exposure which has been magnified as a result of the COVID-19 crisis; (ii) deepening domestic debt markets for government securities to mitigate public exposure to risks associated with external should there be a need for further fiscal stimulus to address socioeconomic impacts of COVID-19; and (iii) strengthening adequacy and fiscal sustainability of social protection programs to protect livelihoods of those most affected by the COVID-19 crisis. Institutional challenges across these three areas require a phased approach under a programmatic approach. The focus of Subprogram 1 is on policy actions that either address an immediate need or that lay the foundation for more tangible policy reforms being achieved under Subprogram 2. The total budget support provided under the program is of $300 million, of which $200 million are to be disbursed upon approval of Subprogram 1 in October 2020 and $100 million under Subprogram 2 in 2021.

18. **Reform area 1: Strenghtening management of public exposure to fiscal risks.** The objective of this reform area is to strengthen management of public exposure to fiscal risks stemming from PPPs/PPAs and SOEs to mitigate the risk of hidden deficit and not to further decrease fiscal space to support an inclusive and sustainable recovery. Under Subprogram 1, (i) MOF fully operationalized a dedicated Fiscal Risk Management Unit, which assess and quantify public exposure to fiscal risks stemming from SOEs and PPPs which are more likely to materialize as a result of the COVID-19 crisis, staffed with at least 7 technical staff of which at least 75% are women; (ii) MOF approved PPP Guidelines which include methodological guidelines for the assessment of contingent liabilities and VfM methodology for PPP evaluations and completes PPP framework that ensures adequate identification, monitoring and reporting of fiscal risk stemming from PPPs; (iii) MOF, through the Fiscal Risk Management Division, expanded the scope of the Fiscal Risk Statement to include: disclosure and discussion of methodological instructions to identify, quantify, finance and report Quasi Fiscal Activities of SOEs; assessment of impact of COVID-19 on the likelihood that fiscal risks stemming from SOEs materialize in the

[45] Government of Georgia (2020) 'Giorgi Gakharia presented an Anti-Crisis Economic Plan', (accessed 25 August 2020)

short-medium term; expansion of fiscal risk analysis of SOEs from 12 to 13 individual SOEs; discussion on effect of SOE sectorization on Public Finance Statistics, including impact on public debt Law; analysis of SOEs from sectoral perspective, with the aim of normalizing financial statements from SOEs; assessment of stock of PPP liabilities based on International Public Sector Accounting Standards (IPSAS32) and VfM methodology for PPPs included in the recently approved PPP guidelines; and include draft discussion of fiscal risks stemming from natural disasters affecting municipalities. Under Subprogram 2, (i) GoG revises legislative framework of the SOE sector, increasing MOF's role in SOE related fiscal risk management, developing a formal system to account and fund community service obligations, and increasing SOE accountability; (ii) MOF publishes a ministerial statement which includes (i) a rationale for SOE ownership; (ii) competitive Neutrality of SOEs; and (iii) an analysis of corporate governance practices in comparison with the OECD guidelines on transparent and (iv) a merit-based appointments of supervisory boards for all SOEs defined as Public Interest Entities comprising 90% of annual turnover. This statement will inform reforms to SOE corporate governance; (iii) MOF identifies and discloses fiscal risks stemming from Natural Disasters, including climate change related disasters and published it on MOF's website to ensure comprehensive identification and reporting of fiscal risks; and (iv) MOF submits amendment on the Law of Public Debt of Georgia to Parliament which expand coverage of public sector debt statistics which helps strengthen management of fiscal risks.

19. **Reform area 2: Deepening domestic market for government securities.** The objective of this reform area is to address the adverse effects associated with high public sector exposure to foreign currency denominated debt, which was amplified by the crisis. To this end, the Program promotes institutional reforms which help further deepen the domestic debt market for government securities and, ultimately, reduce the share of public foreign currency denominated debt. This will help minimize public exposure to refinancing and currency risks which threaten macroeconomic stability, an essential precondition for economic recovery. Under Subprogram 1, (i) MOF and NBG commenced Primary Dealer Pilot with appropriate rights and obligations and PD rules published and Primary Dealers System to promote activity on the primary and secondary markets, ensuring decreased public reliance on external debt to finance future fiscal stimulus packages as the one needed to mitigate the adverse socio-economic impacts of COVID-19; (ii) MOF issued ministerial decree which mandates that the Debt Management Strategy is updated, approved and published on its website on an annual basis to increase predictability of the market for government domestic debt securities; (iii) MoF issued benchmark bonds with nominal value of at least GEL2 billion in 2020 to increase investor interest towards Georgian government securities and promote capital market development, which in turn ensures the growth of GEL liquidity; (iv) Parliament approved new Investment Funds Law needed to develop investment fund legal, regulatory and tax framework and creating an enabling environment for the development of capital markets in Georgia. Under Subprogram 2, (i) MOF and NBG add at least one new tenor to the PD Pilot and publish the plan of moving towards full-fledged PD System; (ii) MOF mandates Primary dealers to disclose and make publicly available all pre-trade and post-trade figures for all securities included in the PD system; (iii) MOF approves new Debt Management Strategy 2021–2023 which include an increase in the stock of domestic debt to at least 10% of GDP by October 2023 to deepen the domestic debt market for government securities; (iv) MOF adopts strategy to develop retail participation in Government bond market which may include a savings certificate style market issued electronically distributed by PO or Banks subject to deliberation with NBG; (v) GoG in collaboration with NBG approve Capital Market Development Strategy to promote mobilization of domestic private financial resources available to government and minimize reliance on external financing; (vi) GoG submits the law on Securitization to the Parliament to deepen capital markets by creating a new class of debt instruments and allowing access to new participants—corporates and others—to the market; and (vii) GoG submits the law on Covered

Bonds to deepen domestic capital markets by widening the range of investment instruments available to investors.

20. **Reform area 3: Ensuring adequacy and fiscal sustainability of social protection programs which were expanded during the crisis.** The pandemic significantly impacted the financial wellbeing of senior citizens. To address this issue, the Government adopted reforms to ensure adequacy and fiscal sustainability of the pension scheme. Further, the COVID-19 pandemic shed light on the need for reform of other existing social protection systems in order to ensure that all those affected are given adequate financial support and increase the social resilience of the country in case of new crisis. The Program will support government in these initiatives to ensure that Georgia's social protection infrastructure supports an inclusive return to economic growth. Under Subprogram 1, (i) Parliament approved revised budget in 2020 which includes an increase of at least GEL 30 in universal pension payout for pensioners aged 70 and above, 65% of whom are women, to mitigate the adverse impact of the COVID-19 crisis on old-age poverty; (ii) Parliament approved amendment to the Law of Georgia on State Pensions which introduces a rules-based mechanism for increases in payouts for universal pension beneficiaries, 70% of whom are women; (iii) Government of Georgia establishes and operationalizes an independent public Pension Agency for administration of the new supplementary contributory pension scheme (Pillar II pension scheme) where at least 50% of staff are women; (iv) Pension Agency ensured registration of 100% of formal employees and collected contributions from at least 80% of registered employers, as well as and associated contributions from Government and employees; and (v) Pension Agency adopted an interim Cash and Cash Equivalent Investment Policy allowing investments to be managed without any undue risk and ensuring transfer of all contribution payments into individual interest-bearing accounts. Under Subprogram II, (i) NBG and Pension Agency approve long term investment policy for Pension Savings Scheme to guide long term investment strategy of contributions; (ii) Pension Agency, in coordination with MOF, approve enforcement mechanism for pension scheme contributions to ensure increased compliance by all formal employers with the Law of Georgia on Pension Savings; and (iii) GoG submits Law on Third Pillar Pensions to Parliament to enable Georgian workers to accumulate additional voluntary savings, when possible, and generate a third source of old-age income.

21. **ADB's value addition.** The program forms part of a broader package of support to Georgia to address the health and socioeconomic impacts of COVID-19. It complements the CARES Program[46] approved in May 2020 by supporting long term institutional reforms which also help address immediate institutional fragilities exposed by the COVID-19 crisis and pave the way for sustainable and inclusive economic recovery. The need to accelerate long-term institutional reforms to serve immediate needs that emerged as a result of the COVID-19 crisis justify the utilization of the fast track procedure. The program builds on more than a decade of close cooperation across key policy reform areas such as fiscal risk management, public debt management and social protection. Starting in 2014 ADB has been continuously engaged in policy dialogue with the government regarding fiscal management and social protection reform supported by technical assistance has helped strengthen public debt management and fiscal risk management while supporting government efforts to reform its public pension system[47]—the largest social protection program in the country.[48] The MEL Lab is an innovative solution incorporated under the CARES Program which helped guide policy discussions around the

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[46] ADB. 2020. *Report and Recommendation of the President to the Board of Directors: Proposed Countercyclical Support Facility Loan to Georgia for the COVID-19 Active Response and Expenditure Support Program*. Manila.

[47] ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loans for Subprogram 1 to Georgia for the Improving Domestic Resource Mobilization for Inclusive Growth Program*. Manila.

[48] ADB. 2018. *Preparing the Second Domestic Resource Mobilization Program: Technical Assistance Report*. Manila.

proposed program and will keep on providing the evidence needed to guide policy discussions which will inform the final shape of policy actions under Subprogram 2. It provides ADB and the government with live data on evolution of key socioeconomic indicators, necessary to support an adequate and timely policy response to emerging needs. Through this Program, ADB also ensured mainstreaming of a pro-poor and gender sensitive policy reform environment underpinning economic recovery. ADB has maintained a clear position with regards to gender and poverty alleviation with government in these discussions and will continue to do so moving forward. ADB's financial support will help government bridge its financing gap for 2020 at less onerous terms that would otherwise be available to the government, contributing towards debt sustainability in the long run. The financing support provided under the program is complemented with other ADB Sector Development Loans and policy-based loans which in total contribute towards roughly 30% of Georgia's financing needs for 2020. Finally, and to complement ADB's support to Georgia's inclusive economic recovery agenda, ADB is als o providing grant.[49]

22. **Lessons learnt.** Underpinned by a strong base of country knowledge, the program is also informed by lessons learnt through previous policy-based program support provided to Georgia.[50] Most importantly, ADB's previous engagement in structural and politically sensitive policy reform programs in Georgia such as reform to the pension system and domestic debt market development, highlighted the importance of flexibility and sequencing to manage bottlenecks.[51] The choice of a programmatic approach for policy-based lending, combined with TA, was deemed a suitable modality to overcome potential challenges by ensuring flexibility and allowing for adequate sequencing of reforms across the subprograms.

23. **Alignment with Strategy 2030.** The Program is fully aligned with ADB's Strategy 2030, specifically the operational priorities on addressing poverty and reducing inequality (through its support for social protection expected to mitigate an increase in poverty incidence), accelerating progress in gender equality (through gender sensitive targets integrated into the policy actions), and strengthening governance and institutional capacity (through support public debt management and fiscal risk management functions).[52]

C. Impacts of the Reform

24. The country's overarching development objective is sustained and inclusive growth based on macroeconomic stability as enshrined in the government's socio-economic development strategy "Georgia 2020".[53] The effect of the reforms supported under the program will be the return to sustainable and inclusive economic growth, minimizing exposure of Georgia's fiscal position to shocks caused by the COVID-19 whilst safeguarding welfare of the most vulnerable members of society. These reforms will primarily work through three transmission channels which are reflected in the Public Financial Management Reform Strategy[54]: (i) the improved management of public exposure to fiscal risks (stemming from PPPs, PPAs, SOEs and natural disasters); (ii) improved debt sustainability through deeper domestic markets for government debt; (iii) adequacy and fiscal sustainability of social protection programs.

[49] ADB. 2020. Regional Support to Address the Outbreak of Coronavirus Disease 2019 and Potential Outbreaks of Other Communicable Diseases: Technical Assistance Report. Manila.
[50] ADB. 2017. Improving Domestic Resource Mobilization for Inclusive Growth Program: Project Completion Report. Manila.
[51] ADB. 2018. Georgia: Improving Domestic Resource Mobilization for Inclusive Growth Program: Validation Report. Manila.
[52] ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.
[53] Government of Georgia. 2014. Social-Economic Development Strategy of Georgia. Tbilisi
[54] Government of Georgia. 2018. Public Financial Management Reform Strategy to 2018-2021. Tbilisi

D. Development Financing Needs and Development Partner Coordination

25. **Development financing needs for 2020**. Despite the government's efforts to reprioritize expenditure and create additional fiscal space, the financing gap for fiscal year 2020 remains considerably high at $1,613 million. The financing gap is to be closed primarily through by loans and grants from development partners as well as domestic borrowing, with government deposits available to weather against downside risks, if necessary. The IMF, World Bank, the Asian Infrastructure Investment Bank and selected bilateral partners have committed to assist Georgia in accessing finance (Table 2). Total ADB budget support in 2020 will tentatively amount to $530 million, or 30% of the total financing gap.

Table 2: Development Financing Needs and Budget Support (GEL million)

Item	2019	2020 (f)	2020 (f) revised	2021 (f)
Revenues[a]	4,336	4,407	3,944	4,375
o.w. taxes[a]	3,852	3,978	3,496	3,932
Expenditure[a]	4,631	4,792	5,282	5,157
o.w. recurrent[a]	3,417	3,712	4,281	4,101
Financing Gap		**261**	**1,613**	**569**
Budget Support[b]		**234**	**1,782**	**145**
Asian Development Bank			530	
Asian Infrastructure Investment Bank			150	
European Union			223	
France (Agence Française de Développement)			205	
Germany (KfW)			294	
International Monetary Fund			200	
World Bank			180	

[a] In GEL millions
[b] Estimated as of September 2020.
Source: ADB staff estimates.

26. **ADB continues to coordinate closely with all relevant development partners.** ADB team has consulted and coordinated closely with all relevant development partners providing budget support to Georgia in 2020, especially those providing technical assistance support to public debt management, fiscal risk management and to social protection reform.[55] Coordination with the IMF has been particularly important to ensure complementarity of ADB support with the IMF's Extended Financing Facility, particularly on structural benchmarks and quantitative performance criterias pertaining relevant to the coverage and monitoring of fiscal risks, and strengthening the corporate governance of state-owned enterprises.

27. The government has requested a loan of $200,000,000 from ADB's ordinary capital resources to help finance the program. The loan will have a 15-year term, including a grace period of 3 years; an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; a commitment charge of 0.15% per year and such other terms and conditions set forth in the draft loan agreement. Based on the straight-line method, the average loan maturity is 9.25 years and there is no maturity premium payable to ADB.

E. Implementation Arrangements

28. 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

[55] ADB coordinated closely with the IMF on public debt management and fiscal risk management support and with Agence Francaise de Développement, the World Bank and the European on reform to the pension system.

implementing agencies. The indicative implementation periods are December 2018 to October 2020 for subprogram 1 and October 2020 to October 2021 for subprogram 2. The proceeds of the loan will be disbursed in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time).[56]

III. DUE DILIGENCE

29. **Governance**. Public financial management (PFM) systems have improved significantly in Georgia with the implementation of the Public Financial Management Reform Strategy—minimizing the risks associated with poor financial management of the Program. According to the most recent Public Expenditure and Financial Accountability Assessment (2018) Georgia has sound systems in place for strategic budget planning, execution and accounting and reporting.[57] Notable improvements in fiscal discipline are reflected in a reduction of variance of expenditure outturn when compared with the budget (decreased use of virements) and robust execution rates for revenue and stronger oversight of aggregate fiscal risk from state-owned enterprises and public-private partnerships, which the program supports. Georgia has improved its strategic allocation of resources through its multi-year budgeting tool and preparation of costed sector strategies. Finally, Georgia has witnessed an increase in the efficiency of the use of resources for service delivery, with increased effectiveness of payroll controls; internal audit; timelier and more regular reconciliation of accounts; and expansion of the scope and nature of follow-up audits.

30. **Poverty and Gender.** The proposed program supports the government of Georgia to address the advers impacts of the pandemic on the most vulnerable, in particular the elderly who are disproportionally exposed to the consequences of the COVID-19. Despite substantial gains, households in Georgia remain highly vulnerable to shocks, including those associated with the outbreak of COVID-19 which is estimated to increase the national poverty headcount from 20.1% in 2019 to 28.5% in 2020.[58] Further, while absolute poverty ($1.90/day) has declined sharply from 12.2% in 2010 to 3.7% estimated for 2020, the effects of COVID-19 could lead to a rise in poverty incidence to 8.6%[59] Georgia's current social welfare system covers a relatively high share of the population but may not be sufficient to address the needs of its poorest citizens. As of 2018, only 11.7% of Georgians receive a subsistence allowance under the targeted social assistance, against 20.1% of people living under the national poverty line, suggesting that wider coverage may be necessary.The proposed program introduces structural and institutional reforms that seek to mitigate increases in poverty incidence, especially old-age poverty, whilst also including proactive gender mainstreaming features. Increases in pension payouts for people aged 70 and above is particularly relevant for women who make up 66% of all beneficiaries within this age bracket and who are disproportionately vulnerable to the adverse health and economic effects of the COVID-19 crisis. Further, indexing increases in pension payouts to maintain its purchasing power protect the 71% of women that benefit from the universal pension scheme from gradual loss of income and poverty. The Program also ensures that newly or recently created public agencies are staffed in a gender-sensitive manner. To this end, at least 50% of technical staff recruited for the Pension Agency are women. Likewise, 85% of all technical staff in the Fiscal Risk Management Division are women. The program is classified as Effective Gender Mainstreaming.

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[56] List of Ineligible Items (accessible from the list of linked documents in Appendix 2)

[57] PEFA Secretariat. 2018. Georgia: *Public Expenditure and Financial Accountability (PEFA) Assessment 2017*. Washington DC: World Bank.

[58] Geostat. Living Conditions. (accessed 14 August 2020).

[59] ADB Staff updated estimates assuming the average income/consumption decline of 26.6%. ADB. 2020. COVID-19 and Poverty: Some Scenarios Based on Grouped Distribution Data on Household Consumption. Manila.

31. **Safeguards**. The loan is categorized C for environment, involuntary resettlement, and indigenous peoples. The loan funds are not expected to cause land acquisition or adverse impacts to the environment or indigenous peoples. Investment activities prohibited under ADB's Safeguard Policy Statement (2009) will be excluded.

32. **Risks and mitigation measures.** Major risks and mitigating measures are summarized in Table 3 and described in detail in the risk assessment and risk management plan.[60]

Table 3: Summary of Risks and Mitigating Measures

Risks	Mitigating Measures
Incidence of coronavirus disease (COVID-19) increases substantially placing significant burden in public health systems and triggering another nation-wide lockdown.	Cooperate with Ministry of Internally Displaced Persons from the Occupied Territories, Labour, Health and Social Affairs (MoILHSA), other international financial institutions, specialized donors and UN-specialized agencies to support government's efforts to contain spread of coronavirus (immediate- to short-term) and strengthen health care system and capacity (long-term). Utilize existing technical assistance (TA) resources to provide technical assistance support to MoILHSA and grant resources made available under a regional TA facility to help procuring medical supplies and equipment.
Regional and global economic outlook worsens, creating pressures on the external balance and placing downward pressure on the GEL, leading increasing debt burden for foreign currency denominated public debt, and higher inflationary pressure.	In the short-term: • Continue to monitor evolution of macroeconomic situation closely with Ministry of Finance and other international financial institutions. • Utilize existing TA resources, particularly the Monitoring, Evaluation and Learning Lab, to provide evidence-based policy recommendations on how to best address adverse impacts of a weaker GEL on the economy. In the medium-term: • Support Georgia's ability to effectively identify and manage fiscal risks, including and especially those stemming from foreign exchange exposure of both general government debt and SOEs. • Support the government's efforts under the Georgia 2020, to further development of a domestic debt market to ensure higher share of domestic debt and minimize foreign currency exposure.

Source: Asian Development Bank.

IV. ASSURANCES

33. The government has assured ADB that implementation of the Program shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the loan and grant agreements.

V. RECOMMENDATION

34. I am satisfied that the proposed policy-based loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve (i) the programmatic approach for the Fiscal Resilience and Social Protection Support Program, and (ii) the loan of $200,000,000 to Georgia for the Subprogram 1 of the Fiscal Resilience and Social Protection Support Program from ADB's ordinary capital resources on regular terms, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 10 years, including a grace period of 3 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Masatsugu Asakawa
President

October 2020

[60] Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

DESIGN AND MONITORING FRAMEWORK

Overarching Development Objective: Inclusive economic recovery from the COVID-19 crisis[a]

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Effect of the Reform: More effective management of risk exposure by the public sector and enhanced and fiscally responsible social protection of vulnerable people.	By October 2022, Public debt to GDP ratio is brought below the 60% ceiling specified in the Economic Liberty Act. (May 2020 baseline: 62.8% of GDP) Share of domestic debt increased to at least 25% of total Government Debt. (2018 baseline: 18.7%) Share of total employees (hired and self employed) registered in the contributory pension scheme increases to at least 70% (December 2018 Baseline: 0%)	National Statistics Office of Georgia IMF EFF Staff Reviews Pension Agency Report	Incidence of COVID-19 increases substantially placing significant burden in public health systems and triggering another nation-wide lockdown
Reform Areas under Subprogram 1: 1. Management of public exposure to fiscal risks is strengthened.	**Policy Actions, by October 2020:** MOF fully operationalized a dedicated Fiscal Risk Management Division, which assess and quantify public exposure to fiscal risks stemming from SOEs and PPPs which are more likely to materialize as a result of the COVID-19 crisis, staffed with at least 7 technical staff of which at least 75% are women. (October 2018 baseline: FRMD staffed with 1 person) MOF approved PPP Guidelines which include methodological guidelines for the assessment of contingent liabilities and VfM methodology for PPP evaluations and completes PPP framework that ensures adequate identification, monitoring and reporting of fiscal risk stemming from PPPs. (June 2020 baseline: No PPP Guidelines or VfM methodology approved) MOF, through the Fiscal Risk Management Division, expanded the scope of the Fiscal Risk Statement to include (i) disclosure and discussion of methodological instructions to identify, quantify, finance and report Quasi Fiscal Activities of SOEs; (ii) assessment of impact of COVID-19 on the likelihood that fiscal risks stemming from SOEs materialize in the short-medium term; (iii) expansion of fiscal risk analysis of SOEs from 12 to 13 individual SOEs; (iv) discussion on effect of SOE sectorization on Public Finance Statistics, including impact on public debt Law; (v) analysis of SOEs from sectoral perspective, with the aim of normalizing financial statements from SOEs; (vi)	MOF Fiscal Risk Management Division sex-disaggregated staff list. PPP guidelines MOF Fiscal Risk Statement	Regional and global economic outlook worsens, creating pressures on the external balance and placing downward pressure on the GEL, leading increasing debt burden for foreign currency denominated public debt, and higher inflationary pressure. Changes in government may affect its commitment to reform measures envisaged under ADB support. Premature phasing out of measures provided under the Anti-Crisis Plan due to fiscal pressures lead to sharp increase in unemployment and

	assessment of stock of PPP liabilities based on International Public Sector Accounting Standards (IPSAS32) and VfM methodology for PPPs included in the recently approved PPP guidelines; (vii) Include draft discussion of fiscal risks stemming from natural disasters affecting municipalities.(August 2020 baseline: Scope of 2019 FRS does not include these analyses)		poverty resurgence.
2. Domestic debt market for government securities is deepened.	MOF and NBG commenced Primary Dealer Pilot with appropriate rights and obligations and PD rules published and Primary Dealers System to promote activity on the primary and secondary markets, ensuring decreased public reliance on external debt to finance future fiscal stimulus packages as the one needed to mitigate the adverse socio-economic impacts of COVID-19..(September 2020 baseline: No Primary Dealer Pilot in place)	Memorandum of Understanding between MOF, NBG and commercial banks,	
	MOF issued ministerial decree which mandates that the Debt Management Strategy is updated, approved and published on its website on an annual basis to increase predictability of the market for government domestic debt securities. (2018 baseline: No decree mandating annual updating and publishing of the Debt Management Strategy)	MOF Minsiterial Decree	
	MOF issued benchmark bonds with nominal value of at least GEL2 billion in 2020 to increase investor interest towards Georgian government securities and promote capital market development, which in turn ensures the growth of GEL liquidity. (2018 baseline: MOF issued benchmark bonds with cumulative nominal value of GEL855 million)	MOF Benchmark Bond Actual Emission Notice	
	Parliament approved new Investment Funds Law needed to develop investment fund legal, regulatory and tax framework and creating an enabling environment for the development of capital markets in Georgia. (June 2020 baseline: No Investment Fund Law)	Investment Funds Law	
3. Adequacy and fiscal sustainability of social protection programs strengthened	Parliament approved revised budget in 2020 which includes an increase of at least GEL 30 in universal pension payout for pensioners aged 70 and above, 65% of whom are women, to mitigate the adverse impact of the COVID-19 crisis on old-age poverty. (June 2020 Baseline: monthly payout to pensioners aged 70 and above is GEL220)	Rectified Budget 2020	
	Parliament approved amendment to the Law of Georgia on State Pensions which introduces a rules-based mechanism for	Law of Georgia on State	

	increases in payouts for universal pension beneficiaries, 70% of whom are women. (August 2020 baseline: no rules-based mechanism for indexation of pension payouts)	Pension; Budget Documents	
	Government of Georgia establishes and operationalizes an independent public Pension Agency for administration of the new supplementary contributory pension scheme (Pillar II pension scheme) where at least 50% of staff are women (June 2018 baseline: No contributory pension scheme of Pension Agency established)	Law of Georgia on Pension Savings and sex-disaggregated staff list from the PA.	
	Pension Agency ensured registration of 100% of formal employees and collected contributions from at least 80% of registered employers, as well as and associated contributions from Government and employees. (January 2019 baseline: Pension Agency did not have any registered employers and did not collect contributions)	Pension Agency annual report	
	Pension Agency adopted an interim Cash and Cash Equivalent Investment Policy allowing investments to be managed without any undue risk and ensuring transfer of all contribution payments into individual interest-bearing accounts. (January 2020 baseline: Contributions not transferred into individual interest-bearing accounts)	Pension Agency Cash and Cash Equivalent Policy	

Budget Support ADB: $200,000,000 (loan)

COVID-19 = coronavirus disease, GDP = gross domestic product, MOILHSA = Ministry of Internally Displaced Persons from the Occupied Territories, Labour, Health and Social Affairs, MOF = Ministry of Finance, NA = not applicable, NBG = National Bank of Georgia, PA = Pension Agency, PFM = public financial management,

[a] Socio-economic Development Strategy of Georgia: Georgia 2020.

LIST OF LINKED DOCUMENTS

1. Loan Agreement
2. Sector Assessment (Summary): Public Financial Management
3. Development Coordination
4. International Monetary Fund Assessment Letter[1]
5. Summary Poverty Reduction and Social Strategy
6. Risk Assessment and Risk Management Plan
7. List of Ineligible Items
8. Country Economic Indicators

Supplementary Documents

9. Sector Assessment (Summary): Social Protection
10. Sector Assessment (Summary): Pension Reform

[1] The IMF confirmed on {date of confirmation} that the attached {relevant document} may serve as the IMF assessment letter

DEVELOPMENT POLICY LETTER

საქართველოს
ფინანსთა მინისტრი
Minister of Finance
of Georgia

№ 07-05/113442
18 / 09 / 2020

DEVELOPMENT POLICY LETTER

Masatsugu Asakawa
President
Asian Development Bank
Manila, Philippines

Dear President Asakawa,

I thank the Asian Development Bank (ADB) for its support to Georgia's efforts to overcome the challenges posed by the COVID-19 pandemic to the wellbeing of our people. ADB is a trusted partner of the government and the development impact of our cooperation has been tremendous over the past years. The COVID-19 outbreak had significant adverse effects on the Georgian economy and disrupted a trajectory of inclusive economic growth. We have reacted rapidly and effectively to contain and mitigate the health risks associated with the pandemic, protect our thriving private sector, especially small and medium enterprises, and protect people's livelihoods through expansion of existing social program. While we continue to provide immediate relief to the most affected members of society, the government of Georgia has also already began paving the way for a quick return to inclusive economic growth. Our mission within the next months is to ensure that the Georgian economy returns to pre-crisis levels of economic growth, underpinned by macroeconomic stability, whilst maintaining the livelihoods of those most affected by the crisis. To this end, we have undertaken several significant institutional reforms which to strengthen the resilience of our public financial system, ensuring that Georgia can return to a solid fiscal position without compromising critical social spending.

0114 ქ. თბილისი, გორგასლის ქუჩა 16
ტელ: (+99532) 2 262979
ელ-ფოსტა: info@mof.ge
ვებ-გვერდი: www.mof.ge

0114 Tbilisi, 16 Gorgasali Street
Tel: (+99532) 2 262979
E-mail: info@mof.ge
website: www.mof.ge

As part of our efforts to strengthen the resilience of our public finances, we have undertaken a number of significant and structural reforms to the way we manage our exposure to fiscal risks. While these reforms have been in preparation for a number of years now, partly thanks to the support of ADB and the IMF, we have taken concrete steps to ensure that public exposure to fiscal risks stemming from PPPs/PPAs and SOEs is adequately quantified and integrated into our broader budgetary cycle. This will minimize unplanned fiscal pressures stemming from the materialization of fiscal risks and which can significantly disrupt macroeconomic stability. In light of the current economic outlook in Georgia and globally, the government expedited these reforms to ensure that our return to inclusive economic growth is not hindered by unplanned fiscal pressures.

Another key reform area which we consider critical to address to effects of the COVID-19 crisis in the medium term pertains to the development of domestic market of government securities, which implies increasing liquidity, transparency and predictability of the market going forward. Under the development of government securities market one of the main issue is the growth of existing securities volume, in order to increase investors' interest towards domestic government securities. A more developed domestic market should decrease the budget expenses on debt service and reduce risks in the medium and long-term, freeing up fiscal space for key social spending and economic recovery efforts. Developed government securities market will support the development of domestic capital market, which in turn will create additional GEL denominated financial resources available for the market participants. It will also help reduce Georgia's reliance on external debt to finance countercyclical expenditure programs should the current crisis be prolonged.

Finally, and parallel to our institutional reforms to fiscal risk management and public debt management, Georgia has also accelerated key institutional reforms to existing social protection systems in order to ensure adequate financial support to the most vulnerable members of society in a fiscally responsible way. ADB has been an important partner of Georgia in the reform of its pension system, the largest social protection program in Georgia, providing significant TA resources to help implement and operationalize a new supplementary contributory pension scheme, to be administered on a fully funded basis, in addition to the universal pension scheme. The intent being to reduce the expectation from the universal pension scheme, maintaining it as a poverty alleviation program, and enhancing adequacy of old age income of citizens by accumulating additional savings to generate old age income. With ADB's support, the Government of Georgia developed a legal framework for the new supplementary contributory pension scheme (i.e. a Pillar II pension scheme) that defined the Pension Savings Scheme and established and operationalized an independent public Pension Agency for its administration. The introduction of the Pension Savings Scheme and approval of a legal framework guiding indexation of payout increases, is expected to substantially enhance old-age income in a fiscally responsible way. Going forward, Georgia will continue working with ADB to help develop an additional voluntary pension savings scheme (Pillar III), to generate a third source of old-age income to achieve full adequacy. The outbreak of the COVID-19 pandemic highlighted the importance of these reforms in ensuring that older adults, high risk citizens who depend on pension payouts from their livelihoods, continue to be supported in a fiscally responsible way.

We welcome ADB's support rethinking the layout of our existing social welfare system to make it more inclusive and progressive yet fiscally sustainable. ADB has a significant role to play in these reforms given its proven familiarity with the country context. We would appreciate continued policy dialogue on these specific reform areas within the coming years.

Once again, I express my sincere gratitude to ADB for the support it has extended to the Government of Georgia in the most difficult of times. We are committed to working closely with you and other development partners under a strong and coordinated approach to ensure that all our interventions are complementary and help us overcome the critical challenges we now face.

Sincerely,

Ivane Matchavariani

POLICY MATRIX

Reform areas	Subprogram 1 Policy Actions (December 2018 – September 2020)	Subprogram 2 Indicative Policy Actions (October 2020 – October 2021)
1. Management of public exposure to fiscal risks is strengthened.	1. MOF fully operationalized a dedicated Fiscal Risk Management Division, which assess and quantify public exposure to fiscal risks stemming from SOEs and PPPs which are more likely to materialize as a result of the COVID-19 crisis, staffed with at least 7 technical staff of which at least 75% are women. **(Documents required: MOF Ministerial Decree and Letter from Ministry of Finance confirming engagement of all 7 staff)** 2. MOF approved PPP Guidelines which include methodological guidelines for the assessment of contingent liabilities and VfM methodology for PPP evaluations and completes PPP framework that ensures adequate identification, monitoring and reporting of fiscal risk stemming from PPPs. **(Documents required: PPP Guidelines and VfM methodology)** 3. MOF, through the Fiscal Risk Management Division, expanded the scope of the Fiscal Risk Statement to include (i) disclosure and discussion of methodological instructions to identify, quantify, finance and report Quasi Fiscal Activities of SOEs; (ii) assessment of impact of COVID-19 on the likelihood that fiscal risks stemming from SOEs materialize in the short-medium term; (iii) expansion of fiscal risk analysis of SOEs from 12 to 13 individual SOEs; (iv) discussion on effect of SOE sectorization on Public Finance Statistics, including impact on public debt Law; (v) analysis of SOEs from sectoral perspective, with the aim of normalizing financial statements from SOEs; (vi) assessment of stock of PPP liabilities based on	1. GoG revises legislative framework of the SOE sector, increasing MOF's role in SOE related fiscal risk management, developing a formal system to account and fund community service obligations, and increasing SOE accountability. 2. MOF publishes a ministerial statement which includes (i) a rationale for SOE ownership; (ii) competitive Neutrality of SOEs; and (iii) an analysis of corporate governance practices in comparison with the OECD guidelines on transparent and (iv) a merit-based appointments of supervisory boards for all SOEs defined as Public Interest Entities comprising 90% of annual turnover. This statement will inform reforms to SOE corporate governance. 3. MOF identifies and discloses fiscal risks stemming from Natural Disasters, including climate change related disasters and published it on MOF's website to ensure comprehensive and adequate identification and reporting of fiscal risks.

	International Public Sector Accounting Standards (IPSAS32) and VfM methodology for PPPs included in the recently approved PPP guidelines; (vii) Include draft discussion of fiscal risks stemming from natural disasters affecting municipalities. **(Documents required: MoF Fiscal Risk Statement 2020)**	
2. Domestic debt market for government securities is deepened.	4. MOF and NBG commenced Primary Dealer Pilot with appropriate rights and obligations and PD rules published and Primary Dealers System to promote activity on the primary and secondary markets, ensuring decreased public reliance on external debt to finance future fiscal stimulus packages as the one needed to mitigate the adverse socio-economic impacts of COVID-19. **(Documents required: Memorandum of Understanding between MOF, NBG and commercial banks)** 5. MOF issued ministerial decree which mandates that the Debt Management Strategy is updated, approved and published on its website on an annual basis to increase predictability of the market for government domestic debt securities. **(Documents required: MOF Ministerial Decree)** 6. MOF issued benchmark bonds with nominal value of at least GEL2 billion in 2020 to increase investor interest towards Georgian government securities and promote capital market development, which in turn ensures the growth of GEL liquidity. **(Documents required: MOF benchmark bond issue calendar)** 7. Parliament approved new Investment Funds Law needed to develop investment fund legal, regulatory and tax framework and creating an enabling	4. MOF and NBG add at least one new tenor to the PD Pilot and publish the plan of moving towards full-fledged PD System. 5. MOF mandates Primary dealers to disclose and make publicly available all pre-trade and post-trade figures for all securities included in the PD system. 6. MOF approves new Debt Management Strategy 2021–2023 which include an increase in the stock of domestic debt to at least 10% of GDP by October 2023 to deepen the domestic debt market for government securities. 7. MOF adopts strategy to develop retail participation in Government bond market which may include a savings certificate style market issued electronically distributed by PO or Banks subject to deliberation with NBG. 10. GoG in collaboration with NBG approve Capital Market Development Strategy to promote mobilization of domestic private financial resources available to government and minimize reliance on external financing. 11. GoG submits the law on Securitization to the Parliament to deepen capital markets by creating a new class of debt instruments and allowing access

	environment for the development of capital markets in Georgia. **(Documents requires: Investment Funds Law)**	to new participants—corporates and others—to the market. 12. GoG submits the law on Covered Bonds to deepen domestic capital markets by widening the range of investment instruments available to investors.
3. Adequacy and fiscal sustainability of social protection programs strengthened.	8. Parliament approved revised budget in 2020 which includes an increase of at least GEL 30 in universal pension payout for pensioners aged 70 and above, 65% of whom are women, to mitigate the adverse impact of the COVID-19 crisis on old-age poverty. **(Documents required: Budget Amendment)** 9. Parliament approved amendment to the Law of Georgia on State Pensions which introduces a rules-based mechanism for increases in payouts for universal pension beneficiaries, 70% of whom are women. **(Documents required: Law on of Georgia on State Pension)** 10. Government of Georgia establishes and operationalizes an independent public Pension Agency for administration of the new supplementary contributory pension scheme (Pillar II pension scheme) where at least 50% of staff are women. **(Documents required: Law of Georgia on Pension Savings establishing creation of Pension Agency; Letter from PA identifying sex-disaggregated staff per department)** 11. Pension Agency ensured registration of 100% of formal employees and collected contributions from at least 80% of registered employers, as well as and associated contributions from Government and	13. NBG and Pension Agency approve long term investment policy for Pension Savings Scheme to guide long term investment strategy of contributions. 14. Pension Agency, in coordination with MOF, approve enforcement mechanism for pension scheme contributions to ensure increased compliance by all formal employers with the Law of Georgia on Pension Savings. 15. GoG submits Law on Third Pillar Pensions to Parliament to enable Georgian workers to accumulate additional voluntary savings, when possible, and generate a third source of old-age income.

	employees. **(Documents required: Pension Agency official report)** 12. Pension Agency adopted an interim Cash and Cash Equivalent Investment Policy allowing investments to be managed without any undue risk and ensuring transfer of all contribution payments into individual interest-bearing accounts. **(Documents required: Pension Agency Cash and Cash Equivalent Investment Policy)**	

COVID-19 = coronavirus disease, GDP = gross domestic product, GOG = Government of Georgia, IPSAS = International Public Sector Accounting Standards, MEL = Monitoring, Evaluation and Learning, MOESD = Ministry of Economy and Sustainable Development, MOF = Ministry of Finance, NBG = National Bank of Georgia, OECD = Organisation for Economic Co-operation and Development, PPP = public-private partnerships, SOE = state-owned enterprises, VFM = value-for-money