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FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR GEORGIA

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TABLE OF CONTENTS

EXECUTIVE SUMMARY **3**

1 OVERVIEW OF THE BANK'S ACTIVITIES **6**

1.1 THE BANK'S CURRENT PORTFOLIO 6
1.2 IMPLEMENTATION OF THE PREVIOUS STRATEGIC DIRECTIONS 6
1.3 KEY LESSONS 9

2 OPERATIONAL ENVIRONMENT **9**

2.1 POLITICAL CONTEXT 9
2.2 MACROECONOMIC CONTEXT 10
2.3 STRUCTURAL REFORM CONTEXT 11
2.4 BUSINESS ENVIRONMENT AND LEGAL CONTEXT 12
2.5 ACCESS TO FINANCE 13
2.6 ACTIVITIES OF INTERNATIONAL ORGANISATIONS AND AREAS OF COOPERATION AND COMPLEMENTARITY WITH EBRD 14
2.7 SOCIAL CONTEXT 15
2.8 RESOURCE EFFICIENCY AND CLIMATE CHANGE CONTEXT 16

3 STRATEGIC ORIENTATIONS **17**

3.1 STRATEGIC DIRECTIONS 17
3.2 KEY CHALLENGES AND BANK ACTIVITIES 19
3.3 POTENTIAL RISKS TO COUNTRY STRATEGY IMPLEMENTATION 30
3.4 ENVIRONMENTAL AND SOCIAL IMPLICATIONS OF BANK PROPOSED ACTIVITIES 31

ANNEX 1 – POLITICAL ASSESSMENT **33**

ANNEX 2 – SELECTED ECONOMIC INDICATORS **41**

ANNEX 3 – ASSESSMENT OF TRANSITION CHALLENGES **42**

ANNEX 4 – LEGAL TRANSITION **47**

ANNEX 5 – GENDER PROFILE **51**

ANNEX 6 – EBRD AND THE DONOR COMMUNITY **54**

EXECUTIVE SUMMARY

Georgia is committed to and applying the principles of multiparty democracy, pluralism and market economics in accordance with the conditions specified in Article 1 of the Agreement establishing the Bank.

In the period since the adoption of the previous Strategy, Georgian authorities continued to pursue a reform agenda aimed at transforming Georgia into a European democratic state. The constitutional and legislative framework to achieve this objective has been put in place and significant progress has been made on the path of transition to an open market oriented economy. Implementation of the commitments in the areas of the rule of law and independence of the judiciary will contribute to the continued development of Georgia's democratic institutions.

Economic growth remains positive but has slowed to 2.8 per cent in 2015, mainly due to a challenging external environment, with remittances and exports negatively affected by the recession in Russia and a sharp slowdown in regional trading partners. While the banking sector remains resilient, well capitalised and with low level of non-performing loans, risks are increasing as the sector is highly dollarized and the 21 per cent depreciation of the lari in 2015 is having an effect on the asset quality of banks. Growth is expected to improve to 3.4 per cent in 2016, supported by increased investor confidence, growing trust in the lari and central bank policies, which can be expected to reduce dollarization in the economy, and a strong tourism season. Progressive benefits of the EU Deep and Comprehensive Free Trade Area (DCFTA) implementation and improved competitiveness are expected to support further growth in 2017. However, downside risks remain, as Georgia's large current account deficit and high levels of external debt expose it to external shocks.

Overall, Georgia's business environment remains favourable, having undergone significant structural reforms over the past several years. The country continues the implementation of its commitments under the DCFTA and the Association Agreement, a key anchor for further reforms, improvements in standards and competitiveness, which will require substantial efforts to adopt new legislation and standards under a tight schedule. Georgia has already made progress in the liberalisation of trade and trade-related issues by introducing necessary amendments in food safety, veterinary and customs legislation. Electricity tariffs where increased in 2015. The government has intensified its efforts towards improving policy delivery, simplifying tax administration, fostering innovation, accelerating infrastructure development including by mobilising further private investment, and re-aligning the educational system towards the needs of the private sector. In this context, the following strategic orientations are proposed to guide EBRD's engagement with Georgia in the forthcoming strategy period:

- **Priority 1: Support private sector competitiveness through innovation, enhanced value added and convergence with DCFTA standards and obligations:** While Georgia's investment climate, among the best in the EBRD's countries of operation, is conducive to innovation, much of the economy is dominated by low-value industries and Georgia is below its innovation potential. DCFTA provides further basis and incentive for improving quality standards and enhancing value-added, including through the introduction of new technologies and processes. In this context, the Bank will support corporates and SME competitiveness through financing and business advisory, seeking to finance projects promoting innovation, skills transfer and convergence with DCFTA standards. The focus will be on the agribusiness, tourism, light manufacturing and healthcare sectors as well as the knowledge economy. Finally the Bank will seek to contribute to bridging the skills and vocational training gap, with a particular focus on the tourism and agribusiness sectors.

- **Priority 2: Deepen financial intermediation and develop local currency and capital markets to enable access to finance:** Although on a declining trend, dollarization of the banking sector remains high (66% of private sector credit, 68% of deposits), representing an important vulnerability for both banks and borrowers. In addition, certain segments of the market are still underserved by financial institutions, such as the agriculture sector, women entrepreneurs, or investments related to resource efficiency. Capital markets remain underdeveloped and do not have the adequate depth to provide long term local currency funding for banks, nor do they constitute a meaningful source of finance for companies wanting to scale-up. In this context, the Bank will continue to provide partner banks with dedicated SMEs credit lines and risk sharing facilities, when possible in local currency, with a focus on supporting projects promoting alignment with DCFTA requirements, women in business and resource efficiency. EBRD will also support the development of capital markets, in particular on the debt side, by both issuing lari bonds and investing selectively in local corporate bonds, as well as seek to facilitate the introduction of debt instruments and financial products that are new to Georgia.

- **Priority 3: Expand markets through inter-regional connectivity:** As a small, open economy at the crossroads of several global trade routes, Georgia stands to reap significant benefits from enhanced connectivity and improved logistics. The Bank will therefore seek to support transport, energy and logistics infrastructure that can strengthen Georgia's strategic position as a transit link between Europe and Turkey on one side, and Central Asia and China on the other, including as part of the One Belt One Road Initiative, as well as facilitating North-South links that allow Armenia to increase exchanges with its trade partners. In conjunction with enhancing the country's transit capacity, the Bank will help realise its potential as a regional logistics platform. To help mobilise private capital for these infrastructure investments, the Bank will continue to support the development of adequate legal frameworks for private sector participation in infrastructure, and work closely with other MDBs, including the newly created AIIB. In addition, the Bank will actively support Georgia's exporters through the provision of trade finance and dedicated business advisory, including that to access DCFTA markets.

- **Priority 4: Support renewable energy, resource efficiency, and climate change adaptation to enhance competitiveness and resilience of the economy:** The country's energy sector, which virtually collapsed in the immediate post-Soviet years, has undergone significant transformation in recent years as hydropower capacity was rebuilt and expanded, and transmission networks established. However, energy intensity in the country is still significantly above the EU28 average, and the power sector still suffers from significant distribution losses and seasonal supply patterns, leading to shortages. There is a need to improve resource efficiency across sectors, through enhanced institutional framework and capacity for resource efficiency projects. The Bank will continue to support the development of renewable energy resources, working with private sector operators including both local and foreign strategic private investors. The Bank will step up engagement in energy and resource efficiency investments in the built environment, agribusiness and industrial sectors. Additionally, the Bank will engage in promoting energy efficiency and sustainability in the municipal sector, and help municipalities prioritise their energy efficiency investments. Lastly, the Bank will support the authorities in delivering their commitment under the COP21 agreement, including mainstreaming climate change mitigation measures in key sectors.

1 OVERVIEW OF THE BANK'S ACTIVITIES

1.1 The Bank's current portfolio

Private sector ratio: 90.3per cent, as of 31 October 2016

Sector Group	Sector Team	Portfolio no of operations	Portfolio (€m)	% Portfolio	Op Assets	% Op Assets
Energy	Natural Resources	3	23	3%	23	4%
	Power and Energy	10	266	36%	246	40%
		13	**289**	**39%**	**269**	**44%**
Financial Institutions	Depository Credit (banks)	21	194	27%	163	26%
	Insurance, Pension, Mutual Funds	0	0	0%	0	0%
	Leasing Finance	0	0	0%	0	0%
	Non-depository Credit (non-bank)	6	15	2%	10	2%
		27	**209**	**29%**	**173**	**28%**
Industry, Commerce & Agribusiness	Agribusiness	6	37	5%	37	6%
	Equity Funds	3	8	1%	6	1%
	ICT	2	70	10%	70	11%
	Manufacturing & Services	7	32	4%	32	5%
	Property and Tourism	4	34	5%	17	3%
		22	**181**	**25%**	**162**	**26%**
Infrastructure	Municipal & Env Inf	9	52	7%	12	2%
	Transport	1	1	0%	1	0%
		10	**53**	**7%**	**13**	**2%**
Summary		**72**	**733**	**100%**	**616**	**100%**

Source: EBRD

1.2 Implementation of the previous strategic directions

The previous Country Strategy for Georgia was approved by the Board on 4th September 2013 with the following priorities:

- Fostering private investments
- Completing the modernisation of the energy sector
- Supporting Georgia's regional and global economic integration

In the previous strategy period, Georgia had to confront both political uncertainties and economic adversities that undermined investment appetite. The newly elected government went through several high level changes at Prime Minister and ministerial level, as well as publicly exposed debates on important issues, while the Georgian economy was affected by the sharp economic deterioration of its key regional trading partners.

In pursuing its cross-sectoral objective of **fostering private investments**, the Bank invested €584.1 million in 49 operations since 2013, with the following highlights:

- The Bank promoted best operational practices and energy efficiency in Georgia's corporate sector through engagement in manufacturing, retail, services, food processing, health, pharmaceutical and hospitality. EBRD for example supported the modernisation of a steel mill near Tbilisi, financed the only diesel engine servicing centre in the South Caucasus, and in the retail sector supported the expansion of supermarket and pharmacy chains.

- The Bank also stepped up its Advice for Small Businesses: between 1 September 2013 and 31 December 2015, the Bank undertook 175 advisory projects (163 with local consultants and 12 with international advisers) supporting SMEs with management information systems, business strategy, financial management and reporting and marketing. 83 per cent of the enterprises assisted reported an average increase in turnover of 198 per cent in 2015. EBRD also explored opportunities to support Geographic Indications in the agribusiness sector beyond the wine industry, but to date has received limited traction from the private sector.
- EBRD played an important role in facilitating private sector's access to finance through its support to the banking sector. The Bank provided its partner banks with targeted credit lines, such as the Georgian Agricultural Finance Facility (GAFF), which resulted in doubling the share of agricultural loans in partner banks' portfolio. Under the Bank's Small Business Initiative, partner banks benefitted from the recently launched Women in Business (WiB) line, Energy Efficiency credit lines, as well as local currency facilities under its SME Local Currency Programme, complemented by grants and TC to strengthen institutional capacity. Its risk sharing framework is in place with five local banks, including on an unfunded basis with two financial institutions.
- The Bank continued to play a leading role in supporting local currency lending, developing capital markets, as well as the de-dollarization of the Georgian banking sector. In early 2014, the Bank issued the first ever IFI bond in Georgian lari, followed by two more local currency bonds in 2015 and 2016, in order to diversify sources of funding for its lending activities, facilitate its support to SME clients with income in local currency, and deepen the local capital market. Each of the subsequent placements lengthened the tenor of the instrument, from 2 to 5 years maturity.
- The Bank supported the National Bank of Georgia in developing the yield curve of government obligations and started to support the development of a proper legal framework to effectively trade derivative financial instruments. Georgia was one of the first countries to undergo a joint EBRD-IMF-World Bank assessment for the development of local currency capital markets, and sign a framework agreement with the authorities on policy reforms required to support de-dollarization.
- The Bank's previous equity participation in two Georgian banks proved instrumental to their ability to successfully list in London and resulted in a profitable return to the Bank.
- To continue to build on Georgia's good record in improving the business environment, the Bank sponsored the Investors Council established in May 2015, a dialogue platform between the private and public sector, and actively participated in high-level meetings and preparatory work as one of the Council's permanent member. The Bank's active engagement in supporting the enhancement of the bankruptcy laws, public procurement procedures, PPP regulatory framework (on-going advisory), as well as the switchover from analogue to digital transmission, enabled the country to advance in meeting international commitments in these areas.

The EBRD was instrumental in assisting Georgia in the **modernisation of its energy infrastructure**.

- With the help of NIF grants from the EU, the Bank supported the state-owned electricity transmission company in the construction of a new substation in Jvari, as well as additional 68 km of the transmission line. The project was critical for facilitating increased trade in the regional electricity sector and the market development for renewable energy sources in Georgia.

- The Bank continued to play a leading role in the development of the country's renewable energy resources. EBRD financed five projects in the renewable energy sector, adding over 1 thousand MWh/y renewable capacity, with a total financing of €132.4 million for large and small HPPs, including Dariali HPP and Shuakhevi HPP, the first private energy project in Georgia to be registered under the Clean Development Mechanism (CDM). The Bank also supported Gori, the first wind farm in the southern Caucasus under limited recourse project-finance structure, a project that will generate 85,000 MWh/y.
- In addition to these large renewable energy projects, the Bank assisted in improving the regulatory framework for renewable energy, in particular through its policy dialogue on the action plan on the regulatory environment for exporting electricity, which is currently being implemented. The Bank also assisted the government in the preparation of the first Energy Efficiency Action Plan, as well as with a detailed assessment of the potential of implementing Energy Efficiency projects in the residential sector.
- As a result of the Bank's policy dialogue, Georgia also signed the Eastern Europe Energy Efficiency and Environment Partnership (E5P) contribution agreement. The initiative allows authorities to invest in energy savings, while supporting municipal energy efficiency projects aiming at reducing greenhouse gas emissions. E5P also includes a strong commitment to policy dialogue, allowing partners to address policy issues to find practical solutions to municipal energy efficiency projects. The first project supported under E5P for Georgia is the partial renovation of the bus fleet in Tbilisi and other cities, replacing diesel vehicles with CNG.
- EBRD supported the introduction of compressed natural gas (CNG) in petrol stations, an environmentally-friendly alternative to conventional fuels, through its loan to Wissol Petroleum Georgia. The Bank was also instrumental in developing energy efficiency lending amongst MSMEs, by introducing the first MFI energy efficiency credit line in Georgia, with an emphasis on promoting the concept in the MFIs regional networks.
- Overall, as a result of the Bank's sustainable energy activities, led to an estimated CO_2 emissions reduction of 168 kt CO_2/year, on average, and an estimated 5,000,215 GJ/year energy savings.

The Bank was less impactful in helping Georgia to enhance its **regional and global economic integration,** largely owing to the lack of private investment flows in that area in the strategy period. Nonetheless, some progress towards that objective was achieved, as follows:

- The Bank supported the construction of a major logistics centre, next to Tbilisi airport, addressing the demand for quality warehouse infrastructure, and paving the way for future similar projects.
- The EBRD continued to expand its Trade Facilitation Programme (TFP) with local banks to facilitate trade between Georgia and numerous partners. Between 2013 and 2015, 117 trade finance guarantees were issued for a total amount of EUR 43 million.
- The Bank supported the development of Georgia's tourism sector by financing the construction of new hotels under internationally recognised brands and with high

energy efficiency standards in Tbilisi and the regions to respond to the growing demand resulting from significant increase of visitors to the country.

1.3 Key lessons

- These results provide a strong base for the Bank to further deepen its engagement along these priorities in the next strategy period. In the infrastructure sector, the Bank's on-going advisory project on PPP regulatory framework, coupled with the strong focus of the authorities on accelerating the roll-out of some key infrastructure pieces, including by involving the private sector, is expected to broaden opportunities for the Bank to support regional integration.
- In the corporate and SME sectors, the Bank will continue to leverage its excellent working relationships with local banks, in order to mitigate some of the risks. Projects in risk-sharing structures with Georgian banks have historically demonstrated better risk profiles than direct investments. The Bank has successfully leveraged its Advice for Small Businesses, particularly through the accounting improvement programme, to prepare potential clients for EBRD and other local bank financing.
- In the past, access to competitively-priced local currency has been challenging at times. In order to continue to diversify its access to local currency, the Bank will continue to issue lari bonds, with a focus on increasing maturities and introducing new instruments, and will generally deepen its engagement in capital market development in the new strategy period.
- In the energy sector, the Bank will capitalise on its experience on renewable energy generation, capacity development and the lead position it built in the sector among IFIs, by extending its engagement to wind and solar (depending on demand and affordability), beyond hydropower.

2 OPERATIONAL ENVIRONMENT

2.1 Political context

In the last three years the Georgian authorities continued to pursue a reform agenda aimed at transforming Georgia into a European democratic state. The constitutional and legislative framework to achieve this objective has been put in place and significant progress has been made on the path of transition to an open market oriented economy. Ongoing implementation of the commitments in the areas of the rule of law and independence of the judiciary will contribute to the continued development of Georgia's democratic institutions.

The parliamentary elections of 1 October 2012 marked the country's first democratic transfer of power since independence. The election resulted change of ruling party from the United National Movement (UNM) to the opposition coalition Georgian Dream (GD). The government formed by GD after the 2012 elections had a challenging agenda to manage, focusing on improving social security guarantees, healthcare, and fostering the agricultural sector.

The parliament has strengthened considerably after the constitutional amendments that entered into force in 2013. The constitutional changes reduced the powers of the president in favour of the prime minister and the government, thus shifting the country's political system towards a parliamentary model.

The last parliamentary elections were held in October 2016 and confirmed Georgia's democratic credentials and its leadership in democratic reform in the region. The ruling GD won a landslide victory, especially in single-mandate districts, having gained a constitutional majority being in command of 115 out of 150 parliamentary seats. With 27 MPs, UNM came second solidifying its position as the main opposition party. Additionally, the socially conservative Alliance of Patriots entered the new parliament narrowly passing the 5 per cent threshold and receiving 6 seats, as well as two individual candidates elected from majoritarian election districts. The election outcome promises broad continuity in the country's pro-European foreign policy and the related domestic reform agenda.

In external relations, the government confirmed that Georgia's pro-EU and pro-NATO orientation remains intact. Relations with Russia have improved in terms of re-establishing economic links but remain short of diplomatic ties due to the occupied territories of the Georgian regions of Abkhazia and Tskhinvali region/South Ossetia.

The Association Agreement (AA/DCFTA), which is the basis of Georgia's relationship with the EU, anchors the domestic reform agenda. Good progress has been made with regard to the harmonisation of Georgian law to the EU standards. Georgia has met the benchmarks set out in the visa liberalisation action plan (VLAP) and is expected to finalise the process of obtaining visa-free travel to the EU for Georgian citizens soon.

See Annex 1 for a detailed political assessment of the context of Article 1 of the Agreement Establishing the Bank.

2.2 Macroeconomic context

Economic growth has slowed to 2.8 per cent in 2015, after reaching 4.6 per cent in 2014. The slowdown in 2015 reflected mainly a deteriorating external environment, with remittances and exports negatively affected by the recession in Russia and a sharp slowdown in regional trading partners (such as Azerbaijan and Ukraine). Domestic political uncertainty also weighed on consumer and business confidence, as well as growth. External trade turnover shrank by 13 per cent, with exports down by 23 per cent and imports down by 10 per cent; remittances inflow dropped by 25 per cent in 2015 year-on-year, due to sharply declining money transfers from Russia and Greece. Foreign direct investment (FDI) was also negatively affected, declining 23 per cent in 2015 year-on-year.

As a result of this challenging external environment, the lari depreciated significantly (21.4 per cent over 2015). In response to currency pressure, the National Bank of Georgia (NBG) gradually raised the monetary policy rate from 4 per cent in 2014 to 8 per cent by the end of 2015. However, amid decreasing inflation expectations and decreasing pressure on the local currency, the policy rate was reduced to 7% by the mid-2016. The NBG's interventions in the currency market to support lari were relatively modest and the international reserves in December 2015 remained adequate at US$2.5 billion, or the equivalent of around three months of imports. The banking sector remains resilient, well capitalised and with low level of NPL's, but risks are increasing as lari depreciation is having an effect on the asset quality of banks, particularly clients that have borrowed in foreign currency (dollarization in the banking sector stands at 66 per cent on the loan side and 70 per cent on the deposit side as of end-April 2016). Inflation in 2015 increased, averaging 4.0 in 2015, compared to 3.1 per cent in 2014.

Fiscal and external balances remain under pressure. Budget deficit reached around 3.8 per cent in 2015. The government is maintaining a fiscal stimulus, backed by international financial institution (budget support and infrastructure financing), pushing up the public debt-to-GDP ratio to around 41.5 per cent in 2015, compared to 35.7 per cent in 2014, with a significant part of the increase attributed to exchange rate depreciation. The current account deficit reached 11.8 per cent of GDP, with total external debt at 86 per cent in 2015 (107 per cent including intercompany lending), putting further pressure on the currency and making the country more vulnerable to domestic and external shocks.

In 2016, growth is expected to improve to 3.4 per cent, compared to 2.8 per cent in 2015. While the external environment remains challenging, the country is likely to enjoy a strong tourism season helped by constraints on other tourism destinations, as well as increased investor confidence supported by the government and National Bank of Georgia's business-friendly policies. Trust in the lari and in central bank policies is also increasing. Following the decline of the lari in 2015, the current account deficit is expected to stabilise and dollarization to gradually decline in 2016. This will reduce downward pressure on the currency. Over the rest of the strategy period Georgia's economic growth outlook is expected to further improve. In 2017, growth is projected to increase to 3.9 per cent, supported by the progressive benefits of DCFTA implementation and improved competitiveness, as well as strong domestic and foreign direct investment in infrastructure and other sectors. However, downside risks remain, as Georgia's large current account deficit and high levels of external debt expose it to external shocks.

2.3 Structural reform context

Georgia continues the implementation of its commitments under the DCFTA, a key anchor for further reforms, improvements in standards and competitiveness. Implementation of the commitments will bring country's legislation closer to that of EU in such areas as food safety, sanitary requirements, rules for export of agricultural goods, management of customs, including enforcement of property rights at the border, and rules on public procurement. In the past few years, Georgia made progress in the liberalisation of trade and trade-related issues by introducing necessary amendments in food safety, veterinary and customs legislation. The gradual approximation to the EU legislation is helping to further improve investment climate, providing a more stable and predictable legislative framework. This will provide basis for improvement of competitiveness of Georgian companies, including SMEs, and enhance their ability to export to the EU and other markets. In 2015, Georgia's trade turnover with the EU increased to USD 3.2 billion (or 32 per cent of total trade turnover) compared to US$ 3.0 billion (26 per cent) in 2014.

Electricity tariffs have been increased. From August to September 2015, the tariffs were raised from 4-7.5 US cents to 5.75-9 US cents depending on the electricity consumption level – for more than one million customers in the regions of Georgia and for customers in the capital city, Tbilisi. The government is subsidising the rate hike in the regions by providing GEL 20 million (around US$ 8.9 million) for socially vulnerable households; the same subsidy scheme is applied to Tbilisi customers.

The Parliament passed a bill on corporate income tax reform in April 2016, known as "Estonian model", to support investment. According to the bill, corporate income tax (regular rate is 15 per cent) will only apply to distributed profit; undistributed profits, reinvested or retained, will not be subject to income taxation as of January 2017. Banks, insurance companies, microfinance institutions and pawn broking businesses will benefit from the rule starting 2019. The introduction of this model might bring benefits in terms of improved investment attractiveness of Georgia and more generally increased competitiveness and growth. However, such shifts in tax model usually carry a risk of a larger than expected drop in government's tax income.

2.4 Business environment and legal context

Business environment
Georgia's business environment remains favourable having undergone significant structural reforms over the past several years, in areas such as starting business procedures, construction permits, deregulation of business by cutting red tape and simplifying licencing and permitting regimes, as well as tax and customs reforms. The country remained 24th out of 189 countries in the Doing Business 2016 report. In June 2014, the government launched a successful "Produce in Georgia" programme in support of entrepreneurship, facilitating access to finance, property and business consultancy services.

Some of the proposed legislative changes over recent years may have had an uneven effect on the business environment, however they were later reversed. Changes to visa regulations, for example, caused disruption in tourism and business travel. These restrictions were later eased. Also a new law, approved by the parliament in July 2015, stipulates the creation of a Financial Supervisory Agency to regulate the banking sector, taking away the regulatory function from the NBG. The proposed changes may have undermined confidence in the banking sector, as they could have been perceived as weakening the independence of supervision. The application of legislation was, however, suspended in October 2015 by the constitutional court and the law is not likely to be enacted.

Legal Context
Georgia is still negotiating targets for transposing the EU rules and regulations in its existing legislative framework, following its signature of the EU Association Agreement in 2014. Despite significant reforms, the legislation remains to be made compliant in many sectors with the applicable EU rules and further reform is needed.

The 2015 EBRD assessment on corporate governance legislation and practices of companies highlighted, that the Georgian framework needs reforms in most areas under consideration. Access to finance, pledging of movable property and mortgaging seem to be well regulated in the law but no special laws on factoring or financial leasing exist. While Georgia has a system of credit information reporting, there is no regulatory body and no guidelines in place for access to credit information by users. The Law on Insolvency contains the mechanisms for both liquidation and reorganisation of an insolvent debtor but continues to be weak in areas regarding creditors' rights and protection of the insolvency estate.

The legal framework on electronic communication/telecom needs further alignment with the latest EU legal and regulatory framework, which is projected to be completed by the end of 2017. Similarly, the most recent EBRD assessment of the Concessions Law found that it is outdated, limited and inconsistent with international good practices and has a number of drawbacks which make it difficult to implement.

The legal framework related to energy efficiency and renewable energy remains to be made fully compliant with the EU rules, in particular, harmonising the energy legal and regulatory framework by improving the environment for private sector involvement and introducing a modern and dedicated renewable energy law. The Public Procurement Law in Georgia is also yet to be aligned with the 2014 EU Directives, as required by the Association Agreement with the European Union. Georgia has a modern eProcurement system which supports procurement planning, tendering, and management of public contract and provides reliable data on public procurement. However, it is an area of concern that a significant number of procurements are still concluded using the direct selection method. In 2015, with a view to align Georgian public procurement legislation with the EU regulations, as provided by the Agreement on Deep and Comprehensive Free Trade Areas (AA/DCFTA), the State Procurement Agency of Georgia (SPA) in cooperation with the United Nations Development Program (UNDP) and Swedish International Development Cooperation Agency (SIDA), prepared a comprehensive roadmap and action plan-schedule which were subsequently adopted by the Georgian Government on 31 March 2016. Among other amendments, the possibility to initiate negotiated procedure without prior publication will be subject to a fundamental review in order to restrict the direct selection method to strictly defined cases and circumstances.

2.5 Access to finance

Gaining access to finance remains a challenge for SMEs in Georgia, where bank lending is the predominant source of external financing and non-bank options remain underdeveloped. Despite strong credit growth (on average 17 per cent over the past five years), financial intermediation levels remain low, with domestic credit to GDP at 47.7 per cent in 2014.SME lending remains chronically low at 16.1 per cent and SMEs still largely rely on the owners' capital and retained earnings. High levels of interest rates (around 16 per cent) and high collateral requirements - that can represent up to 220 per cent of the value of the loan - hinder access to finance. In the context of a highly dollarised banking sector, access to local currency financing is a critical issue particularly for SMEs and individuals.

Alternative non-bank sources of finance are limited. Leasing levels are relatively low, albeit increasing. The insurance market is small and mainly focused on the non-life segment. Factoring remains largely unused and could benefit from improvements in the legal framework to foster the development of such services. A local commercial private equity sector is yet to develop and to date the country has not attracted significant interest of international private equity funds.

Capital markets are relatively undeveloped and do not provide access to finance for any but the largest companies and banks. Many choose to issue bonds or list their equity offshore due to the low levels of liquidity in the domestic market. The introduction of a private pension system, planned for 2017, is expected to support the strengthening of an institutional asset base necessary for capital market development.

2.6 Activities of international organisations and areas of cooperation and complementarity with EBRD

Cooperation among IFIs in Georgia is close both on investment as well as policy dialogue. The Bank will continue its engagement with existing IFIs[1] and seek to develop co-financing opportunities with the newly established Asian Infrastructure Investment Bank.

In the financial and SME sector, the **International Finance Cooperation's** (IFC), **European Investment Bank** (EIB), **Asian Development Bank** (ADB) and **KfW** are providing credit lines to local banks for MSME finance. The **European Union** is also active in Georgia on MSME financing with a focus on agribusiness companies and supporting the private sector to adopt the necessary standards for DCFTA. Georgia is also in the process of gaining access to the EU's research and innovation funding programme Horizon 2020. Furthermore, the ADB has provided support to financials sector authorities to develop a capital market development strategy, and alongside IFC and **Black Sea Trade Development Bank** (BSTDB), it has followed EBRD's path in issuing a local currency bond.

- ➢ The Bank will work with the EU and the Georgian authorities to mobilise EU grants to assist, private sector clients in improving corporate governance structures, product quality and service efficiency to enable them to benefit from DCFTA, including via its small business advisory. It will also coordinate closely with the EU on its advisory project with the Georgian Competition Authorities. Additionally, EBRD will seek to share risks on large corporate sector projects with the IFC where possible.

Alongside EBRD, the ADB, the **World Bank,** the IFC and **USAID** are the most active organisations on investment climate issues. Through its Georgia Investment Climate Project, the IFC has been focusing on improving the efficiency of regulations in tax, trade logistics, and investment policy.

- ➢ The Bank will coordinate with the ADB and IFC in the Investment Council, as temporary rotating members, in order to enhance public private dialogue in the country and further improve the business environment.

In the water and road sectors KfW**,** EIB, ADB and World Bank are all active in financing sovereign infrastructure. The EIB and World Bank are both financing the East-West Highway II to develop regional integration.

- ➢ The EBRD will continue to cooperate closely with these IFIs on large infrastructure projects that aim at achieving regional connectivity. The Bank will also closely work on building good relations with the newly established **Asian Infrastructure Investment Bank** (AIIB) and has already started exploring co-financing opportunities on large infrastructure projects.

The Bank is recognised by the authorities and other donors as being the most active IFI in the power and sustainable energy sector. EBRD works in close coordination with other international donors (USAID, EU NIF) and IFIs in the sector – KfW, the World Bank Group

[1]Main IFIs annual investment in Georgia (2013-2015 average, except for USAID and KfW 2012-2014 average): ADB (€235m), World Bank excl. budget support (€193m), USAID (€107m), IFC (€82m), EIB (€76m), KfW, (€40m), EU excl. budget support (€40m).

(including IFC) and ADB. In parallel with ADB and KfW, EBRD has been focusing on improving the country's electricity transmission and distribution network, enhancing energy efficiency through the rehabilitation of aging assets, and supporting the country's hydropower potential. In addition, in close cooperation with the World Bank Group and USAID, the Bank has been facilitating renewable energy investment including by developing market rules, network infrastructure and financial solutions to leverage private investment. The Bank together with KfW, EIB and EU NIF has been supporting the expansion of the power network and exchange of electricity between neighbouring countries through its support to the Black See Electricity Transmission Network.

- The Bank will continue to cooperate with other IFIs on energy projects that can benefit from the participation of several IFIs, such as Shuakhevi HPP (with IFC and ADB) or the Nenskra HPP (alongside ADB and EIB).

2.7 Social context

Georgia ranks 76th out of 188 countries on the UNDP 2015 Human Development Index (HDI). Life expectancy at birth stands at 75 years (as compared to the EU-average of 79 years). Coupled with low fertility rates and negative net immigration, this is expected to translate into a 13 per cent decrease in Georgia's population between 2015 and 2050, according to the UN population forecast. Educational attainment is relatively high, with average years of schooling at 12.1 years, compared to the OECD average of 11 years, and only 2 per cent primary school dropout. However, public expenditure on education is well below the EU average with an expenditure-to-GDP ratio at 1.98 per cent and gross graduation ratio for tertiary student remains critically low at 19 per cent.

At 67 per cent in 2014, labour force participation is above the EU average. Nevertheless skills mismatch has become a growing concern. According to the Business Environment and Enterprise Performance Survey (BEEPS V), 10 per cent of Georgian businesses report an inadequately skilled workforce to be a major obstacle for their business, comparable with the regional average for Eastern Europe and Caucasus, and Turkey. Despite a slight decline since 2010, unemployment remains one of the highest levels in the region, at 12.4 per cent in 2014. Young people (age 15-24) are more than twice as likely to be unemployed compared to adults. The youth unemployment rate (15-24 years old) stood at 30.8 per cent in 2014, highest for young people with a secondary degree (at 66.2 per cent). In parallel, more than 60 per cent of Georgia's work force is employed in vulnerable employment.

Georgia has still room to improve young people's access to finance. On par with Armenia and Azerbaijan, Georgia' youth faces additional challenges of financial inclusion: only 10 per cent own an account at a formal financial institution , compared to 48 per cent in Belarus and 55 per cent in Ukraine and Russia.

Gender gaps still exist in labour market participation, skills profile and earnings. According to ILO's Key Labour Market Indicators, the gender gap in employment had risen to 16.3 percentage points in Georgia by 2015. The share of women in employment is 51.1 per cent compared to 66.6 per cent for men, which is below the EU average (59.6 per cent for women and 77.5 per cent for men). According to UNESCO, women's share of enrolment in tertiary education in Georgia was higher than that of men (55 per cent versus 45 per cent), however, only 24.4 per cent of the students specialising in engineering, manufacturing or construction (STEM subjects) were female (representing 3.6 per cent of female tertiary graduates). In

2014, the gender pay gap in Georgia was 39.8 per cent, compared to the EU average of 16.4 per cent.

Finally, regional disparities persist. Significant differences exist between large cities and small communities in income levels, employment and social infrastructure (such as education). There are fewer private-sector opportunities in rural areas and most universities are situated in Tbilisi, driving youth of working age, particularly women, to migrate to the capital. According to the 2014 population census, 42 per cent of interregional migrants in Georgia live in Tbilisi and Kvemo Kartli. Unemployment rate remains highest in Tbilisi at 22.5 per cent. Across the remainder of Georgia's regions the main share of the active population is self-employed, with agriculture employing more than 50 per cent of the population, and unemployment fluctuates from 5 (Kakheti) to 16 per cent (Adjara).

2.8 Resource efficiency and climate change context

Georgia's energy intensity is about 30per cent higher than the EU-28 average. The country does not have significant oil and gas reserves and imports over two thirds of its primary energy from neighbouring countries. Electricity production in Georgia relies mainly on hydro power sources which supply 78 per cent of the total electricity production. With projected increasing energy demand and reliance on energy imports, Georgia would benefit from the diversification of its energy mix and the decoupling of economic growth from energy consumption by enhancing rational energy use.

Energy demand in Georgia stems primarily from: residential sector (30 per cent), transport (33 per cent) and industry (15 per cent)[2]. The industrial sector in Georgia offers significant energy saving potential (~ 30 per cent) and financially viable energy efficiency (EE) investments, particularly for large/medium companies operating in iron & steel, chemicals, non-metallic minerals production and food & beverages. Awareness of the benefits of investing in energy and resource efficient technologies and services, especially amongst corporates, SMEs and households, remains low.

The residential sector is one of the largest energy end-user in Georgia. The majority (70 per cent) of the housing units has been built during 1961-1990 and it is estimated that 10-15 per cent of these buildings are in a state of decay with only a limited building lifetime remaining. The energy performance of the Georgian building stock is very low due to age and construction standards of the building stock as well as lack of energy performance regulation for new constructions. While energy saving potential is available, the financial viability and affordability of urban regeneration schemes remains challenging. The introduction of energy performance standards for new buildings and the introduction of energy performance criteria in the renovation of existing public building stock could enable immediate results in improving energy performance of the built environment sector.

Currently there is no specific law or regulation in place addressing EE in Georgia. Nevertheless, the signing of the EU Association Agreement and Georgia's application for full Energy Community membership are two recent examples of government commitment to increasing the level of EE in the country and introducing the relevant enabling policy. As part of these efforts, the Ministry of Energy and of Economy and Sustainable Development are in

[2]Source: Geostat, Energy Balance of Georgia, 2014

the process of drafting Georgia's first National Energy Efficiency Action Plan (NEEAP) with EBRD's support.

There are two important national strategies/action plans related to climate and energy: the National Environmental Action Programme (NEAP) of Georgia 2012-16 and Georgia's Intended Nationally Determined Contribution (INDC) which was submitted to the United Nations Framework Convention on Climate Change (UNFCCC) at the COP21 in Paris at the end of 2015. As part of the INDC, Georgia plans to unconditionally reduce its greenhouse gas emissions by 15 per cent for the year 2030. The 15 per cent reduction target can be increased up to 25 per cent in a conditional manner, subject to a global agreement addressing the importance of technical cooperation, access to low-cost financial resources and technology transfer. Addressing the energy and climate performance of urban areas will be instrumental in supporting Georgia's national plans and strategies. A Green City Approach is also key to help Georgian cities meet their mitigation and adaptation goals, where cities like Tbilisi pledged to reduce CO2 equivalent emissions to 20 per cent below 1990 levels by 2020 as part of the Covenant of Mayors.

Georgia also faces significant challenges with respect to climate change adaptation. On water resources, Georgia's Second National Communication to the UNFCCC reports that significant variability in precipitation and surface run-off are already experienced and are projected to become more severe as a consequence of climate change, with overall reductions in water surplus under most climate change scenarios. There are growing concerns about long-term climate change impacts on Georgia's glaciers, which have significant implications for water resource management and hydropower. Water is scarcer in the eastern regions than in the western regions and summer droughts are increasingly expected which will put pressure on water availability. Furthermore, coastal infrastructure and facilities such as ports on the Black Sea coast are projected to be affected by sea-level rise and associated impacts on the frequency and severity of coastal storm and flood events.

3 STRATEGIC ORIENTATIONS

3.1 Strategic Directions

Signing the Association Agreement (AA) and DCFTA with the European Union was a significant achievement for Georgia. Commitments under the AA and the DCFTA will require substantial efforts to adopt new legislation and standards under a tight schedule. The government has intensified its efforts towards improving policy delivery, simplifying tax administration, fostering innovation, accelerating infrastructure development including by mobilising further private investment, and re-aligning the educational system towards the needs of the private sector. In this context, the following strategic orientations are proposed to guide EBRD's engagement with Georgia in the forthcoming strategy period:

- **Priority 1: Support private sector competitiveness through innovation, enhanced value added and convergence with DCFTA standards and obligations:** While Georgia's investment climate, among the best in the EBRD's countries of operation, is conducive to innovation, much of the economy is dominated by low-value industries and Georgia is below its innovation potential. DCFTA provides further basis and incentive for improving quality standards and enhancing value-added, including through the introduction of new technologies and processes. In this context, the Bank will support corporates and SME competitiveness through financing and business advisory, seeking to finance projects promoting innovation, skills transfer and convergence with DCFTA standards. The focus will be on the agribusiness, tourism, light manufacturing, mining and healthcare sectors, as well as the knowledge economy. Finally the Bank will seek to contribute to bridging the skills and vocational training gap, with a particular focus on the tourism and agribusiness sectors.

- **Priority 2: Deepen financial intermediation and develop local currency and capital markets to enable access to finance:** Although on a declining trend, dollarization of the banking sector remains high (66 per cent of private sector credit, 68 per cent of deposits), representing an important vulnerability for both banks and borrowers. In addition, certain segments of the market are still underserved by financial institutions, such as the agriculture sector, women entrepreneurs, or investments related to resource efficiency. Capital markets remain underdeveloped and do not have the adequate depth to provide long term local currency funding for banks, nor do they constitute a meaningful source of finance for companies wanting to scale-up. In this context, the Bank will continue to provide partner banks with dedicated SMEs credit lines and risk sharing facilities, when possible in local currency, with a focus on supporting projects promoting alignment with DCFTA requirements, women in business and resource efficiency. EBRD will also support the development of capital markets, in particular on the debt side, by both issuing lari bonds and investing selectively in local corporate bonds, as well as seek to facilitate the introduction of debt instruments and financial products that are new to Georgia’s capital markets.

- **Priority 3: Expand markets through inter-regional connectivity:** As a small, open economy at the crossroads of several global trade routes, Georgia stands to reap significant benefits from enhanced connectivity and improved logistics. The Bank will therefore seek to support transport, energy and logistics infrastructure that can strengthen Georgia’s strategic position as a transit link between Europe and Turkey on one side, and Central Asia and China on the other, including as part of the One Belt One Road Initiative, as well as facilitating North-South links that allow Armenia to increase exchanges with its trade partners. In conjunction with enhancing the country’s transit capacity, the Bank will help realise its potential as a regional logistics platform. To help mobilise private capital for these infrastructure investments, the Bank will continue to support the development of adequate legal frameworks for private sector participation in infrastructure, and work closely with other MDBs, including the newly created AIIB. In addition, the Bank will actively support Georgia’s exporters through the provision of trade finance and dedicated business advisory, including that to access DCFTA markets.

- **Priority 4: Support renewable energy, resource efficiency, and climate change adaptation to enhance competitiveness and resilience of the economy:** The country’s energy sector, which virtually collapsed in the immediate post-Soviet years, has undergone significant transformation in recent years as hydropower capacity was rebuilt and expanded, and transmission networks established. However, energy intensity in the country is still significantly above the EU28 average, and the power sector still suffers from significant distribution losses and seasonal supply patterns, leading to shortages. There is a need to improve resource efficiency across sectors, through enhanced institutional framework and capacity for resource efficiency projects. The Bank will continue to support the development of renewable energy resources, working with private sector operators including both local and foreign strategic private investors. The Bank will step up engagement in energy and resource efficiency investments in the built environment, agribusiness and industrial sectors. Additionally the Bank will engage in promoting energy efficiency and sustainability in the municipal sector, and help municipalities prioritize their energy efficiency investments. Lastly, the Bank will support the authorities in delivering their commitment under the COP21 agreement, including mainstreaming climate change mitigation measures in key sectors.

3.2 Key challenges and Bank activities

Priority 1: Support private sector competitiveness through innovation, enhanced value added and convergence with DCFTA standards and obligations

<u>Transition challenges</u>

- Standards need to be raised in the areas of product quality, safety management and food security including through the implementation of requirements under the DCFTA.
- Company-level innovation remains low and needs to be improved to enhance private sector's competitiveness, while technology infrastructure, including broadband and other information technology platforms, needs to be expanded and improved.
- Improving productivity in farming and processing subsectors, enhancing market-based financing mechanisms for pre- and post-harvest financing, as well as consolidating highly fragmented land holdings, are key pre-conditions for creating a more competitive agricultural sector.
- Although Georgia's investment climate is among the best in the EBRD's countries of operation, with the country carrying out significant structural reforms over the past several years in areas such as starting business procedures, construction permits, deregulation of business, and customs reforms, work on improving the business environment needs to continue to make it even more conducive to domestic entrepreneurship, as well as to attract FDI: some of the measures required include progressing the tax reform, strengthening the role of competition authorities and improving insolvency procedures.
- Lack of market-oriented skills hinders development of value added activities. In the agriculture and tourism sectors in particular, training routes often do not provide skills that match the needs of the private sector.

<u>Operational focus</u>

- The Bank will continue to selectively support private corporates and SMEs, through provision of direct, as well as intermediated debt and equity finance, with a particular focus on agribusiness, light manufacturing and healthcare where Georgia can best take advantage of the DCFTA's enhanced exports opportunities. EBRD will also support the tourism sector, where Georgia has a growing potential with diversified incoming markets (EU, Russia, Caucasus, Central Asia) but still lacks adequate infrastructure (e.g., hotels, resorts, conference facilities) and skills. Additionally, the Bank will seek to strengthen value chains, by working alongside established aggregators (e.g. export-oriented buyers, local processing companies, off-takers, natural resources operators) and their suppliers. Through its projects, the Bank will seek to support the introduction of processes and technologies that are new and innovative for Georgia and enhance quality standards, as well as improve governance and business practices.

- DCFTA convergence will be further supported by a dedicated on-lending facility to partner banks for DCFTA related investments by local SMEs, which face the challenge of upgrading their technology and equipment to meet more demanding product standards in terms of product quality, health and safety measures and environmental preservation.
- The Bank will look for opportunities to support greater private sector participation in the mining sector, a key contributor to exports, with a focus on increased standards (in particular in health and safety), improved resource efficiency, stronger local value chains, and greater transparency and accountability.
- In addition, investments will be complemented by the Bank's Advice for Small Businesses to build export capacity and support SMEs in meeting DCFTA requirements, strengthen corporate governance standards and financial management, and provide specialised training with an emphasis on agribusiness (dairy, meat and horticulture in particular), hospitality and related services.
- In line with the authorities' recent focus on developing the knowledge economy, the Bank will seek bankable opportunities in the technology sector, as well as help develop broadband infrastructure and related information technologies. It will also explore cooperation opportunities with the newly created Innovation and Technology Agency.

Policy dialogue

- The Bank will continue to support the Investors Council (IC), a key platform for effective dialogue between the public sector and the private sector on business environment issues, through financing and capacity building of its Secretariat, as well as active participation in preparatory and formal meetings. Key issues on the IC agenda include further improvement in the tax administration, pension and commercial justice reforms, as well providing input to sectoral strategies. The Bank will also provide technical assistance to strengthen the Georgian Competition Authority institutional capacity and support its advocacy function as a regulator, in close cooperation with the EU.
- The Bank will seek to address the skills mismatch in the private sector, by working with the authorities and private sector clients on enhancing vocational training, work based learning and skills standards, with a particular focus on youth and women in the hospitality and agribusiness sectors.

Theme 1: Support private sector competitiveness through innovation, enhanced value-added and convergence to DCFTA standards and obligations

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
1.1	The economy remains dominated by low-value industries, while standards need to be raised in the areas of product quality, safety management and food security	**Foster productivity and efficiency through improved operating standards and implementation of requirements under the DCFTA**	• Investments in selected private corporates and SMEs with focus on agribusiness, tourism, healthcare, light manufacturing, mining, and value chain approaches • Direct lending and on-lending including risk sharing, supporting convergence towards DCFTA, complemented by Advice for Small Businesses on DCFTA requirements and implementation • Support to the Investors Council and Competition Authority	• Number of projects successfully introducing standards and operating models meeting DCFTA requirements *(Baseline – 0)* • ASB indicator on increased productivity *(Baseline – established at project approval)* • Qualitative account of improvement in investment climate as a result of the Bank's engagement with IC and Competition Authority(e.g., tax administration, pension, commercial justice reform, Competition Authority), *(Baseline - N/A)*
1.2	Georgia is below its innovation potential, due to both low innovation culture at company-level, and underdeveloped IT and communication infrastructures	**Facilitate technology transfers, support innovative products, and enable development of technology infrastructure**	• Investments in selected private corporates and SMEs supporting new and innovative processes and technologies; • As opportunities arise, support innovative / technology firms as well as broadband and related technologies.	• Number of projects (and qualitative account) that introduced technology / innovative processes with Bank's support entering successful operation*(Baseline – 0)*
1.3	Lack of market-oriented skills hinders development of value-added activities	**Address skill-mismatch between labour market and private sector demand**	• Provide specialised trainings with an emphasis on agribusiness (dairy, meat and horticulture in particular) and hospitality and related services • Support development of vocational training schemes in these sectors, with focus on youths and women.	• Number of youth and women accessing training to acquire skills due to Bank's support *(Baseline - 0)* • Qualitative account of sustainable training mechanisms created *(Baseline – N/A)*
	Context indicator: Δ Business sophistication index (*Baseline 2015-2016: score 3.5 / rank 112th*). Source: Global Competitive Index (WEF)			

Priority 2: Deepen financial intermediation and develop local currency and capital markets to enable access to finance

Transition challenges

- Despite strong credit growth in recent years, financial intermediation levels remain low, with domestic credit to GDP at 47.7 per cent in 2014.In particular, SME lending is chronically low at 16.1 per cent and SMEs still largely rely on owners' capital and retained earnings.
- Dollarization of the banking sector remains high (66% of private sector credit, 68% of deposits), and access to local currency financing remains a key obstacle to reducing foreign currency risk for local companies. The policy framework to support de-dollarization also needs to be improved;
- Capital markets remain underdeveloped and do not represent a meaningful source of finance for midcaps wanting to scale-up, nor for banks to source long term local currency funding. There is very limited liquidity and trading volumes in the stock exchange, and local banks remain the only investors in the corporate bond market. It is important to create a comprehensive and actionable capital markets plan, rationalise local capital market infrastructure and deepen sources of financing.
- The pension reform, expected to enter into force in 2017, should facilitate the build-up of assets and demand for corporate bonds. However supply remains constrained by the limited number of issuers with adequate corporate governance standards.
- The non-banking financial sector is still nascent. The insurance industry is undercapitalised the regulatory framework in the sector is underdeveloped. The leasing sector is expected to experience renewed growth, on the back of recent improvements in the regulatory framework.

Operational focus

- To improve access to finance for the private sector, the Bank will continue to deploy its risk sharing facilities and credit lines, including in local currency through the EBRD's SME Local Currency Programme, via local partner banks and microfinance institutions, with a focus on facilities supporting convergence towards DCFTA standards, trade promotion, women in business, agribusiness, and resource efficiency;
- In order to stimulate bond markets and diversify its sources of local currency funding, the Bank will continue issuing lari bonds, with gradual increase in maturities, and support the issuance of local corporate bonds. It will also seek to broaden the range of financial instruments available, by exploring opportunities to issue new types of products (e.g., inflation indexed local currency bonds), or to support the development of securitized instruments (e.g., covered bonds, mortgage backed securities) and "green" bonds.
- The Bank will explore opportunities to support the non-banking financial sector, in particular the leasing market.

Policy dialogue

- To further support de-dollarization of the financial sector and develop local currency capital markets, the Bank will provide advisory on strengthening money market and derivative instruments, with the view to ease FX liabilities management for banks.

Theme 2: Deepen financial intermediation and develop local currency and capital markets to enable access to finance

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
1.1	Limited access to long term finance in some segments, and in particular in local currency, remains a key obstacle for MSMEs to achieve scale	**Broaden access to finance, with a focus on underserved segments (e.g., agri, women-led SMEs, resource efficiency) and products, (e.g., local currency, non-banking)**	• SMEs credit lines and risk-sharing facilities to partner banks, with focus on agribusiness, women in business, resource efficiency, DCFTA and trade promotion • Local currency programme with1st loss coverage (direct and intermediated lending) • Explore opportunities to support non-banking financial products (e.g., leasing, insurance)	• Total number/volume of MSME sub-loans provided by client banks to target areas (DCFTA convergence, women entrepreneurs, agribusiness, resource efficiency) and share in local currency *(Baseline – established at project approval)*
1.2	Dollarization remains high, notably due to under- developed local currency capital markets, and a lack of adequate instruments to manage FX exposure	**Continue to support de-dollarization of the banking sector, including by deepening local currency debt capital markets**	• Continue issuance of local currency bonds, with gradual increase in maturities and explore opportunities to issue new types of bonds to broaden products range (e.g., inflation indexed) • Support issuance of corporate bonds in local currency, as well as development of securitized instruments (e.g., covered bonds, MBS) and "green" bonds. • Advisory on strengthening money market and derivative instruments, to ease FX liabilities management for banks	• Number, volume, tenor and trading platforms of new bond issuances in the debt capital market with the Bank's support *(Baseline – 0)* • Evidence of successful introduction of new capital market instruments with support of the Bank (number and qualitative account of replication as appropriate) *(Baseline – N.A)*
	Context indicator: Δ Financial Market Development index (*Baseline 2016-2016: score 3.9 / rank 68th*). Source: Global Competitive Index (WEF) and Δ in dollarization (*Baseline 2015, 60% of private sector credit, 65% of deposits*)			

Priority 3: Expand markets through inter-regional connectivity

Transition challenges

- Inter-regional connectivity needs to be improved through enhancing critical infrastructure to facilitate cross-border trade and expanding markets for Georgian exporters. A key pre-condition for closing the infrastructure gap in the country remains the development of adequate capacity and legislative framework enabling more PPP projects in the transport and energy sectors. In its current form, the Concessions Law found is outdated, limited and inconsistent with international good practices.
- The lack of modern logistics facilities prevents Georgia from realising its natural comparative advantage as a potential regional logistics hub that could offer local value added.
- The country's integration in regional energy markets remains incomplete and the power sector still suffers from significant distribution losses and seasonal supply patterns. Appropriate infrastructure and regulatory framework need to be developed in order to further increase cross-border energy trade.
- While in the past year, Georgia has made good progress in the liberalisation of trade and trade-related issues by introducing necessary amendments in food safety, veterinary and customs legislation during 2014, business standards (e.g., compliance with EU sanitary requirements) need to be improved in line with DCFTA requirements, which will facilitate access of Georgian companies to the EU markets, as well as increase their competitiveness and ability to export to other markets.

Operational focus

- The Bank will promote and support solutions to the development of Georgia's transport infrastructure in order to further strengthen regional economic links. In particular, EBRD will seek to contribute to further develop the East/West[3] and North/South[4] transport corridors connectivity, in cooperation with other MDBs (including AIIB) and encourage PPP structures if and where possible.
- The Bank will also seek to support the development of the country's ports and airports, a key requirement for Georgia to realise its potential as a regional logistics platform and a growing tourism destination, and where possible promote private sector participation in these sectors.
- The Bank will explore opportunities to support development of gas storage facilities and gas pipeline connections to support Georgia's energy security and integration into regional gas markets, as well as support power infrastructure enhancing Georgia's internal capabilities and interconnections with the region.
- The Bank will continue to support Georgian exporters by providing trade finance credit lines through partner banks, as well as business advisory to small businesses on export oriented activities;

[3] East-West Highway corridor connects Central Asia and the Far East to Turkey and Europe. In Georgia, the East-West Highway Corridor runs from the border with Azerbaijan at Red Bridge to Poti and from Poti to Sarpi at the border with Turkey.
[4] The North-South Road Corridor aims at connecting Iran, Armenia and Georgia, reaching the ports of Poti and Batumi at the Black Sea in the West, and Tbilisi in the East.

- The Bank will continue to support the development of logistics and warehousing centres that can support Georgia's potential for becoming a regional transit hub.

Policy dialogue

- The Bank will continue to support the development of the regulatory framework for PPPs, by assisting in drafting relevant primary and secondary legislation and strengthening the authorities' capacity in undertaking and implementing the concessions and PPP legal reform.
- In order to increase regional energy linkages, the Bank will provide technical assistance and advisory for the development of a power trading platform with focus on trade with Turkey, the largest and most open energy market in the region.

Theme 3: Expand markets through inter-regional connectivity

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
1.1	Insufficient inter-regional connectivity hinders cross-border trade and markets expansion	**Support development of key transport links, with an emphasis on commercial solutions and private sector participation**	• Investment in cross-border transport connectivity (East-West and North South corridors), in cooperation with other MDBs • Support port and airports sector, with emphasis on private sector participation • Support logistics and warehousing centre • Encourage PPPs, including through legal advisory on regulatory framework and capacity building	• Number of projects and qualitative account of regional transport and logistics infrastructure services successfully incorporating commercial solutions *(Baseline – 0)* • Evidence of successful changes to PPPs legislation as a result of the Bank's advisory *(Baseline – N/A)*, and number of PPP projects signed (*Baseline – 0)*
1.2	The country's integration in regional energy markets remains incomplete and the sector still suffers from significant distribution losses and seasonal supply patterns	**Improve regional energy integration and support development of energy corridors**	• Explore opportunities to support development of gas storage facilities and gas pipeline connections, • Support power infrastructure enhancing Georgia's internal capabilities and integration with regional markets • Technical assistance and advisory for the development of a power trading platform with focus on trade with Turkey	• Number of projects and qualitative account of Bank's projects successfully expanding regional cross border energy infrastructure *(Baseline – 0)*
1.3	Difficulties in trading across borders remain, while FDI across the region remain low	**Support trade and investments flows with the extended region**	• Continue to provide trade finance credit lines • Advice for Small Businesses focused on improving export readiness and linking with trade finance • Support entry of foreign investors, with a focus on the extended region	• Δ in share of exports in total turnover of export-oriented ASB clients *(Baseline – established at project approval)* • Total number and volume of TFP finance projects undertaken by client banks *(Baseline –0)*
	Context indicator :Δ Trading Across Borders Rank *(Baseline 2015 - 78th)* Source: Doing Business Report(World Bank); Annual trade turnover in goods with Turkey, Russia, Armenia and Azerbaijan *(Baseline 2015 - USD 2,935m)*			

Priority 4: Support renewable energy, resource efficiency, and climate change adaptation to enhance competitiveness and resilience of the economy

Transition challenges

- Georgia's energy intensity is 30 per cent above the EU28 average it is therefore critical to improve energy efficiency across all sectors of the economy (e.g., industry, urban transport, public buildings).
- Due to its mountainous topography, Georgia is highly vulnerable to climate change issues (e.g. increased glacial melt, changing river flows and increased sedimentation deposition in coastal areas). Institutional and technical measures leading to the efficient use of water resources will be required, alongside upgrades of infrastructure, equipment and practices in sensitive sectors such as power generation, agribusiness and water-related services including irrigation.
- To improve conditions for energy efficiency, renewable energy and climate adaptation investments, it is important to promote a competitive market through gradual liberalisation and introduce relevant regulatory practices by GNERC, the regulatory body.

Operational focus

- The Bank will continue to support the development of Georgia's renewable energy resources by investing in small, medium and large hydropower plants (including the Nenskra HPP alongside ADB), and will explore opportunities in wind power generation, as well as solar depending on affordability, with both foreign and local private investors;
- The Bank will make increased efforts to foster resource efficiency across all sectors of the economy (e.g. industry, urban transport, public and private buildings), both through direct investments and dedicated resources efficiency credit line facilities via local private banks;
- The Bank will promote development of a long term vision towards 'green cities', by providing financing and advisory for municipal infrastructure projects addressing environmental and resource efficiency challenges. Support will also be provided to develop action plans helping municipalities prioritise their resource efficiency investments. A special emphasis will be made on helping municipalities to take advantage of the Clean Development Mechanism and other partnerships such as the E5P initiative, and on supporting the implementation of EU Association Agreement requirements. Projects in the sector will also seek to support the provision of infrastructure services by private operators, in particular in waste management, water supply or road maintenance.
- The Bank will work with its clients to introduce climate change adaptation elements in relevant projects (e.g., agribusiness, water-intensive industries, hydropower, transport and municipal infrastructure), in order to increase resilience against issues such as water scarcity, coastal floods risks or increased heat stress.

Policy dialogue

- The Bank will provide support in mapping and developing Georgia's solar energy potential to serve as a guide for potential private investment in the sector;
- The Bank will consider providing additional support to the Government in the drafting of primary legislations required to successfully implement the National Energy Efficiency Action Plan (NEEAP);
- The Bank will contribute to Georgia's delivery of its undertakings taken at the COP21 international conference in December 2015.

Theme 4: Support renewable energy, resource efficiency, and climate change adaptation to enhance competitiveness and resilience of the economy

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
1.1	Private sector investments in renewable energy are lacking	**Act as a catalyst investor to develop private sector investment in renewable energy**	• Continue to support hydro (small, medium and large) as well as solar (depending on demand and affordability) and wind energy • Provide support in mapping and developing Georgia's solar energy potential	• Change in renewable energy generated with the Bank's support (in MWh)*(Baseline – 0; (*Δ for *2013-2015: 1,011,649 MWh))*
1.2	Energy intensity remains significantly above EU 28 average, with both environment and competitiveness costs	**Promote reduction in energy intensity across all sectors and support development of green cities**	• Direct resource efficiency investments across sectors (e.g. industry, urban transport, public and private buildings) • Energy and resources efficiency credit lines facilities to partner banks • Financing and advisory for municipal infrastructure projects addressing environmental and resource efficiency challenges, (Green cities) " framework, and supporting private sector participation • Support definition of primary legislation required for successful implementation of NEEAP	• Volume of energy savings achieved through Bank investments based on EBRD methodology in toe/yr *(Baseline – 0; (Volume for 2013-2015: 5,000,215 GJ))* • CO2 emissions reduction as result of the Bank's operation in tCO2e/yr *(Baseline – 0; (Reduction 2013-2015: 502.9 kCO2))*
1.3	Due to its mountainous topography, Georgia is highly vulnerable to climate change	**Support climate change adaptation across sectors**	• Support Georgia's COP21 undertakings • Introduce climate change adaptation elements in relevant projects (agribusiness, water-intensive industries, hydropower, transport and municipal infrastructure)	• Number of operations and qualitative info of successful implementation of projects that provide climate adaptation co-benefits *(Baseline – 0)*
	Context indicator: Δ in Georgia's emission intensity*(Baseline 2013 0.68 kgCO2/ 2005 USD GDP, source IEA)*			

3.3 Potential Risks to Country Strategy implementation

The proposed Strategy for Georgia is ambitious, yet realistic given the Bank's past experience in the country and the generally conducive reform environment. EBRD's ability to deliver on its strategy will be influenced by a number of factors outside the Bank's control. Where feasible, the Bank will work to address and mitigate these risks through proactive and sustained engagement with its clients, IFI partners and the government.

Specific risks to the Strategy implementation include:

- While the government has a clear vision for its future, Georgia's economy remains vulnerable to external shocks. Accumulated high current account deficits (11.8 per cent in 2015) have caused rapid increases in external debt (107 per cent in 2015), while FX reserves, while adequate, remain modest (3.2 months of exports). Dollarization in the banking sector remains high, creating vulnerabilities for both banks and borrowers in the event of currency depreciation. The introduction of additional corporate tax breaks (e.g., 'Estonian model', new free economic zones) and increase in contingent liabilities (e.g., undertakings related to Power Purchase Agreements and PPP schemes) could also create fiscal risks.
- Overall success on Strategy delivery is dependent on the government sustaining its reform momentum and continuing to build implementation capacity. This includes legislative reforms as well as effective implementation of DCFTA requirements, under a tight schedule. As illustrated during the first half of the previous strategy period, a rapid turnover of personal on key ministerial positions would lead to slow down in the definition of economic policies and the pace of reforms.
- Escalation of external conflicts in the wider region (Nagorno Karabakh, Ukraine, Syria) may have negative effects on FDI inflows, as foreign investors reassess the extended region's risk premium, and impact the Bank's ability to make progress across its four priorities;
- Youth inclusion (under Theme 1) is a new area for the Bank. Progress is conditioned on the ability of the Bank to forge effective partnership locally, as well as the readiness of private sector clients to engage on the opportunity;
- The Bank's ability to provide finance in lari as outlined under Theme 2 (local currency and capital markets) will continue to be dependent on its access to local currency funding on competitive terms;
- The Bank's ability to meaningfully support regional integration as outlined under Theme 3, is conditioned to the launch of new infrastructure projects during the strategy period, to progress on implementation of the PPP law, as well as to effective mobilisation of other IFIs and private sector finance, as EBRD is unlikely to provide more than a fraction of the financing needed for large infrastructure projects.
- Successful implementation of Theme 4 (renewable energy and resource efficiency) will require government to continue on its path of liberalisation of energy markets, including removal of regulated prices for most end-consumers. Such reforms are often unpopular, and therefore are likely to be implemented only gradually.
- Given the limited fiscal space and affordability constraints, projects in municipal infrastructure, SME capacity building, investment climate, and energy efficiency require important donor resources, both as TC and investment grants.

3.4 Environmental and Social Implications of Bank Proposed Activities

The 2014 Association Agreement signed with the EU commits Georgia to adopt a number of EU directives within defined timelines, which are expected to drive several key legal, regulatory and institutional changes in the coming years, in particular with regards to the management of environmental and social issues. All sectors where EBRD has been traditionally active in Georgia are expected to be influenced. Notably, the progressive adoption of the EU water framework directive will impact both the municipal infrastructure and hydropower sectors. Large infrastructures development will be influenced by the implementation of the EU habitats directive. EU directives related to waste management and emissions will also have an effect on manufacturing and services, as well as on municipal and environmental infrastructure projects. Implementation of these EU directives is expected to present some challenges and technical cooperation might need to be considered to assist Georgia at project or national level through capacity building or institutional strengthening.

For municipal sector investments, the Bank will seek co-financing from the Eastern Europe Energy Efficiency Environmental Partnership (E5P). The E5P provides mostly capital expenditure grants to support the Bank's lending for projects such as energy efficiency measures for public buildings, waste management, street lighting and local transport, therefore improving municipal infrastructure, delivering environmental benefits and paving the way for reforms and policy dialogue.

There are a number of initiatives in Georgia in relation to legally protected or internationally recognized areas of biodiversity value, for example to consolidate their boundaries or to improve their zoning or management. Projects considered by EBRD in the vicinity of areas with a specific protection status should be developed in consultation with the Agency for Protected Areas, in order to both minimize the risk of adverse impacts and seek synergies and cooperation opportunities. TC funds might be used at project level to support initiatives aimed at boosting such synergies or restoring biodiversity. This may notably include reforestation initiatives similar to the pilot reforestation programme associated with the Dariali hydropower project.

Georgian labour laws have been revised and amended on various occasions since 2008, culminating in the adoption of a new labour code in June 2013. Despite recent modifications in consultation with the ILO, gaps still persist between Georgian legislation and EBRD PR2 requirements with respect to child labour, collective bargaining, retrenchment, worker accommodations, gender discrimination and non-employee workers. EBRD will continue its efforts to ensure that clients' HR policies and labour practices are compliant with relevant ILO conventions as ratified by Georgia.

Occupational safety and health (OSH) is a key area that EBRD will be carefully reviewing in individual project appraisals. In 2015 a new labour inspectorate was established and is now in a transitional period of capacity building of its labour inspectors, with EU OSHA and ILO support. Road safety standards also need to be improved and vehicle accidents are common. Where deemed necessary, EBRD will consider providing support through TC funds to communities and clients to improve road safety, especially around public service vehicles and occupational road risks.

Land acquisition remains a challenge for private investors in Georgia due to unregistered lands/assets and differences between Georgian legislation and IFIs' requirements. Only formal property rights are recognised in Georgia. EBRD will continue to assist through TC funds and work with clients to register land titles and ensure expropriation, compensation and livelihood restoration processes are undertaken in accordance with the Bank's requirements including respect for customary ownership rights.

The potential involvement of EBRD in the extractive sector in Georgia will require particular attention from an environmental and social point of view: meeting good international practices and ensuring transparent stakeholder engagement will notably be essential.

Georgia is a diverse country and any violation of the equality of citizens (race, colour, language, sex, religion, origin or nationality) is banned by the Georgian Constitution. The Bank will continue to monitor and consider technical support as appropriate to its clients in order to maintain a high level of stakeholder engagement in local languages spoken by various different minority groups in Georgia to ensure that stakeholder concerns and priorities are understood and taken into account in decision making processes.

Georgia also has a rich cultural heritage that needs to be protected. Greenfield infrastructure projects and construction works should therefore be developed in consultation with the Ministry of Culture and Monument Protection in order to devise approaches needed to avoid or mitigate potential adverse effects.

ANNEX 1 – POLITICAL ASSESSMENT

Georgia is committed to and applying the principles of multiparty democracy, pluralism and market economics in accordance with the conditions specified in Article 1 of the Agreement Establishing the Bank. Implementation of the commitments in the areas of the rule of law and independence of the judiciary is important for the continued development of Georgia's democratic institutions.

In the last three years since the last country strategy, adopted in 2013, the Georgian authorities continued to pursue a reform agenda aimed at transforming Georgia into a European democratic state. There have been notable achievements on this path, including finalising the Association Agreement with the EU, which introduces the Deep and Comprehensive Free Trade Area. Georgia has met all the benchmarks set out in Visa Liberalisation Action Plans (VLAP) and therefore fulfilled the relevant criteria for its citizens to be exempted from the visa requirement when travelling to the EU.[5]The Commission has put the suggestion to the EU Council and the European Parliament and once adopted, Georgian citizens will be permitted to travel to the Schengen Area visa-free for periods of up to 90 days.

Despite these achievements, some challenges remain, including the need to ensure adequate checks and balances between the executive, legislative and judicial branches of power, to maintain cross-party dialogue and to bring legal practices in line with Council of Europe standards.

Free Elections and Representative Government

Free, fair and competitive elections

The Constitution provides citizens with the right to change their government through periodic elections based on universal suffrage.

The key electoral legislation includes the Constitution, the Election Code, the Law on Political Unions, the Law on the State Audit Office and the Criminal Code. The constitution provides for an executive branch that reports to the prime minister and the parliament, and a separate judiciary branch. The president is elected under a majoritarian system for five years and may serve up to two consecutive times. Georgia's unicameral parliament, elected for a four-year term, consists of 150 seats, with 77 chosen by party list and 73 in single-member districts. Given the growing demand from opposition parties for changes in the mixed electoral system and Georgian Constitutional Court's ruling that large discrepancies in the size of majoritarian constituencies violate the equality of votes, the debate on the amendments to the Election Code is expected to continue.
The last presidential election took place on 27 October 2013. The election was monitored by an International Election Observation Mission (IEOM), consisting of OSCE/ODIHR, the Parliamentary Assembly of the Council of Europe, the European Parliament and the NATO Parliamentary Assembly. According to the observer mission, "the 27 October presidential election was efficiently administered and transparent, and took place in an amicable and constructive environment. During the election campaign, fundamental freedoms of

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[5] European Commission, Report from the Commission to the European Parliament and the Council, Fourth Progress report on Georgia's implementation of the action plan on visa liberalisation, 18 December 2015.

expression, movement, and assembly were respected and candidates were able to campaign without restriction. The media were less polarised than during the 2012 elections and presented a broad range of viewpoints. On election day, voters were able to express their choice freely".[6]

The parliamentary elections of 1 October 2012 marked the country's first democratic transfer of power since independence. The elections were competitive with active citizen participation throughout the campaign. Fourteen political parties and a number of independent candidates took part in the elections, providing voters with a wide choice.

Parliamentary by-elections were held in April 2013 in three single-mandate constituencies where members of parliament elected in October 2012 parliamentary elections were subsequently appointed to government positions. The by-elections were "competitive with 13 political parties, 1 electoral bloc and 4 initiative groups fielding a total of 23 candidates. In general, candidates were able to freely campaign".[7]

The 2014 municipal elections took place in a competitive atmosphere. Several amendments were adopted to bring the legislation in line with the new code of local self-government. In the absence of the OSCE/ODIHR, which normally does not observe municipal elections, these elections were monitored by a large number of domestic and other international election observation organisations. The elections were found to be in line with international standards, with only minor procedural violations reported, which were not deemed to have influenced the outcome.[8]

The last parliamentary elections were held in October 2016, in two rounds (on 8 and 30 October respectively). The ruling Georgian Dream (GD) won a landslide victory having gained a constitutional majority and another term in office. The OSCE/ODIHR-led IEOM assessed both rounds of the elections as "competitive, well-administered" and with fundamental freedoms "generally respected."[9]

Separation of powers and effective checks and balances

The Constitutional amendments adopted in October 2010 diminished the powers of the president and considerably strengthened the position of the prime minister. The Venice Commission, which acts as the Council of Europe's advisory body on constitutional matters, characterised the changes as "a step in the right direction", but identified parliament's continued limited influence as a shortcoming.[10]

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[6] OSCE/ODIHR, Election Observation Mission, Georgia, Presidential Election 27 October 2013, Final Report, 14 January 2014, p.1.
[7] OSCE/ODIHR, Georgia Parliamentary By-Elections 27 April 2013, Election Expert Team, Final Report, 9 July 2013, p.1.
[8] European Commission, Joint Communication on the implementation of the European Neighbourhood Policy in Georgia Progress in 2014, 25 March 2015, p.5.
[9] OSCE/ODIHR, International Election Observation Mission, Georgia, Parliamentary Elections, 8 October 2016, Preliminary Conclusions, p.1; and Second Round, 30 October 2016, Preliminary Conclusions, p.1.
[10] Final opinion on the draft constitutional law on amendments and changes to the constitution of Georgia - Adopted by the Venice Commission at its 84th Plenary Session, 15-16 October 2010.

The European Commission has also recommended further separation of powers and checks and balances between the executive, legislative and judicial powers in the framework of constitutional reform.[11]

Effective power to govern of elected officials

Georgia's elected officials have effective power to govern without constraints.

The military is under civilian control and does not take part in the country's political decision-making process. The influence of the Georgian Orthodox Church on society and politics is high, reflecting the special role and status of the Church in the country.

Civil Society, Media and Participation

Scale and independence of civil society

Domestic and international civil society organisations in most cases register and operate without government restriction, and are allowed to investigate and publish their findings. Civil society organisations (CSOs) monitor government activities and their dialogue with the parliament remains strong. Funding for civil society organisations remains a challenge, especially for smaller and less experienced organisations and funding sources are largely limited to foreign donors and wealthy Georgian individuals.

The constitution and law provide for freedom of association and labour and trade union rights are generally respected in practice. The labour code provides for the right of most workers to form and join independent unions and to strike and bargain collectively.

Independence and pluralism of media operating without censorship

The media in Georgia operate without state censorship and express a wide variety of views, while at the same time remain politically polarised. The Constitution provides guarantees for press freedom, and the print media offer a wide range of political views.

The latest Progress Report by the European Commission states that the media environment has improved and become more diverse, although the protection of privacy rights and the freedom of expression and opinion must be ensured.[12]

Media ownership remains highly concentrated and even though some outlets display a political bias, ties to politicians are less direct than a few years ago.

Television remains the main source of information, while a great number of newspapers and several television stations also have an online presence. The internet penetration rate in Georgia is growing rapidly, although it still remains relatively low in comparison with other neighbouring countries. More specifically, over recent years, the percentage of users

[11] European Commission, Joint Communication on the implementation of the European Neighbourhood Policy in Georgia Progress in 2014, 25 March 2015, p.3.
[12] European Commission, Joint Communication on the implementation of the European Neighbourhood Policy in Georgia Progress in 2014, 25 March 2015.

increased from 7.6 per cent in 2006 to 48.9 per cent in 2015.[13] Social media are playing an increasingly important role with Facebook being the main service used by Georgians.

Multiple channels of civic and political participation

Civil society organisations are being consulted on a number of legal reform draft laws thus gaining a stronger voice in policy-making as the government is more open to take stakeholder comments into consideration while drafting new legislation. However, civil society representatives perceive that dialogue with the authorities could be further improved.

Freedom to form political parties and existence of organised opposition

There are no restrictions on political party formation beyond registration requirements, and the Election Code allows an individual to run for office without party affiliation.

The major opposition party United National Movement (UNM) is represented in parliament. The cooperation between the opposition and ruling parties is important for further development of Georgia's democratic institutions ensuring space for cross-party dialogue in the interests of consolidating democracy, focusing on priorities such as economic development of the country. Nineteen political parties and six electoral blocs, comprising a further sixteen parties, took part in the parliamentary elections of 2016.

Rule of law and Access to Justice

Supremacy of the law

The Constitution is the supreme law of the country, and is accepted by all political forces.

The right to a fair trial is envisaged in the legislation, although the strong position of the prosecutor and the need to enhance the independence of the judiciary continue to undermine this right. The constitution and law also prohibit arbitrary arrest and detention.

Independence of the judiciary

While the Constitution provides for the independence of the judiciary, outside influence remains a problem. The amendments made to the Law on Common Courts have created the basis for judges to be more independent; however the judicial independence remains fragile.[14]

The reported issues in this area relate to the practice of selecting and transferring judges between courts and allocating cases to judges without a fully transparent procedure. This practice may not amount to violations of the defendants' right to an independent tribunal established by law, but it raises concerns as to the independence of the judiciary as a whole, and the public's perception of such independence.[15]

[13] Internet World Stats: http://www.internetworldstats.com/asia/ge.htm
[14] European Commission, Joint Communication on the implementation of the European Neighbourhood Policy in Georgia Progress in 2014, 25 March 2015, p.2.
[15] OSCE/ODIHR, Trial Monitoring Report Georgia, 9 December 2014, p.7.

According to the European Commission, Georgia will have to ensure the full independence of the judiciary, bringing criminal justice policies into line with Council of Europe standards.[16]

For this reason further reform of the judiciary has been under consideration in parliament, focusing on the guarantees of independence of individual judges. According to the amendments, the guarantees for non-interference in the activities of a judge are clearly articulated; besides, all the candidates will occupy the position of a judge through participating in the open competition; transfer of a judge to different court will be regulated; the transparency of the High Council of Justice and High School of Justice will be increased; the principle of automatic allocation of cases will be introduced, etc.

Government and citizens equally subject to the law

The Constitution guarantees the equality of all citizens before the law.

In practice, however, the main issue is related to the strong position of the prosecutor and the need to enhance the independence of the judiciary. While the law provides for public access to government sessions and documents, there were cases where the authorities denied access to these.

In order to strengthen institutional independence of the prosecution service, ensure complete non-interference in the activities of the prosecutors and provide legal foundation for the prosecutors to carry out their professional functions impartially and objectively, the Government of Georgia carried out the Institutional Reform of the Prosecution Service, which passed through the parliament and entered into force in September 2015.

Effective policies and institutions to prevent corruption

The law provides criminal penalties for corruption by Georgian officials. Significant progress has been achieved in preventing corruption and diminishing organised crime. Various indicators measuring corruption acknowledged the country’s progress in this area by placing it among more advanced European countries. Recent initiatives to fight corruption involve, among others, elaboration of the comprehensive Anti-Corruption Strategy and Anti-Corruption Action Plan and its monitoring tool, strengthening of the national Anti-Corruption Council, the formation of an effective State Audit Office, and the introduction of an e-procurement system.

Transparency International’s Corruption Perception Index (CPI) in 2015 ranked Georgia 48th out of 168 countries. Perceived corruption in Georgia’s immediate neighbours is much higher, with Armenia ranking 95th and Russia and Azerbaijan both ranking 119th.[17]

According to the latest evaluation (2015) report by Council of Europe’s Group of States against Corruption (GRECO), Georgia has no recommendation of GRECO with the status of “not implemented”; all recommendations under the Theme I (incriminations) have been implemented in a satisfactory manner, while the recommendations in the Theme II (transparency of party funding) have been either partly implemented or implemented in a satisfactory manner. Regarding the criminalisation of corruption, GRECO was pleased with

[16] European Commission, Joint Communication on the implementation of the European Neighbourhood Policy in Georgia Progress in 2014, 25 March 2015, p.3.
[17] Transparency International, Corruption Perceptions Index (2015).

the ratification of the Additional Protocol to the Criminal Law Convention on Corruption and it urged the Georgian authorities to adopt as soon as possible guidelines on how to preclude the misuse of provisions on effective regret.[18]

Civil and Political Rights

Freedom of speech, information, religion, conscience, movement, association, assembly and private property

A member of the UN, Council of Europe, OSCE and an active participant in the Eastern Partnership with the EU, Georgia developed a strong legal basis for the protection of civil and political rights by ratifying the core UN Human Rights Conventions and the fundamental conventions of the ILO.

The implementation of the commitments in this area was uneven. Even though the human rights environment has significantly improved in recent years, prosecutions and investigations aimed at the political opposition raised concerns about the rule of law. The Constitution protects religious freedom and the government generally respects it.

In April 2014, the parliament of Georgia adopted the National Strategy on Human Rights for 2014-2020. The main goal of the Strategy is to develop a strategic approach to ensure the implementation of obligations stemming from human rights with a view to build an interagency, multi-sector, unified, and consistent policy and, accordingly, implement good governance. The Strategy determines clear priorities, which include particular goals and guiding principles for that period.

According to the European Commission's fourth progress report on Georgia's implementation of the action plan on visa liberalisation, the Georgian government has fulfilled all the human rights related benchmarks they have undertaken within the framework of the dialogue.[19]

There were no reports about government restrictions on access to the internet or reports that the government monitored e-mails or internet chat rooms.

The latest assessment of the track record of Georgia in the area of human rights in the framework of the United Nations Universal Periodic Review (UPR) was conducted in 2015 (second cycle) with Georgia supporting most of the 203 recommendations that it received.[20]The top three recommendations during the first cycle (2011) related to international instruments (15 per cent of recommendations); women's rights (14 per cent); and rights of the child (13 per cent). Georgia accepted 83 per cent of a total of 169 recommendations made through the review process.[21]

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[18] GRECO, Third Evaluation Round, Second Compliance Report on Georgia, Transparency of Party Funding, 11 August 2015.
[19] European Commission, Report from the Commission to the European Parliament and the Council, Fourth Progress report on Georgia's implementation of the action plan on visa liberalisation, 18 December 2015.
[20]United Nations, Report of the Working Group on the Universal Periodic Review. Georgia, Addendum. Views on conclusions and/or recommendations, voluntary commitments and replies presented by the State under review, 3 February 2016.
[21] United Nations, Universal Periodic Review (UPR), Georgia, and UPR Info Statistics http://www.upr-info.org/database/statistics/index_sur.php?fk_sur=63&cycle=1

Political inclusiveness for women, ethnic and other minorities

The gender equality legislation provides for the establishment of a Gender Equality Council, the enhancement of women's security, equality in the labour market, and the strengthening of women's political participation. Anti-discrimination legislation and a national action plan on gender equality (2014-16) were adopted in 2014, while the Labour Code was amended in 2013 enhancing the protection of women in the workplace. The Committee on the Elimination of the Discrimination against Women has highlighted the high unemployment rate of women and the significant wage gap that remain unresolved problems.[22]In order to promote women's political participation the Organic Law on Political Unions of Citizens was amended in 2013. According to the amendment, a political party, which receives funding from the state budget, will receive a supplementary funding of 30 per cent if the gender difference in the submitted party list is at least 30 per cent.

Georgia generally respects the rights of ethnic minorities; however these groups remain poorly represented in state administration.

The Constitution and laws of Georgia prohibit discrimination based on sexual orientation. However, homosexuality is perceived as inconsistent with the traditional Orthodox Christian values prevalent in the country. Consequently, social discrimination remains an issue in practice, as homosexuals are often targets of verbal and physical abuse. In May 2014, the Law on Elimination of all Forms of Discrimination was adopted by the parliament. The purpose of the Law is to eliminate all forms of discrimination and to ensure for every person equal enjoyment of rights prescribed by law irrespective of race, skin colour, language, sex, age, citizenship, origin, place of birth or residence, property or social status, religion or belief, national, ethnic or social origin, profession, marital status, health, disability, sexual orientation, gender identity and expression, political or other opinions, or other characteristics.

Freedom from harassment, intimidation and torture

The Constitution prohibits torture and cruel, inhuman and degrading treatment and punishment.

CSOs and Public Defender's Office reported that despite progress on this issue since 2012, in some cases there was reluctance to investigate abuses. A delegation of the Council of Europe's European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment (CPT) last visited Georgia in December 2014.The latest report on this visit, published in 2015, acknowledged the measures taken by the Georgian authorities to address the previous recommendations of the CPT, especially in improving the treatment of prisoners and persons in police custody. However it was noted that little or no progress was made in other areas, such as regime activities and contact with the outside world in the prison system.

The CPT also observed delays in collecting and securing evidence, failure to question witnesses and the initiation of investigations under inappropriate sections of the criminal

[22] UN Committee on the Elimination of Discrimination against Women, Concluding observations on the combined fourth and fifth periodic reports of Georgia, 24 July 2014.

code.[23] In addition, in his 2015 report, the UN Special Rapporteur on torture observed a number of remaining problems in prisons including pre-trial prisoners having no access to telephones or family visits and no work opportunities, recreational activities or access to educational services.[24]It is however to be mentioned that as of 1 January 2016 pre-trial detainees enjoy the right to telephone calls and visits, unless the communication is prohibited by a reasoned decision of a prosecutor or a judge.

The UN Special Rapporteur on Torture also observed number of positive changes regarding the situation with combating torture and ill-treatment in Georgia. Thus, it is mentioned in the report that the situation has been drastically changed since the parliamentary election in October 2012. The UN Special Rapporteur marked clear signals by the Government to give high priority to the combating torture and ill-treatment.[25]

[23] Council of Europe, Report to the Georgian Government on the visit to Georgia carried out by the European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment (CPT), 15 December 2015.
[24] UN Report of the Special Rapporteur on torture and other cruel, inhuman or degrading treatment or punishment on his mission to Georgia, 1 December 2015, p.13.
[25] UN Report of the Special Rapporteur on torture and other cruel, inhuman or degrading treatment or punishment on his mission to Georgia, 1 December 2015, p.6.

ANNEX 2 – SELECTED ECONOMIC INDICATORS

Georgia	2009	2010	2011	2012	2013	2014	2015
Output and Expenditure				*(Percentage change in real terms, sa.)*			
GDP	-3.7	6.2	7.2	6.4	3.4	4.6	2.8
Private consumption	2.2	-2.5	5.2	3.4	-0.6	2.8	na
Public consumption	-9.0	-8.5	-7.4	3.3	-2.7	4.7	na
Gross fixed capital formation	-31.4	34.0	24.7	17.2	-8.7	23.2	na
Exports of goods and services	0.0	24.9	11.1	11.8	21.0	0.5	na
Imports of goods and services	-19.4	14.6	11.3	12.0	3.0	9.7	na
Industrial gross output	-4.2	13.7	10.4	10.0	7.5	2.0	-2.0
Labour market							
Gross average monthly earnings (annual average)	4.1	7.3	6.4	12.0	8.5	5.8	na
Real LCU wage growth	2.3	0.2	-2.0	13.1	9.1	2.7	na
				(In per cent of labour force)			
Unemployment rate	16.9	16.3	15.1	15.0	14.6	12.4	-12.0
Prices				*(Percentage change)*			
Consumer prices (annual average)	1.7	7.1	8.5	-0.9	-0.5	3.1	4.0
Consumer prices (end-year)	3.0	11.2	2.0	-1.4	2.4	2.0	4.9
Fiscal Indicators				*(In per cent of GDP)*			
General government balance	-9.2	-6.7	-3.6	-2.8	-2.6	-3.2	-3.8
General government revenues	29.3	28.3	28.2	28.9	27.7	27.9	28.3
General government expenditure	37.2	33.9	30.7	30.6	29.3	30.2	30.5
General government debt	41.1	42.4	36.5	34.8	34.7	35.7	41.5
Monetary and Financial Sectors				*(Percentage change)*			
Broad money (M2, end-year)	16.6	27.0	27.8	7.6	33.2	9.1	-2.5
Credit to the private sector (end-year)	-14.0	19.3	25.3	12.4	20.8	23.4	21.6
				(In per cent of total loans)			
Non-performing loans ratio	17.9	12.5	8.6	9.3	7.5	7.6	7.5
Interest and exchange rates				*(In per cent per annum, end-year)*			
Local currency deposit rate	9.4	7.9	9.4	8.5	6.2	5.3	5.2
Foreign currency deposit rate	9.2	7.6	9.1	8.3	5.4	4.8	4.0
Lending rate	20.8	17.7	19.2	18.6	15.6	14.3	15.3
Interbank rate (7 day loans, end-month)	7.1	7.8	7.3	4.7	3.5	4.0	8.9
Policy rate	5.0	7.5	6.8	5.3	3.8	4.0	8.0
				(GEL per US dollar)			
Exchange rate (end-year)	1.7	1.8	1.7	1.7	1.7	1.9	2.4
Exchange rate (annual average)	1.7	1.8	1.7	1.7	1.7	1.8	2.3
External sector				*(In per cent of GDP)*			
Current account	-10.5	-10.3	-12.8	-11.7	-5.8	-10.6	-11.8
Trade balance	-22.3	-22.3	-24.2	-26.6	-21.6	-25.9	-30.9
Merchandise exports	17.6	21.2	22.5	22.1	26.3	24.7	21.8
Merchandise imports	39.9	43.4	46.7	48.7	47.9	50.6	52.7
Foreign direct investment	6.1	7.0	7.3	5.8	5.9	10.6	9.6
Gross reserves, excluding gold (end-year)	19.6	19.5	19.5	18.1	17.5	16.4	18.1
External debt stock (incl. intercompany lending)	82.0	86.9	80.3	83.8	82.3	83.2	107.3
Public external debt	25.5	28.7	25.6	26.8	25.9	25.7	33.0
Private external debt	56.6	58.2	54.7	57.1	56.4	57.5	74.3
				(In months of imports of goods and services)			
Gross reserves, excluding gold (end-year)	4.8	4.4	4.2	3.8	3.7	3.4	3.4
Memorandum items				*(Denominations as indicated)*			
Population (end-year, millions)	4.4	4.4	4.5	4.5	4.5	3.7	3.7
GDP (in billions of GEL, nominal)	18.0	20.7	24.3	26.2	26.8	29.2	31.7
GDP per capita (in USD, nominal)	2,455	2,623	3,231	3,523	3,600	3,676	3,743
Share of industry in GDP (in per cent)	12.1	13.2	14.0	14.0	14.5	14.3	13.9
Share of agriculture in GDP (in per cent)	9.4	8.4	8.8	8.6	9.4	9.3	9.2
FDI (in billions of USD)	0.7	0.8	1.1	0.9	0.9	1.8	1.4
External debt - reserves (In US$ billion)	6.7	7.8	8.8	10.4	10.7	11.1	12.5
External debt/exports of goods and services (per cent)	275.4	249.0	220.2	219.8	184.3	193.7	239.4
Broad money (M2, end-year in % of GDP)	26.5	29.9	29.2	30.2	36.6	38.4	42.1

ANNEX 3 – ASSESSMENT OF TRANSITION CHALLENGES

Market Structure	Market Institutions	Key challenges
CORPORATES		
Agribusiness		
Medium	Medium	▪ Supporting market based financing mechanisms to increase access to pre- and post-harvest financing; ▪ Improving productivity in farming and processing subsectors.
Manufacturing and Services (M&S)		
Medium	Medium	▪ Further improving the enforcement of competition legislation; ▪ Enhancing corporate governance and business standards in the areas of product quality, environment and health and safety management.
Real Estate		
Large	Small	▪ Increasing the supply of modern commercial property across sub-segments; ▪ Increasing the focus on modern construction techniques and technologies, including energy efficiency and sustainability.
Information & Communication Technologies (ICT)		
Medium	Small	▪ Further developing the telecommunications infrastructure (broadband internet); ▪ Ensuring that the regulator has sufficient enforcement powers.
ENERGY		
Natural Resources		
Large	Large	▪ Increasing private sector participation in the extractive sectors and the presence of international companies and regional players; ▪ Unbundling and privatising of the existing vertically-integrated energy companies; ▪ Effectively liberalising the gas and electricity markets; ▪ Improving transparency and accountability in the extractive industry; ▪ Fully aligning to the principles of the Energy Community Treaty; ▪ Strengthening the role of the regulator and increasing its financial and operational independence.
Sustainable Energy		
Medium	Large	▪ Introducing cost reflective tariffs for end consumers; ▪ Strengthening legal and institutional framework for supporting sustainable energy; ▪ Further developing capacity for energy efficiency projects.

Market Structure	Market Institutions	Key challenges
Power		
Medium	Medium	▪ Removing regulated supply prices; ▪ Removing cross-subsidies and implementing cost reflective tariffs; ▪ Further increasing cross border trade.
INFRASTRUCTURE		
Water and wastewater		
Large	Large	▪ Building institutional and regulatory capacity; ▪ Improving contractual arrangements; ▪ Tariff reform; ▪ Restructuring to improve efficiency.
Urban Transport		
Large	Large	▪ Restructuring of public transport companies, including the turnaround of Tbilisi public transport services that has been long delayed; ▪ Decentralisation of some core regulatory aspects, including responsibility of tariff setting and service provision organisation; ▪ Strengthening of institutional and legal capacity of the municipalities to regulate and monitor public transport service provision.
Roads		
Large	Medium	▪ Establishing arms-length relationship between the government and road agency; ▪ Enhance competition in road maintenance and rehabilitation ▪ Developing PPP projects; ▪ Improvements in corporate governance and transparency.
Railways		
Medium	Medium	▪ Implementing the institutional restructuring plan; ▪ Commercialising and restructuring core operations; ▪ Improving governance and transparency; ▪ Increasing private sector participation and competition in the railway sector.

<table>
<tr><th>Market Structure</th><th>Market Institutions</th><th>Key challenges</th></tr>
<tr><th colspan="3">FINANCIAL INSTITUTIONS</th></tr>
<tr><td colspan="3">Banking</td></tr>
<tr><td>Medium</td><td>Medium</td><td>▪ Improving the policy framework to support de-dollarisation;
▪ Continuing to develop local currency loan products.</td></tr>
<tr><td colspan="3">Insurance and other financial services</td></tr>
<tr><td>Large</td><td>Medium</td><td>▪ Further developing insurance industry product range and skills;
▪ Bringing insurance legislation and regulation to IAIS standards;
▪ Improving the regulatory framework for leasing and further growing this sector;
▪ Clarifying the tax treatment of Pillar III pension savings.</td></tr>
<tr><td colspan="3">Micro, small and medium-sized enterprises</td></tr>
<tr><td colspan="2">Medium</td><td>▪ Expanding local currency bank lending;
▪ Further strengthening of local consultancy market to support SME development
▪ Developing other sources of finance available to SMEs such as leasing and equity capital.</td></tr>
<tr><td colspan="3">Private equity</td></tr>
<tr><td>Large</td><td>Large</td><td>▪ Continuing improvements to the business environment to enable local and regional fund managers to successfully deploy capital in Georgia;
▪ Broadening the available investment strategies.</td></tr>
<tr><td colspan="3">Capital markets</td></tr>
<tr><td>Large</td><td>Large</td><td>▪ Developing a comprehensive and actionable capital markets plan;
▪ Rationalizing local capital market infrastructure;
▪ Improving implementation and enforcement of securities laws and regulations.</td></tr>
</table>

ECONOMIC INCLUSION[26] GAP RATINGS

ECONOMIC INCLUSION		
Inclusion gap dimension	**Inclusion gap**	**Key challenges**
Regions		
Labour Markets	Large	▪ Improving regional integration and labour mobility through improved access to local jobs and training in sectors other than agriculture; ▪ Enhancing the engagement with local educational providers and facilitating dialogue between public and private sector stakeholders to improve local skills matching.
Access to Services and Education	Medium - Large	▪ Improving regional access to social infrastructure (such as local healthcare and education); ▪ Improving water resource management and access to water services in the eastern regions.
Youth		
Youth Employment	Large	▪ Establishing work based learning opportunities (i.e. internships, apprenticeships, trainee programmes) through collaboration between the private sector and education providers to improve vocational education and technical training outcomes in line with labour market requirements, with a particular focus on labour intensive sectors (including hospitality and tourism); ▪ Introducing skills standards and verification mechanisms that reflect labour market requirements.
Financial Inclusion	Medium	▪ Improving access to finance for young people and the availability of financial and business advisory services targeted at young entrepreneurs.
Quantity of Education	Medium	▪ Supporting the Government's effort to improve educational outcomes at both secondary (including vocational) and tertiary levels through increased retention rates of students by enhancing the adoption of models based on dual principles.
Gender		

[26]The EBRD Economic Inclusion gaps rate the institutions, markets and education systems across all of EBRD's countries of operation in terms of their capacity to extend economic opportunity to individuals regardless of their gender, age or place of birth. These gaps measure *differences* in opportunities – between 15 to 24-year-olds and older workers, and between women and men – rather than opportunity *levels*. Gaps are reported in this Country Strategy where there exists an Inclusion Gap above Small. These gaps are consistent with the EBRD 2015 Inclusion Gap update. Please note that regional inclusion gaps are from 2013, to be updated by the end of 2016.

Labour Practices, Legal Regulations and Social Norms	Medium - Large	▪ Incentivising private sector clients to improve equal opportunity practices, including: equal pay practices; access to employment; access to quality child care; and adoption of female leadership programmes; ▪ Supporting the dialogue in favour of equal-pay-for equal-work legislation.
Employment and Business	Medium	▪ Improving entrepreneurial opportunities and training for women, particularly in relation to financial literacy, business training and access to employment; ▪ Improving client HR policies with regards to increasing female employment in sectors and types of positions with low female work force participation, including technical positions, as well as progression routes into management roles.
Education and Training	Medium	▪ Improving partnerships between the private sector clients and technical universities to enhance opportunities for women in STEM professions (science technology, engineering and mathematics) and thereby incentivising female enrolment.
Health Services	Medium	▪ Supporting better access to quality health services for women.

ANNEX 4 – LEGAL TRANSITION

This annex offers critical analysis on selected legal topics relevant to the Bank's investment strategy in Georgia during the forthcoming period. It is based on the assessments of commercial laws conducted by EBRD Legal Transition Programme. For ease of reference, the analysis is presented along the main strategic orientations defined in this country strategy, in particular the actions proposed under 'Policy dialogue and TC'.

Theme 1: Support private sector competitiveness through innovation, enhanced value added and convergence with DCFTA standards and obligations

Public Procurement (PP)

The Public Procurement Law in Georgia is modern and based on transparency, competition and non-discrimination principles, but is yet to be aligned with the 2014 EU Directives, as required by the Agreement on Deep and Comprehensive Free Trade Areas (AA/DCFTA) with the European Union. On 31 March 2016 the Georgian Government adopted a Roadmap and action plan schedule to harmonise Georgian public procurement legislation with EU standards by 2022.
Georgia has a comprehensive eProcurement system that supports procurement planning, tendering, and management of public contracts and provides reliable data on local public procurement market. In 2016, in addition to electronic reverse auction new electronic procurement methods were introduced, enabling two-stage and multi-criteria (best price quality ratio) selections for some procurement. However, the high number of direct selection contracts stands out as one of the main problems in the current public procurement system. In 2015, competitive electronic tendering based on reverse auction covered 66 per cent of the state procurement budget[27], and remaining procurement was contracted via direct selection. While the government introduced a mandatory administrative *ex-ante* review of direct contracting, the legislation is still permissive and level of direct selection (34 per cent of procurement budget) remains very high comparted to the EU Member States (on average 6 per cent of procurement budget).

The public procurement institutional framework also needs further development. The main issue is the lack of an independent review and remedies body for public procurement. Presently, all public procurement related functions are managed by the State Procurement Agency which is against international best practices and raises suspicions for potential conflicts of interest[28]. The Dispute Resolution Board in charge of public procurement review and remedies accepts complaints submitted electronically and works very timely but is not independent – it includes 3 elected representatives of the civil society but some members of the Board are appointed by the State Procurement Agency and the head of the Agency is chairing the Board's review proceedings. Complaints and respective decisions of the Dispute Resolution Board are available electronically to the public and the decisions made can be appealed in court.

[27] Public Procurement Annual Report 2015- http://www.procurement.gov.ge/ELibrary/AnalyticalStudiesReports.aspx
[28] The procedural gaps will be addressed in Phase 2 (2019), Phase 3 (2020), Phase 4 (2021) and Phase 5 (2020) of the legal approximation schedule.

The Georgian public procurement reform is close to achieving compliance with the 2012 WTO GPA standards but further regulatory work is necessary to ensure a robust institutional structure and appropriate regulation for all types of public contracts.

Theme 2: Deepen financial intermediation and develop local currency and capital markets to enable access to finance

Access to finance

The secured transactions framework in Georgia has seen many amendments since its adoption in 2005. The latest amendment was made in 2013 and introduced the possibility for the security interest to extend to the products, proceeds and replacement of collateral.

The taking of pledge over movables is regulated by the Civil Code. The pledge is registered in the public registry which is accessible online. The 2011 amendments of the Civil Code further strengthened creditors' rights by explicitly providing for the pledge to automatically extend to the proceeds of the pledged item or insurance payment, even if such provision is not provided for by the parties in the agreement. Creation and registration of a mortgage is relatively quick and inexpensive but the legislation regulating enforcement is contained in different laws. The enforcement is usually led by the courts and the out-of-court sale is rarely used. The mortgage creditor cannot request out-of-court sale of the real property without mortgagor's consent. Nevertheless, the mortgagee can request compulsory administration of the property.

There are no special laws on factoring or financial leasing in Georgia. Factoring is vaguely defined in the Banking Law which does not distinguish between different types of factoring. There is no specific supervisory body for factoring companies or any accompanying regulatory mechanism. As factoring is not regulated there are no restrictions on receivables that can be factored. Financial leasing is regulated by the Civil Code, however, the Law on Promoting of Leasing Activity further develops rights and obligations of the parties to the leasing agreement by distinguishing between four types of leasing. Financial lessors are regulated and the leasing contracts are registered in the public registry, but lack of registration cannot be ground for invalidation of the leasing agreement. The Civil Code provides a relatively simple repossession procedure but according to local legal professionals the repossession in practice is not always straightforward due to various evasive activities undertaken by defaulting lessees.

Corporate governance

The 2015 EBRD assessment on the corporate governance legislation and practices of companies highlighted that the Georgian framework needs reform in most areas under consideration. Only banks are subject to qualification requirements for their supervisory board and to establish audit committees. However, the composition of the audit committees is not regulated and there is no requirement to have independent directors in the audit committee. Moreover, the law does not provide the board of a company with the authority to approve the budget and the risk profile of the company. On a positive note, according to Georgian legislation, companies are required to disclose their financial statements in line with IFRS, to appoint external auditors and to disclose their names. All largest listed companies appear to comply with these requirements. Having said this, external auditors are allowed to provide non-auditing services, which might undermine their independence.

The 2015 EBRD assessment also revealed that the Georgian Stock Exchange has very low liquidity and does not seem to be in a position to promote good corporate governance standards. There is no corporate governance code for companies, while it seems that the corporate governance code for banks is not well implemented in practice.

Theme 3: Expand markets through inter-regional connectivity

Concessions/PPP
The general legislation of Georgia appears to incorporate certain provisions that may constitute obstacles to PPP development in the country, including but not limited to, inadequate/restricted budget, tax and administrative legal framework. There also appear to be inconsistencies among various legislative provisions that discourage private sector participation in PPPs. Although investment legislation is rather liberal, the lack of incentives for investment and insufficient regulation of the concessions sector discourages private investment. Further to the above, gaps and deficiencies exist in sector-specific legislation (transport, healthcare, utilities etc.).

There is no dedicated PPP authority in Georgia, and there are no special units or departments in line ministries dealing with PPP or concessions matters. The 2012 EBRD Concession/PPP Laws Assessment awarded Georgia 7 out of 24 points on the scale of institutional framework development ("very low compliance" with international best standards). That said, certain functions that would normally be attributed to a PPP authority appear to be split between several bodies, however, without structured coordination among them in the absence of any PPP policy. Investment projects selection and supervision is assigned to relevant line ministries and agencies, which in general lack experience and expertise in the PPP sector.

The most recent assessment of the Concessions Law found that it is outdated, limited and inconsistent with international good practices and has a number of drawbacks which make the law difficult to implement and also contradicts the very notion of modern concession as a civil law contract between public and private partners.

The Government is well aware of the above drawbacks and make considerable efforts to upgrade the legal and policy framework in order to incentivise private sector investment. EBRD is currently engaged in a technical cooperation project to draft a new Law on PPP/Concessions as well as advise on PPP Policy Paper which shall aid Georgia in moving closer to conforming to international best standards and practices in this sector. Earlier in June 2016 PPP Policy Paper has been formally approved by the Government promoting PPP, setting out its principles and opening up horizons for the development of its regulatory and institutional frameworks too.

Theme 4: Support renewable energy, energy efficiency, and climate change adaptation to enhance competitiveness and resilience of the economy

Energy Efficiency/Renewable Energy
In 2014 Georgia signed the EU Association Agreement and launched negotiations for accession to the Energy Community. As a result of this, the government is still negotiating targets for the implementation of the necessary legislative reform.

Currently, Georgia has no primary legislation governing Renewable Energy Sources (RES), although aspects relevant to RES are incorporated into general energy legislation. There is also no National Renewable Energy Action Plan adopted in the country. Moreover, there is no adopted dedicated law on energy efficiency (EE) nor a relevant policy framework. Georgia has a substantial potential for improving national EE levels by introducing and implementing EU best practices in the residential sector and unlocking financial opportunities. EBRD is currently providing technical assistance for the development of the country's first National Energy Efficiency Action Plan and review of the barriers to financing EE in residential buildings. Future legislative changes on energy efficiency should be focused on introducing requirements for energy performance of buildings, energy labelling requirements, energy audits for large and medium sized industry and other measures.

ANNEX 5 – GENDER PROFILE

Gender inequality and human development
Georgia ranks 77th out of 155 countries in terms of the UNDP Gender Inequality Index (GII)[29]. The World Economic Forum 2015 Global Gender Gap Index[30] ranks Georgia 82nd out of 145 countries. According to the SIGI Index[31], Georgia is categorised as medium in terms of gender discriminatory laws and practices.

Labour force participation and gender pay gap
Women's labour force participation rates are lower as compared to men's in Georgia. According to 2014 World Bank data[32], the proportion of women (ages 15+) in the labour force was 57 per cent as compared to 76 percent for men. Similarly, there are large gender gaps observed in terms of youth labour force participation. According to the United Nations Economic Commission for Europe , in 2012 women earned on average 39.8 percent less than men making Georgia the country with the third largest gender pay gap in the Caucasus and Central Asia region, after Azerbaijan (53.1 percent) and Tajikistan (50.9 percent).

Table 1. Gender in employment

Indicator	Female	Male	Year
Labour force participation rates (ages 15-64)	57%	76%	2014
Gender Pay Gap	39.8%		2012

Source: World Bank; United Nations Economic Commission for Europe

Health and education
Data from Ministry of Labour, Health and Social Affairs (2014) a neonatal mortality rate of 6.2 deaths per 1000 births, along with an under 5 mortality rate of 9.3 deaths per 1000 births that same year.[33] Most recent UN data (2015) showed that sex ratio at birth in Georgia is one of the highest in EBRD CoOs (111 men for 100 women.

Table 2. Sex ratios at birth in South Caucasus and selected Asian and European countries (2010-2015 average)

Country	Sex ratio at birth
Armenia	114
Azerbaijan	116
Georgia	111
Tajikistan	105
Latvia	106
France	105

Source: United Nations Population Division (2015)[34]

[29] The GII is a composite measure, which captures the loss of achievement, within a country, due to gender inequality, and uses three dimensions to do so: reproductive health, empowerment, and labour market participation.
[30]The WEF GGGI measures how well economies are leveraging their female talent pool, based on economic, educational, health-based and political indicators.
[31] The SIGI value is based on qualitative and quantitative data on discriminatory social institutions.
[32] http://data.worldbank.org/indicator/SL.TLF.CACT.FE.ZS
http://data.worldbank.org/indicator/SL.TLF.CACT.FE.ZS
[33] _http://ncdc.ge/AttachedFiles/Yearbook-_ENG_2014(2)_23e48d63-3434-4ee2-a76c-f7653011ae02.pdf
[34]http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2015/04/24/090224b082e05548/1_0/Rendered/PDF/Exploring0the00n0the0South0Caucasus.pdf;
https://esa.un.org/unpd/wpp/Download/Standard/Fertility/

In 2014, 14 per cent of all male graduates were in the field of engineering, manufacturing and construction as compared to 3.6 per cent of female graduates in these fields. In contrast, 22.5 per cent of women graduated from humanities and arts programmes as compared to 9 per cent of male graduates in these fields. This gender segregation in education results in occupational segregation in the labour market, as the table below shows.

Table 3. Gender segregation in economic sectors

Georgia: total employment by economic activity	Men	Women
Construction	93%	7%
Transport, Storage and Communications	92%	8%
Mining and Quarrying	91%	9%
Electricity, Gas and Water Supply	81%	19%
Manufacturing	73%	27%
Real Estate, Renting and Business Activities	62%	38%
Agriculture, hunting and forestry	49%	51%
Financial Intermediation	46%	54%
Hotels and Restaurants	39%	61%
Education	17%	83%
Human health and social work activities	16%	84%

Source: Laborsta, International Labour Organisation, 2008[35]

Georgia's legislation does not provide for equal-pay for equal-work legislation. Neither do laws exist which mandate non-discrimination in hiring practices on the basis of gender. The mandatory maximum length of fully paid maternity leave is 183 days, (paid at 100 percent of the salary by the government[36]), and unpaid maternity leave is 547 days. [37] The law does not provide for paternity leave. Moreover, the retirement age is higher for men (65 years) than for women (60 years).[38] The lack of these labour rights in the workplace may partially explain the unexpectedly high gender pay gap, alongside noticeable gender differences in the fields of study and subsequent occupational segregation in the labour market, cultural perceptions on what is considered an acceptable and desirable occupation for women to work in as well as the need to balance work with family responsibilities.

Leadership and decision-making

Georgia has not established binding quotas for women candidates or elected members in either national or local government levels. Women are better-represented in the judiciary, where three out of nine constitutional court justices are women. Moreover, no quota has been introduced for women on corporate boards.

Entrepreneurship and access to finance

The absolute numbers of owning a bank account at a formal financial institution in Georgia are low for both men and women. According to the World Bank's Global Financial Inclusion database in 2014, 39.6 per cent of men and 39.8 per cent of women aged over 15 in Georgia owned an account at a formal financial institution.[39] However, according to 2014 data from

[35]http://laborsta.ilo.org/STP/guest
[36] Labour Code of Georgia, Article 29.
[37] Labour Code of Georgia, Article 27.
[38] Law of Georgia on State Pension, Article 5.
[39]http://databank.worldbank.org/data/reports.aspx?source=1228

the Bank of Georgia, the largest commercial bank, only 25 per cent of its total number of MSME borrowers were women-led MSMEs, thus pointing to a significant gender gap in access to finance for women entrepreneurs.

According to the 2015 Business Environment and Enterprise Performance Survey (BEEPS), 34 per cent of the firms surveyed in Georgia had women among its owners and 32 per cent had female top managers. Of the firms surveyed, women comprised 44 percent of full-time workers and 25 per cent had at least 50 per cent women ownership.

ANNEX 6 – EBRD AND THE DONOR COMMUNITY

Donor funded technical cooperation assignments in Georgia have allowed the Bank to undertake early diagnostic work, including feasibility studies and preparation of investment opportunities, to build capacities of prospective clients, in particular in the area of Sustainable Energy and Resource Efficiency, and to share transition experience from policy makers and private sector stakeholders from other Countries of Operations.

Significant donor funds were provided through investment grants for co-investment projects that supported solid waste management in the Rustavi region and for incentive assignments used in the Georgian Agricultural Finance Facility (GAFF) and Caucasus Energy Efficiency Programme (CEEP) benefitting partner financial institutions or sub-borrowers. In addition, Georgia has benefited from TC assignments that contributed to local private SME growth through a range of advisory and investment programmes, including the Business Advisory Services, the Enterprise Growth Programme and the Investment Councils.

For the past two years, there has been increased donor support in Georgia for projects under the Green Economy Transition, Sustainable Energy and Resource Efficiency for solid waste management projects as well as for CEEP consultancy. In Theme 4 (Sustainable Energy and Resource Efficiency) the demand for donor grants is expected to remain strong.

To sustain these needs, the EBRD will rely on a number of donor funds administered by the Bank or managed externally, in addition to resources made available by its shareholders:

- **The Early Transition Countries Multi-Donor Fund (ETC Fund**), with contributions from 14 bilateral donors, has financed projects in 10 countries for over 10 years with Georgia being one of the top recipients of these grants. The ETC Fund will continue to provide TC grants across a range of sectors, focusing mainly on areas such as improved access to essential services in water, waste water, solid waste and district heating as well as support to entrepreneurship and SMEs..

- **Bilateral donors:** grants will be sought from donors through their bilateral accounts administered by the EBRD, who have expressed interest in supporting activities in Georgia across all strategy themes.

- **The EU Neighbourhood Investment Facility (NIF)**is an important funding source for TC and non-TC grants for Georgia, particularly through regional programmes in the energy and SME sectors.

- **The EU National Programme for Georgia** supports the Bank's work in the SME sector, including most recently EBRD's ASB programme.

The EBRD Shareholder Special Fund (SSF) is endowed by the Bank's net income. The SSF is a complementary facility to donor resources and will provide TC and non-TC support, in areas where there is a shortage or lack of support, but where advancing transition remains a priority area for the Bank