

**DOCUMENT OF THE EUROPEAN BANK  
FOR RECONSTRUCTION AND DEVELOPMENT**

**STRATEGY FOR  
GEORGIA**

As approved by the Board of Directors on 21 November 2006

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## EXECUTIVE SUMMARY

Georgia remains committed to and is making progress in applying the principles of Article 1 of the Agreement Establishing the Bank. Following the *Rose Revolution* of November 2003, the Georgian authorities have demonstrated a strong commitment to democracy and market economy. Since the last country strategy there have been significant achievements in economic reforms but, understandably, challenges still lie ahead. These include the need for further development of democratic institutions and implementation of the rule of law, as well as for progress in resolving conflicts in Abkhazia and South Ossetia.

Economic growth has been impressive during the last two years. In 2005 real GDP growth was 9.3 per cent compared to 5.9 per cent in 2004. The high growth has continued during 2006. This performance was led by strong growth in the industrial sector, especially manufacturing, due in part to the recent privatisations of important enterprises, and to structural reforms aimed at decreasing the informal economy. The construction and telecommunication sectors were boosted by the construction of oil and gas pipelines and have continued to benefit from underlying growth, while agricultural production recovered despite recent flooding. While the recently imposed Russian transport embargo and the bans on imports of Georgian wine and mineral water will have a negative impact on economic growth in 2006 and subsequently, the economy has shown some resilience and is expected to remain stable.

Capital flows related to the construction of the BTC pipeline, privatisations and remittances have contributed to the slight nominal strengthening of the Lari amid repeated interventions, mostly unsterilised, from the National Bank. The money supply has grown sharply in the past two years due to strong capital inflows and increased fiscal spending. This, combined with an increase in energy costs, has led to an increase in annual inflation above the National Bank target of 6 per cent. Containing inflation is a major challenge for Georgia and further improving public expenditure management will be a key to easing inflationary pressures.

The fiscal position of Georgia has improved dramatically in the past three years following the Rose Revolution at the end of 2003. Improved tax and customs administration and anti-corruption measures contributed to an increase in budget revenues from 16.2 per cent of GDP in 2003 to an estimated 23.4 per cent of GDP in 2005. The external debt position of Georgia has improved significantly as a result of higher growth rates, a prudent external borrowing strategy from the Government and debt rescheduling in the framework of the Paris Club in 2001 and 2004. Following the Paris Club debt rescheduling in July 2004 (equivalent to USD 161 million), bilateral agreements for debt relief have been reached with all bilateral creditors. The ratio of public external debt to GDP decreased to 27 per cent of GDP in 2005 (down from 36 per cent in 2004).

Over the past two years, Georgia has made good progress toward improving the business climate, as also indicated by the Business Environment and Enterprise Performance Survey (BEEPS), 2005, and has made more progress in making itself business-friendly than any other country according to the World Bank report *Doing Business* in 2006, improving its ranking world-wide from 112<sup>th</sup> place to 37<sup>th</sup>. At the same time, the large-scale privatisation programme launched in September 2004 has progressed well. The programme envisages the sale or liquidation of more than 1800 remaining state-owned enterprises as well as sale of farm land over an 18 month period. Among large companies already sold are a shipping company, a metallurgical plant, two telecom companies, three energy distribution companies and six hydro power plants. Financial intermediation has seen rapid growth during the past two years albeit from a very low base. Domestic credit to private sector increased from 8.7 per cent of GDP in 2003 to 14.8 per cent in 2005. Banking supervision has been considerably strengthened while the introduction of a gradual increase in capital requirements by the National Bank has contributed to consolidation within the sector.

Reform measures under implementation by the Government are aimed at gradual improvement of the investment climate over the medium term including creating a level playing field and a legal framework conducive to the development of private enterprise. The new, improved customs code is

expected to lead to greater transparency in enforcement, and the authorities are working on strengthening the judiciary. The legal framework for secured transactions has been improved with a new law that came into force in July 2005 and a centralised pledge registry for movable property is being established.

Despite its significant progress, Georgia still faces important transition challenges including:

- effective implementation of the energy sector policy adopted by the Government which provide for restructuring, rehabilitation and strengthening of investment incentives with an objective of improving financial and technical performance;
- improving further the business environment, in particular through sustained implementation of anti-corruption measures and through further strengthening of the administrative capacity and the independence of the judiciary system;
- successfully completing the privatisation programme in a fair and transparent manner;
- ensuring fiscal sustainability through further improvements in tax collection, customs legislation, and public expenditure management;
- albeit reduced, corruption remains a problem and sustained efforts will be required to ensure ongoing strengthening of business confidence;
- continued investment in physical infrastructure.

As of October 31, 2006, the Bank had signed a total of 64 investment projects covering energy, transport, agribusiness, general industry and banking for a total commitment of €389.5 million. Seven projects were in the public sector totalling €81.6 million (20.9%) and 57 in the private sector, totalling €307.9 million (79.1%). Net portfolio was €254.8 million, of which €192.5 million (75.5%) was disbursed.

Over the coming strategy period, the Bank will further support the process of economic and democratic reform in Georgia, leveraging on the improved fiscal and external position and progress with reforms and privatisation. Georgia is one of the countries included in the Early Transition Countries Initiative (ETCI). Over the past strategy period the Bank has almost doubled its portfolio (increase by 84%) and tripled the number of operations signed annually from 2003 to 2005, with nearly all new commitments made in favour of the private sector, largely reflecting the impact of the ETCI (launched in mid 2004) and with the support of substantially increased technical cooperation, particularly that financed from the ETC Multi Donor Fund. The ETCI has provided effective mechanisms for better targeting a broad range of projects that address availability of finance in regions throughout Georgia and across a broader range of sectors. Increased availability of grant co-financing in particular has enabled substantial work to be initiated for Municipal projects in regions urgently in need of rebuilt municipal services. The Bank's activities over the coming strategy period will continue to focus primarily on support targeting the development of the private sector, including through an intensified policy dialogue with the authorities on improving the investment climate. In view of Georgia's limited sovereign borrowing capacity, the Bank does not anticipate pursuing sizable sovereign operations unless these involve adequate grant co-financing from other sources.

The EBRD's main operational objectives will be:

- a) **Investment climate** – Policy dialogue with the authorities will be continued and further enhanced, in close coordination with the local business community, other IFIs and international donors and will aim at addressing critical bottlenecks to local private sector investment and FDI. To this end, the Bank will continue to provide stand-alone technical assistance as appropriate, including for legal transition work and to promote public-private sector dialogue.

- b) **Infrastructure** – Investments in support of energy security and efficiency, and strengthening of essential infrastructure will be a priority for the Bank. Key sectors for the EBRD support will be power and energy, municipal and transit infrastructure. Given the importance of the power sector to the overall political, social and economic stability of Georgia and the region, particular efforts will continue to be directed to the successful completion of the Enguri Rehabilitation project and toward investments supporting renewable energy. Priority will also be given to the development and implementation of a number of municipal infrastructure projects, mainly on a non-sovereign basis and if accompanied by appropriate regulatory and institutional reform, including for smaller municipalities. Securing ongoing levels of donor grant support will be critical to success.
- c) **Enterprise Sector** – The Bank will actively expand funding of local businesses, particularly SMEs and micro enterprises. Support will mainly be provided through the ETCI specialised enterprise funding instruments, i.e. non-bank microfinance institutions (NBMFI) framework, Medium-sized Co-financing Facility (MCFF), equity via the Direct Investment Facility (DIF), debt via the Direct Lending Facility (DLF), as well as through traditional tools such as credit lines with local banks and the Trade Facilitation Programme (TFP). It is anticipated that the agribusiness sector will figure prominently given its importance to the Georgian economy, including regional and rural development. Providing financing for leasing operations in support of agriculture and construction activities will receive particular attention. The SME sector will be further strengthened through the TurnAround Management (TAM) and Business Advisory Service (BAS) Programmes. Areas of particular focus will be management skills, market positioning, information systems, technical and environmental upgrades.
- d) **Financial Sector** – The EBRD will continue to expand support to existing and new partner banks in Georgia. Support will typically include expanded TFP and MSME lines of credit as well as mortgage loans. In an effort to address capital adequacy constraints and sector consolidation, the Bank will seek new equity investments in local banks. Intensive implementation of the Bank’s MCFF with selected local banks will continue. Additionally, the Bank will work to support the development of the non-bank financial sector with a specific focus on leasing, insurance and private pension schemes.

The government’s ability, commitment and willingness to continue reform are crucial for the successful implementation of the proposed strategy. Close co-operation with the donor community and in particular with the EC within the framework of the European Neighbourhood Policy as well as collaboration with the US supported Millennium Challenge Georgia will also be important factors to success. This co-operation efforts will be undertaken within the context of the Government’s effective leadership of donor co-ordination.

Recognising the need for enhanced staff and technical resources in the field to ensure the ongoing success of the ETCI and to deepen its engagement with the domestic business communities, the Bank has now established a Regional Hub in Tbilisi. Under this arrangement, the number and seniority of staff positioned in the field and available to directly support from Tbilisi the growth of a healthy portfolio in Georgia, as well as in the other the Caucasus countries and Moldova is in the process of being strengthened.

## ABBREVIATIONS

BAS	Business Advisory Service
BEEPS	Business Environment and Enterprise Performance Survey
BP	British Petroleum
BSTDB	Black Sea Trade and Development Bank
BTC	Baku-Tbilisi-Ceyhan pipeline
CDM	Clean Development Mechanism
CIS	Commonwealth of Independent States
CPI	Corruption Perceptions Index
DEG	Deutsche Investitions und Entwicklungsgesellschaft
DIF	Direct Investment Facility
DLF	Direct Lending Facility
EC	European Commission
EDPRP	Economic Development and Poverty Reduction Programme
ETCI	Early Transition Country Initiative
EU	European Union
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
FMO	Nederlandse Financierings Maatschappij voor Ontwikkelingslanden N.V. (Finance for Development)
FI	Financial Institutions
GDP	Gross Domestic Product
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit GmbH
HPP	Hydro Power Plant
IAIS	International Association of Insurance Advisors
IFI	International Financial Institution
IMF	International Monetary Fund
KfW	Kreditanstalt für Wiederaufbau and Entwicklung
LLD	Lessons Learned Database
MCA	Millennium Challenge Account
MCC	Millennium Challenge Corporation
MCG	Millennium Challenge Georgia
MCFF	Medium Sized Co-Financing Facility
MSE	Medium Sized Enterprises
MSME	Micro, small and medium enterprises
NBG	National Bank of Georgia
NBMFI	Non-Bank Microfinance Institutions
NGO	Non-governmental Organisation
ODIHR	Office for Democratic Institutions and Human Rights
OECD	Organisation for Economic Co-operation and Development
OSCE	Organisation for Security and Co-operation in Europe
PIU	Project Implementation Unit
RDI	Regional Development Initiative
RO	Resident Office
SCP	South Caucasus Pipeline
SIDA	Swedish International Development Agency
SELP	Small Enterprise Lending Programme
SME	Small or medium enterprise
SOE	State Owned Enterprises
TAM	TurnAround Management
TA	Technical Assistance
TACIS	Technical Assistance to Commonwealth of Independent States (CIS)
TC	Technical Cooperation

TFP	Trade Facilitation Programme
TRACECA	Transport Corridor, Europe-Caucasus-Asia
USAID	United States Agency for International Agency
VAT	Value-added Tax
WB	World Bank



## COUNTRY STRATEGY

### 1. THE BANK'S PORTFOLIO

#### 1.1. Overview over Bank activities to date

As of October 31, 2006, the Bank had signed a total of 64 investment projects covering energy, transport, agribusiness, general industry and banking for a total commitment of €389.5 million. Seven projects were in the public sector totalling €81.6 million (20.9%) and 57 in the private sector, totalling €307.9 million (79.1%). Net portfolio was €254.8 million, of which €192.5 million (75.5%) was disbursed.

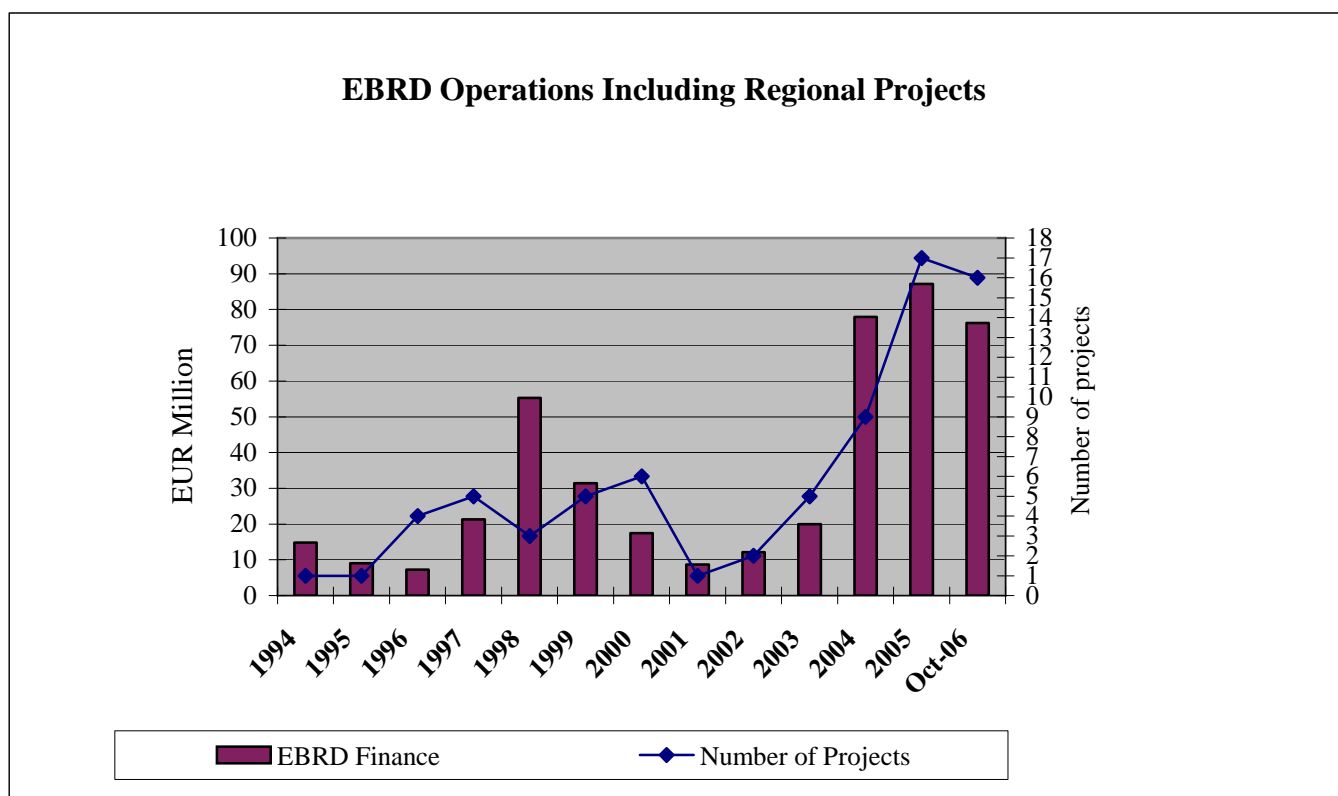
**Table 1: Commitments and Portfolio at 31 October 2006**  
(€million)

Sector Name	CUMULATIVE COMMITMENTS				CURRENT PORTFOLIO <sup>1</sup>			
	No. of Projects	Total Project Cost	EBRD Funds	% of total EBRD	Disbursed	No. of Projects	Portfolio	%
<b>Financial Institutions</b>	<b>36</b>	<b>167.0</b>	<b>121.3</b>	<b>31.1</b>	<b>80.1</b>	<b>25</b>	<b>86.7</b>	<b>34.0</b>
<b>Infrastructure</b>	<b>7</b>	<b>147.5</b>	<b>63.2</b>	<b>16.2</b>	<b>36.4</b>	<b>6</b>	<b>43.8</b>	<b>17.2</b>
<i>Municip. &amp; Environmental Infr.</i>	3	23.3	8.6	2.2	3.0	3	8.3	3.3
<i>Transport</i>	4	124.2	54.6	14.0	33.4	3	35.4	13.9
<b>Energy</b>	<b>7</b>	<b>1574.6</b>	<b>157.7</b>	<b>40.5</b>	<b>130.7</b>	<b>4</b>	<b>96.2</b>	<b>37.8</b>
<i>Natural Resources</i>	4	1,320.8	89.5	23.0	66.4	2	72.2	28.3
<i>Power &amp; Energy</i>	3	253.8	68.2	17.5	64.3	2	24.0	9.4
<b>Specialised Industry</b>	<b>13</b>	<b>66.4</b>	<b>44.8</b>	<b>11.5</b>	<b>28.1</b>	<b>11</b>	<b>28.2</b>	<b>11.1</b>
<i>Agribusiness</i>	11	58.2	36.6	9.4	26.9	9	20.5	8.0
<i>Property &amp; Tourism</i>	2	8.2	8.2	2.1	1.2	2	7.7	3.0
<b>General Industry</b>	<b>1</b>	<b>17.1</b>	<b>2.5</b>	<b>0.7</b>	<b>2.5</b>	<b>0</b>	<b>0.0</b>	<b>0.0</b>
<b>Country Total</b>	<b>64</b>	<b>1972.6</b>	<b>389.5</b>	<b>100.0</b>	<b>277.9</b>	<b>46</b>	<b>254.8</b>	<b>100.0</b>

Details of commitments and net portfolio are provided in Annex 5.

Following relatively low levels of project activities between 1994 and 2003, substantially improved operations are evident subsequently. The effect of the ETCI is an important contribution to the growth in business as has been the accelerated attention to structural reforms subsequent to the Rose Revolution.

## Historical Review



### 1.2. Implementing the Last Country Strategy

- New Business:** New business exceeded planned targets in terms of volume and number of transactions, while at the same time the important demonstration and transition impacts were maintained and enhanced in the core priority areas of the strategy (i.e. critical infrastructure including municipal, support for small- and medium-sized enterprises, the banking and non-bank financial sectors, more direct equity). Since 2004, the EBRD has committed a total of €204.9 million for 31 new projects. This substantial increase was also made possible through the ETCI and through increased TC support provided by donors under the ETC Multi-Donor Fund and bilaterally.
- Enterprise Sector:** Using the instruments and approaches provided under the ETCI, the Bank further expanded its funding of local enterprises, including MSMEs and fast-growing larger private enterprises. Support was provided both directly and through local banks included through six DIF equity transactions and one Direct Lending Facility (DLF) project. Local partner banks were assisted via three SME and two MSE lines of credit, two MCFE risk participation agreements, one syndicated loan and extensive TFP (102 TFP transactions in 2005 alone for a total value of €45.1 million, an increase of 220% vs. 2004). The first loan to a local leasing firm was extended followed by an equity investment. TAM and BAS Programmes actively worked in the country, with BAS carrying out 282 projects and TAM 19 projects by the end of October 2006. These two programmes developed effective synergies with the Bank's operations under the DIF (pre- and post-investment cooperation) as well as with local partner banks in business plan development and other assistance, providing pipeline for banking projects.
- Infrastructure and Regional Projects:** Efforts were maintained to ensure the successful continuation of the Enguri HPP rehabilitation project. Given the importance of the power sector to the political, social and economic stability of Georgia and the region, particular

efforts were made, in close collaboration with other IFIs and donors to help continue restructuring and reform in the power sector. Implementation of the government's Energy Action Plan has yielded results with average collection rates increasing to 78% (up from 12% in 2003) nationwide by the end of 2005 and with key assets privatised during 2006. Implementation of the major regional oil and gas pipeline infrastructure projects continued successfully and complementary activities within the BTC Regional Development Initiative (RDI) were initiated (e.g. in the SME sector, gas transit and municipal waste). The first municipal infrastructure project without a sovereign guarantee (Tbilisi urban transport) has been signed, as well as two public municipal projects aiming rehabilitation of water supply in the country regional centres, Kutaisi and Poti, with other municipal projects being developed in Tbilisi and other cities of Georgia (Poti, Kutaisi, Batumi and Rustavi), all in close collaboration with bilateral donors. Loans have been signed for financing private concessions at Tbilisi and Batumi international airports.

- **Financial Sector:** The EBRD extended further support to partner banks in Georgia using the full range of instruments developed under the ETCI. The Bank signed: (i) two new SME lines for €10.2 million; (ii) two new MSE lines for €7.9 million; (iii) two MCFF risk participation projects for €7.9 million, followed by the increase of available MCFF funds with additional €7.9 million for one partner bank; (iv) four bank equity transactions for €9.4 million; (v) the first ever syndicated loan to a local bank for €16.5 million; (vi) the first ever mortgage loan to a partner bank for €11.8 million; (vii) the first loan and equity to a local leasing firm totalling €2.5 million; and (viii) TFP with two new partner banks and five TFP limit increases for existing client banks. Donor-funded technical assistance was provided for institutional strengthening and insurance regulation enhancement, as well as in support of the Bank's Small Enterprise Lending Programme (SELP). As at December 2005, the Bank's SELP for small and micro loans had an active loan portfolio of 11,708 loans (an increase of 90% vs. 2004) for a total of €40.3 million (an increase of 250%). In May 2006 the EBRD sold its 11.7% stake in Bank of Georgia achieving an attractive rate of return. This was the Bank's first successful exit realized through the Tbilisi Stock Exchange.
- **Investment Climate:** Policy dialogue with the authorities and in close coordination with other IFIs and the international donor community was enhanced and broadened with a special focus on the power sector, effective regulation of railways, water utilities and promotion of MSME development. A new, simplified and reduced Tax Code was put into operation following significant consultation through this process. Reform of various regulatory bodies continues. The Bank together with the USAID supported a follow-up study undertaken by the Foreign Investment Advisory Service of the WB. The EBRD has supported the creation of a Glasnost Committee and together with other participants undertakes an intensive dialogue with the authorities to address key issues including harassment of businesses. A secured transactions TC was put in place in close cooperation with the Ministry of Justice and the USAID. The Bank also supported the preparation of a new insolvency law. Training of public procurement officers was supported under TC, while pilot work for the training of commercial court judges is still on-going.

### 1.3. Project Pipeline

The active project pipeline (estimated at some €150 million) currently includes: five DIF projects; a loan to finance rehabilitation of the main transit gas pipeline; one MCFF facility with an additional bank; a syndicated loan with a second partner bank; mortgage loan to a partner bank; a rural roads rehabilitation project; debt and equity in support of a second leasing company; the addition of one more partner bank with TFP and SME lines; a property development investment fund; municipal infrastructure projects (water supply, waste management, transport and energy efficiency) in Tbilisi and four regional centres; micro-lending programmes with two non-bank microfinance institutions; a mortgage facility with a partner bank; and a DLF project for the development of a business centre in Tbilisi. In general, it is clear that the ETCI has made a substantial difference to the EBRD's ability to exercise its mandate.

## 1.4. Portfolio Performance

The current EBRD portfolio in Georgia has a weighted project risk rating of 5.96 (vs. 6.29 at the time of the last strategy review) compared with the average of 5.45 (vs. 5.49) for the Bank as a whole. The portfolio disbursement ratio in October 2006 stood at 75.5%.

All repayments under projects supported by sovereign guarantees are current. All sovereign-backed public sector operations have performed satisfactorily. No substantial difficulties have been experienced with the Bank's private sector portfolio.

## 1.5. Transition Impact of the Bank's Portfolio and Lessons Learnt

### 1.5.1. The Financial Sector

**Banking.** During the last five years, the Bank continued to play an important role as shareholder in Bank of Georgia (BOG) and United Georgia Bank (UGB) on corporate governance issues. The Bank was instrumental in the negotiation process that led to Bank of Georgia acquiring TbilUniversalBank (TUB) at the end of 2004. Yet, the basic regulatory framework requires further improvement. Banks are generally small and efficiency would result from further consolidation. *A lesson learnt from* ProCredit Bank, Georgia is that prior to participating in the launch of new MSE banks, the EBRD should assess the viability of using existing structures to achieve micro-credit outreach (PE03-255SC). *Another lesson learnt from* the Bank of Georgia project is that timing of equity exits should be guided principally by transition impact potential (PE05-317).

**Private Equity Funds.** The private equity market in Georgia is still at a very early stage of development although stronger interest from investors has been evident during the past year.

**SMEs.** Early involvement of the Bank through SME credit lines accompanied by credit advice and training programmes has had some institution building benefits and has increased competition. More recently, the Bank has consolidated its transition impact through credit lines extended directly (without sovereign guarantees) to TBC Bank, BoG and UGB, and the creation of (and loan extensions to) a dedicated microfinance bank - Procredit Bank Georgia. Despite an episode of fraud, Procredit was able to extend over 60,000 micro and small loans up to March 2006, and has set up a "mobile branch" in order to reach SMEs in very remote areas. The pre-2000 SME credit lines were restructured to be part of a micro-lending programme, and have since disbursed over 12,000 loans, with a good portfolio quality. *A lesson learnt from* the SME Credit Line is that the Bank should be flexible and responsive when a client bank shows an aptitude for and interest in developing a product that is consistent with the Bank's broader transition objectives (PE02-225).

Overall, *significant* transition impact has been achieved in the *Financial Sector*.

### 1.5.2. The Enterprise Sector

**Agribusiness.** The 1997 investment into the Borjomi Mineral Water Company was the first private sector industrial financing in Georgia, and with the restructuring and revitalisation of the company, had significant demonstration effects. In the wine sector, the Bank in 1999 invested in Georgian Wines and Spirits (GWS). This project demonstrated post-privatisation restructuring, advanced market-orientated behaviour in the sector but failed to achieve expected changes, partly due to problems with the quality of local grapes and counterfeit products. A new GWS project focused on improving the quality of grapes, strengthening linkages to suppliers, as well as on enhancing distribution networks in the region followed in 2005.

**Industry.** The 1998 investment into the glass bottle manufacturer Ksani had a strong potential demonstration effect through supporting the privatisation and restructuring of the company together with a leading Turkish sponsor. The Bank's impact in the sector as a whole, however, has been limited due to the lack of projects. Georgia's industry continues to be restricted by a

serious restructuring backlog, as well as widespread governance issues. *A lesson learnt from* the Ksani Glass Packaging Factory project is that Bank projects should have sustainable economic motivation, such as a location near to adequate raw material supplies and major customers (PEX03-189).

Overall, *moderate* transition impact has been achieved in the *Enterprise* Sector.

### **1.5.3. Infrastructure**

**Power.** In the 1990s the Bank supported a radical reform in Georgia through financing the newly privatised Telasi power distribution company. Privatisation occurred, but the impact on collections was sluggish. Elsewhere, the Bank has been instrumental in introducing private sector partnerships under management contracts for operation of the national grid company and the wholesale market. The Bank has facilitated privatisation to a strategic investor of the largest thermal generator in the country. The Bank-supported privatisation of a large hydro power plant (Enguri) is stalled due to the situation stemming from the conflict in Abkhazia. The sector has now been unbundled, with an extensive private sector participation in both generation and distribution. There is an independent regulator, but key regulatory challenges derive from continued low collection rates and theft, although improvements were achieved in 2005 and first half of 2006 through both improved collection performance and reduced technical and commercial losses. *A lesson learnt from* the AES Telasi project is that existence of legislation and appointment of bodies in charge of implementation of sector regulations do not in themselves constitute efficient implementation. (PE03-254).

**Natural Resources Sector.** As a transit country, the Bank's incremental exposure in Georgia has been associated with the BTC and SCP pipeline projects. These projects support regional co-operation and improvement of environmental and business standards. The projects have also contributed to improving transparency in public revenue management. Further measures are required, however, to fully integrate revenue streams into the public budget and further improve transparency.

**MEI.** The Bank approved a loan in May 2005 to the Tbilisi Bus Company, a joint stock municipal company owned by the City of Tbilisi. The objectives are to restore basic municipal transport services by increasing the company's bus fleet and performance, and to establish a transparent, sustainable system to tender routes to private sector mini-bus operating companies.

In September 2006 the Bank signed two loans with sovereign guarantee supporting key improvements of the water supply in two Georgian cities; Kutaisi and Poti. Together with grant finance and TC funds, the loans will finance significant investments in both cities to enable 24 hour water supply. The projects benefited from EU grant funds for preparation, capital grants come from the Swedish International Development Co-Operation Agency (SIDA), the US Millennium Challenge Corporation and the European Union Water Initiative. TC funds are provided by SIDA and ETC fund.

**Transport.** The Bank's presence in the sector has been limited to one airport project, one railway operation, and more recently a second airport project. The Tbilisi Airport Refurbishment project focused on rehabilitation and not on institutional reform with the exception of the introduction of management information systems to improve cost allocation. The transition rationale of the Trans-Caucasian Rail Link project is based on trade facilitation but nevertheless attempts to start the institutional reform in the railways by requiring ratification of the railway law and covenants related to business plans. *A lesson learnt from* the project is that fostering regional cooperation and networking through regional development not only provides potential for synergy effects, but also tends to promote transition (PE05-314). The port project, Channel Energy Poti Port, was signed in 2002. Some transition objectives, including private sector participation in port operations and introduction of the financial accounting system, have been realised. *A lesson learnt from* the project is that international security issues could induce unanticipated diversions of traffic and could affect adversely the project, particularly for transit traffic (PEX05-262).

Overall, *moderate* transition impact has been achieved in the *Infrastructure* Sector.

#### **1.5.4. Overall Assessment and Rating**

The Bank strategies for Georgia have addressed the evolving needs of the economy. The Bank has been an active participant in the transition process and continues to innovate to suit the emerging transition needs. The Bank has had the most significant impact in the Financial Sector while its efforts during the past two years particularly in the Industry and Municipal sectors have started yielding results.

#### **1.6. Private/State Sector Ratio**

At the end of October 2006, 79.1% of total EBRD commitments were in the private sector. Over the new strategy period 2006-2007, the Bank will focus primarily (in terms of number of operations) on private sector financing, but may also consider some public sector operations (e.g. North-South gas pipeline, MEI projects, transport). Preference will be given to operations not requiring sovereign guarantees although, where sovereign guarantees will be required, donor co-funding on a grant basis will be sought.

## **2. OPERATIONAL ENVIRONMENT**

### **2.1. Political Environment**

Three years after the Rose Revolution, the Georgian authorities are working successfully to achieve genuine political pluralism and enhanced market orientation of the economy. Georgia's qualification for the USA's Millennium Challenge Account (MCA) was recognition of progress achieved by the country. The two sets of post-revolutionary parliamentary and presidential elections have brought the country closer to meeting international standards for free and fair elections.

However, many reforms are still at the beginning and serious challenges remain. Territorial conflicts, involving Abkhazia and South Ossetia, are unresolved and remain a source of tension. The government's human rights record improved in some areas but there are still problems, including corruption in law enforcement bodies, cases of arbitrary arrest and detention, lack of judicial independence and government pressure on the media.

Externally, Georgia continues to pursue a well-established pro-Western policy oriented towards joining NATO and establishing closer links with the EU. Together with neighbouring Azerbaijan and Armenia, Georgia has completed the process of negotiating an action plan within the EU's European Neighbourhood Policy and the new instrument of co-operation will be enacted shortly..

A detailed political assessment is provided in Annex 1.

### **2.2. Economic Environment**

Selected economic Indicators are provided in Annex 2.

Economic growth recorded high figures during the last two years. In 2004 real GDP growth was about 5.9 per cent and in 2005 it was 9.3 per cent. The economic growth for the first half of 2006 is estimated at 7.8 per cent. This performance was led by strong growth in the industrial sector, especially manufacturing, due in part to the recent privatisations of important enterprises and to far-reaching structural reforms aimed at decreasing the informal economy. The construction and telecommunication sectors were boosted by the construction of oil and gas pipelines. Such an effect decreased with the completion of construction of the BTC pipeline although the increased buoyancy in the economy has resulted in a sharp increase in construction in Tbilisi and in Adjara. Despite spring flooding, growth in agricultural production recovered significantly in 2005 from a fall in output during 2004 caused by unfavourable weather conditions. The services sector, especially financial intermediation, had a robust performance. Despite this impressive growth, with a GDP per capita at around USD 1416 Georgia remains among the poorest countries in the region.

Increased capital inflows in the past two years, due to oil and gas pipeline construction, improved investment climate, privatisation and remittances, obliged the National Bank of Georgia to make repeated interventions, mostly unsterilised, to avoid the appreciation of the Lari. The currency strengthened by around two per cent against the dollar in nominal terms and about 10 per cent in real terms in 2005. In addition to the impact of high energy costs, the strong capital inflows and increased fiscal spending have boosted money supply and thus put pressure on inflation. Inflation at the end of 2004 was 7.5 per cent, up from 7 per cent a year earlier, while annual average inflation reached 8.3 per cent in 2005 despite a rate of 6.4 per cent at end-2005. Inflation has been on a rising trend during the first seven months of 2006, reaching 14.5 per cent in July, well above the National Bank of Georgia's (NBG) target of 6 per cent.

The fiscal position of Georgia has improved dramatically in the past three years following the Rose Revolution. Improved tax and customs administration (including broadening the tax base with reduction of the grey economy) and anti-corruption measures contributed to an increase in budget revenues from 16.2 per cent of GDP in 2003 to an estimated 23.4 per cent of GDP in 2005. A significant contributor to the budget revenue increase is tax revenue which increased from 14.1 per cent of GDP in 2003 (among the lowest in the region) to an estimated 19.8 per cent of GDP in 2005. Increase in privatisation revenues (USD 230 million in 2005) has also contributed to greater budget revenues. However, due to an increase in government expenditure (mainly capital expenditure on infrastructure) the general government budget recorded a deficit of 1.5 per cent of GDP (on a commitments basis) compared to an overall surplus of 2.3 per cent of GDP in 2004. The proposed merger of Tax and Customs departments and the Financial Police into one entity is currently awaiting Presidential approval and is expected to have a positive impact on improving further tax collections. While the increase in tax revenue has allowed the government to increase fiscal spending, improving public expenditure management is a key to easing inflationary pressures.

Export volumes increased significantly during 2004-2005 aided by an increase in metal prices (Georgia's leading exports) and increased demand for wine from Russia. However, a more rapid import rise, due to the increase in import of capital goods and services from investments related to the oil and gas pipeline construction, and high energy prices, led to a widening of the trade deficit to 14.2% of GDP in 2005 from 13.8% of GDP in 2004. Overall, the current account deficit is estimated at 7.4 per cent of GDP in 2005, down from 8.3 per cent of GDP in 2004. The rise in imports from investments related to the oil and gas pipeline construction slowed down after the pipeline completion in May 2005. The trade deficit widened dramatically in the first half of 2006 (by 82 per cent) compared with the same period last year as imports grew faster than exports. The increase in oil and gas prices had a direct effect on imports. Export growth was also negatively affected by the Russian trade embargo on Georgian wine and mineral water which took effect in March 2006 (see Box below). Wine was Georgia's second most important export in 2005, and the wine ban is estimated to have resulted in a loss of US\$35-40 million in export revenue up until June. The external deficit has been mainly financed by privatisation-related and other private capital inflows.

The recently imposed Russian bans on imports of Georgian wine and mineral water will affect not only exports of these products but may also have a secondary effect elsewhere in the economy. The recent closure of transport routes and possible limitation to remittances transfer from Russia could have a significant negative effect on the external position of Georgia (as well as on growth, inflation and exchange rate). The Government's response to this situation is however likely to further accelerate economic reforms toward a fully market-driven economy.

#### **The economic impact of Russian ban on imports of Georgian products.**

It is still early to measure the impact of the Russian ban on imports of Georgian wine imposed at the end of March 2006. The Georgian government has undertaken a vigorous campaign to promote Georgian wine in the neighbouring countries such as Ukraine and in the European markets. President Saakashvili appointed Defence Minister Irakli Okruashvili as chief "wine ambassador" in charge of wine promotion. Wine is Georgia's second-largest export in value terms accounting for about 9 per cent of total exports in 2005, and about 77 per cent of it is sold in Russia. Nevertheless, according to the IMF, with wine exports to Russia valued at around USD100m per year (about 5 per cent of total exports), the ban is unlikely to have a notable impact on the trade balance, as wine production-related imports and wine export-related services are likely to decline as well. The Georgian Chamber of Trade and Commerce has estimated total export losses during the period April-June at around USD35-40 million. The government is also trying to find new outlets for the grape harvest, such as construction of a grape-juice processing plant that could absorb 60% of export-oriented grapes. However, contraction in the domestic wine industry is likely in 2006 because producers may find it difficult to



quickly divert sales to other markets. Consequently, small farmers may suffer from reduced demand for grapes from the wine producers. The full effect of the Russian ban on wine is likely to be felt in autumn, during the annual grape harvest. Moreover, the ban on imported wine and the consequent contraction of wine production may also have a negative impact on employment. In the largest wine region of Georgia, Kakheti, about 80 per cent of working force is involved in the wine making industry. The IMF estimates that Russia's ban on import and sale of Georgian wine and mineral water may result in a reduction of GDP growth by less than 1 percent in 2006.

The external debt position of Georgia has improved significantly. Following the Paris Club debt rescheduling in July 2004 (equivalent to USD 161 million), bilateral agreements for debt relief have been reached with all creditors apart from Kazakhstan with which negotiations are progressing. The ratio of public external debt to GDP decreased to 27 per cent of GDP in 2005 (down from 36 per cent in 2004). Nevertheless, the pace of further improvement in the debt ratios remains dependent on additional debt relief and rescheduling agreements, which are conditional on reform progress.

### **2.3. Legal Environment**

Georgia has implemented notable reforms to its legal system in the last years and the trend is continuing as numerous draft legislation is currently in preparation in various fields that are expected to affect the local operational environment. The most recently implemented changes include amendments to various laws dealing respectively with the registration of title to immovable property, the status of state-owned lands and ownership enforcement proceedings. An important piece of legislation, the draft Law on the Activities of Commercial Banks, is expected to be voted in the near future. It is designed to remove certain restrictions on the inflow of foreign capital and should make it easier for foreign banks to enter the local market.

However, in practice the country continues to face considerable challenges in entrenching of the legal rules and strengthening of legal institutions. Although Georgia's business law framework provides the basic environment within which investment and business activities can be undertaken, insufficient understanding (especially at local authorities level) of the rule of law does not yet allow for adequate and fair enforcement and results in ongoing corruption and a poorly functioning judiciary. A step towards further improving legal transparency is to be found in the creation of the government-sponsored initiative Georgian Law Review, which covers ongoing legal developments and trends in Georgia and can be consulted online.

Annex 3 provides a detailed review of Georgia's progress in legal transition.

### **2.4. Social and Demographic Environment**

#### ***Demographics***

At the end of 2004, the population of Georgia was approximately 4.6 million, with a small positive growth rate of 0.2%. External migration, mostly prompted by economic reasons, still remains a key factor in the falling population rate. The average life expectancy at birth is 71.6 years. The urban population comprises 52 percent of the total.<sup>1</sup> Ethnic groups in the country include the following (2002 census): Georgian 83.8%, Azeri 6.5%, Armenian 5.7%, Russian 1.5%, other 2.5%.

#### ***Human Development and Poverty***

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<sup>1</sup> WorldBank website: [Georgia country brief, 2005](#) and [WorldBank Georgia at a Glance 2005](#)

According to the IMF 2005 Annual Progress Report (APR), poverty increased during 2001–03, primarily due to non-payment of social transfers and public sector wages, particularly in rural areas. An overall subsequent decline in the poverty rate is attributed to strengthened macroeconomic performance, timely payment of social transfers and public sector wages and significant clearance of arrears. However, these poverty developments and characteristics discussed in the APR should be taken as tentative, as they do not reflect adjustments to the poverty measurement methodology currently underway.<sup>2</sup> Under existing methodologies the government has made the assessment that overall poverty has remained high and has affected more than 50 percent of the population. At the same time the incidence of extreme poverty increased to 17.4 percent in 2004, up from 15.1 percent in 2002.<sup>3</sup> Under revised methodologies, a slight increase in poverty levels was recorded in 2005, while a downward trend was recorded in early 2006.

The law provides for the protection of children's rights and welfare; however, funding shortages limit government services. Primary and basic education is compulsory from age 6 or 7 to age 14, and provided up to age 16. Education is officially free through high school, and most children attend school. However, in some places schools do not function or function sporadically because teachers are not paid and facilities are inadequate,

#### ***Equal Opportunities and Gender<sup>4</sup>***

The Constitution recognizes that all citizens are to be considered equal before the law. However, in practice, discrimination continues to be a problem. Sexual harassment and violence against women in the workplace remain factors that require further addressing. The law prohibits sexual harassment in the workplace; however, incidents are rarely investigated.

The law mandates that the Government ensure appropriate conditions for persons with disabilities. However, in practice, lack of funding precludes much assistance. Societal discrimination against persons with disabilities exists.

#### ***Minorities<sup>5</sup>***

The Government generally respects the rights of ethnic minorities in non-conflict areas.. School instruction in non-Georgian languages is permitted. The new Parliament did not take up a language law drafted under the previous Government that would make Georgian compulsory for government employees. The Government organizes free language courses for government employees in regions inhabited by ethnic minorities.

#### ***Human Rights<sup>6</sup>***

The law prohibits trafficking in persons. However, the country is a source, transit point, and destination for trafficked persons. Georgian victims most likely come directly from the impoverished former industrial centres of Poti, Kutaisi, Rustavi, and Tbilisi. Local NGOs report that men were also trafficked to Russia.

NGOs view the Office of the Public Defender, or Ombudsman, as the most objective of the Government's human rights bodies. The constitutionally mandated office monitors human rights conditions and investigates allegations of abuses.

#### ***Labour Issues<sup>7</sup>***

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<sup>2</sup> IMF - Georgia: Poverty Reduction Strategy Paper Progress Report 2005

<sup>3</sup> State Department of Statistics and government of Georgia, EDHRP Progress Report, June 2005

<sup>4</sup> US Department of State, Country Reports on Human Rights Practices - 2004

<sup>5</sup> US Department of State, Country Reports on Human Rights Practices - 2004

<sup>6</sup> US Department of State, Country Reports on Human Rights Practices - 2004

<sup>7</sup> US Department of State, Country Reports on Human Rights Practices - 2004

Georgia is an ILO member state , has ratified all eight ILO core conventions and has a newly adopted labour code which aimed to be more liberal.

Georgian legislation provides for the right of citizens to form and join unions and workers exercise this right in practice. The law prohibits any discrimination by employers against union members, and employers may be prosecuted for anti-union discrimination and forced to reinstate employees and pay back wages. The law allows workers to organize and bargain collectively, and some workers exercise these rights. However, the practice of collective bargaining is not widespread. Forced or compulsory labour, including by children is prohibited.

According to the law, the minimum age for employment of children is age 16. However, in exceptional cases, children may work with parental consent at ages 14 and 15. Children under age 18 may not engage in unhealthy or underground work, and children between ages 16 and 17 are subject to reduced working hours. Child labour is, however, not considered a serious problem.

## 2.5. Environmental Situation

Georgia has made considerable progress in improving the state of the environment in the country. Further actions have been taken in such challenging areas as improvement of public transportation and monitoring fuel quality, prevention of pollution by adopting best available technologies and cleaner production, rehabilitation and improvement of drinking water supply and sewage systems, efficient management of water resources by introducing economic instruments, introduction of integrated coastal zone management to address pollution issues in the Black Sea, and preservation of ecosystems including forest ecosystem. The government has been trying to harmonise its environmental legislation with EU environmental directives. Georgia’s environmental legislation is very elaborate and comprehensive, including sectoral environmental law, however further development of procedure law is required.

Similar to other countries in the region, Georgia has further potential to enforce the implementation of its environmental legislation and policies, and to enhance its institutional capacity. Furthermore, Georgia faces challenges on the way of implementation of the identified environmental priorities within the forthcoming Georgia-EU Action Plan under the EU European Neighbourhood Programme. In that regard, the EU Water Initiative is an important instrument for supporting related investment and close co-operation is in place with EBRD under that initiative in Georgia.

Annex 4 provides further analysis of environmental developments in Georgia.

## 3. PROGRESS IN TRANSITION AND TRANSITION CHALLENGES

### 3.1. Progress in Transition

Georgia compares well with the rest of the CIS countries in progress with the first phase of reforms, especially price and trade liberalisation and small-scale privatisation which is largely completed (Table 3.1). Although the second phase reforms that focus on institution building are more difficult and require more time to implement, recent progress and the reform momentum suggests an optimistic scenario.

Table 3.1: Transition Indicators of Commonwealth of Independent States (CIS), 2005

Countries	Price liberalisation	Trade & foreign exchange system	Competition policy	Large-scale privatisation	Small-scale privatisation	Governance & enterprise restructuring	Banking reform & interest rate liberalisation	Securities markets & non-bank financial institutions	Infrastructure reform
Armenia	4-	4	2+	4+	4+	2+	3-	2	2+
Azerbaijan	2	4-	2+	4	4	2	2+	2-	2

Belarus	1	2+	1	3-	2+	2	2-	2	1+
<b>Georgia</b>	<b>4-</b>	<b>4</b>	<b>2+</b>	<b>4+</b>	<b>4+</b>	<b>2</b>	<b>3-</b>	<b>2-</b>	<b>2+</b>
Kazakhstan	3	4	2	4	3+	2	3	2+	2+
Kyrgyz Republic	4-	4	2	4+	4+	2	2+	2	2-
Moldova	3	3+	2	4-	4+	2	3-	2	2+
Russia	3	4	2+	4	3+	2+	2+	3-	3-
Tajikistan	2+	4	2-	4-	3+	2-	2	1	1+
Turkmenistan	1	2	1	3-	1	1	1	1	1
Ukraine	3	4	2	4	3+	2+	3-	2+	2
Uzbekistan	3-	3	2-	3-	3-	2-	2-	2	2-

The index ranges from 1, indicating little or no progress to 4.3 pointing to standards similar to advanced economies

Source: EBRD Transition Report, 2005

Georgia has accomplished a wide range of structural reforms during 2004, 2005 and in the first half of 2006 (see more details in Section 3.2). Progress has been achieved with the large-scale privatization programme launched in September 2004. The programme envisages the quick sale or liquidation of more than 1800 remaining state-owned enterprises as well as farm land over 18 months. Among large companies sold since then was the shipping company Georgia Ocean, the metallurgical plant JSC Madneuli, two telecom companies, and two energy distribution companies (see enterprise sector section below). The government has recently invited bids from some additional large enterprises including the Rustavi metallurgical plant.

Progress has also been made in improving the business climate. An ambitious civil service reform was launched in 2004 as a parallel measure to combat corruption. Changes to the tax code introduced in the beginning of 2005 reduced the number of taxes from 21 to 7 and broadened the tax base, thus making the tax system more equitable and creating a more favourable business climate. A new licensing law, passed in July 2005, provides a 'one stop shop' and 'silence is consent' system for issuing licenses.

### **3.2. Transition Challenges**

The key transition challenges faced by Georgia are the following:

#### **3.2.1. Enterprise Sector**

Georgia has made good progress towards improving the business climate as also indicated by the (BEEPS), 2005. An ambitious civil service reform was launched in 2004 as a parallel measure to combat corruption. During that year 30,000 jobs were cut, the resultant savings being applied to financing a gradual increase in the remuneration of the remaining civil servants. Changes to the tax code were introduced in 2005, helping enhance the business climate. The government has also introduced legal reforms for simplifying the business licensing system to reduce corruption.

According to Transparency International's *Corruption Perceptions Index* (CPI) for 2005, Georgia ranks 130<sup>th</sup> out of 158 countries – in the same place as Kyrgyz Republic and only better than Azerbaijan, Uzbekistan, Tajikistan and Turkmenistan among the transition economies. Its CPI score improved from 2.0 in 2004 to 2.3 in 2005 (1.8 in 2003).

At the same time, the large-scale privatization programme launched in September 2004 has progressed quite well. More than 240 enterprises were sold to date and another 137 are currently for

sale. Armstrong Holdings ASP (UK-Australia) bought the shipping company Georgia Ocean for USD93 million. The American company, International Tinsel Inc, bought Georgia Telecom for USD 5 million. Russia's Vneshtorgbank bought a 51 per cent stake in United Georgian Bank. In November 2005, Stanton Equities Corporation (BVI) bought the metallurgical plant JSC Madneuli for USD35.1 million. In May 2006, Danish Greenoak Group, which already owns Batumi Oil Terminal, won a management contract to lease and operate the Batumi Sea port for 49 years for US\$ 92 million.

A gradual improvement of the investment climate is expected in the medium term. The authorities have amended the customs legislation which is expected to lead to greater transparency in enforcement and is working on strengthening the judiciary. The legal framework for secured transactions has been improved with a new law that came into force in July 2005 and a centralised pledge registry for movable property is being established. A draft new insolvency law was finalised with the EBRD's assistance in 2005 and awaits government approval in order to be submitted to Parliament.

Nevertheless, major challenges remain. Further changes in the legislative and regulatory framework for the enterprise sector are necessary to reinvigorate the private sector and attract foreign investment. The judiciary lacks independence from the executive and also lacks experience in modern commercial law. Also, incidents of heavy-handed implementation of anti-corruption measures with little apparent respect for property rights have affected investor confidence. Implementation of newly enacted legislation, strengthening of the public administration and further reduction of corruption are key issues. Restructuring of former state owned enterprises and creation of dynamic and transparent private businesses remain an ongoing process.

### **3.2.2. Infrastructure**

#### ***3.2.2.1. Energy Sector***

The energy sector remains a fundamental bottleneck for businesses due to unreliable power supply. A related problem is the high level of indebtedness of the energy companies. Despite reasonably sound regulation and tariff reform in the electricity network, very low collection rates and energy theft were the major obstacles to energy efficiency in the past. Chronic underinvestment has translated into a deterioration of the power infrastructure, leading to large energy losses and high energy intensity. For example, in 2003, the energy intensity of the economy was 0.73 in nominal terms and 0.22 in power purchase parity (PPP) terms, respectively almost four times and 40% higher than in the EU-15.

Action has been taken to improve technical and financial viability of the sector by strengthening payment discipline and increasing cash collection from key customers. Aided by an ongoing extension of metering to rural areas, the measures have contributed to an increase in cash collection for distribution companies and to a reduction of the quasi-fiscal deficit in the energy sector from 4.9 to 4.7 per cent of GDP in 2004. However, the non-payment rate for electricity outside Tbilisi remained high through 2004 and saw some material improvement in 2005 (over 70% of billing), while payment discipline in the gas sector has not yet improved.

Reform in the sector is ongoing and essential rehabilitation of power plants is under way. In June 2006, two major regional distribution companies – the United Distribution Company and JSC Adjara Energy Company, as well as six power stations, were sold to the Czech company ENERGO-PRO. A new tariff structure being implemented with the support of the World Bank is intended to achieve cost recovery by mid-2006.

Progress is also imminent with regard to strengthening security of gas supply. Millennium Challenge Georgia is currently implementing a USD 40 million project for rehabilitating sections of the main gas transit pipeline, which delivers gas from Russia. The EBRD is working to supplement this rehabilitation work with a USD 40 million loan to complete the core rehabilitation work with loan repayments expected for carbon credit sales resulting from

reduction of gas leakage from both projects. In addition, KazTransGas, Kazakhstan's national gas transmission company, has purchased TbilGas, the gas distribution company for Tbilisi. The Company intends to undertake on an urgent basis, essential rehabilitation work on related gas supply infrastructure.

### ***3.2.2.2. Physical Infrastructure and municipal utilities***

The rehabilitation of decaying physical infrastructure is a major challenge in Georgia. This is important to enable the country to take advantage of its geographic position as an important transit link between the South Caucasus, Central Asia and Europe. The railways are still operated as an unbundled state owned company although some restructuring efforts have already been made. In roads, most construction and maintenance units have been privatised but the institutional framework is still to be reformed.

The BTC oil pipeline is expected to provide Georgia with transit fees at up to USD 50 million per annum by 2009, while the SCP gas pipeline will also provide Georgia with an estimated USD 30-40 million in gas as payments in kind. In order for Georgia to fully benefit from the BTC and SCP pipelines, transparency in revenue management will be essential.

Lack of investments and mismanagement of municipal utilities in Georgia which have negatively affected their technical state have underlined the urgent need for private-sector involvement in the sector. The lack of investment and maintenance has resulted in a very low quality service level from local water utilities. Several of the smaller Georgian cities face chronic water supply problems. Water supply rationing and the lack of metering also result in low payment rates from the population, which in turn affect investments. Improvement of water supply in the regions is one of the priorities of the government's poverty reduction strategy and the Municipal Development Fund is now taking an effective role in managing a range of municipal projects. At the same time, the provision of public sector transport in municipalities lacks transparency and efficiency, is unregulated, and needs significant investments for upgrade. Improving the service and regulation of public transport services is currently one of the major priorities of many municipalities in Georgia. A further priority for many municipalities is to ensure that solid waste management practices are strengthened and related investment undertaken in a manner that complies with European standards

### **3.2.3. Financial Sector**

Financial intermediation has seen rapid growth during the past two years albeit from a very low base. While domestic credit to GDP ratio grew by about 40 per cent in nominal terms in 2005, domestic credit to private sector rose by more than 70 per cent in real terms. Domestic credit to private sector increased from 8.7 per cent of GDP in 2003 to 14.8 per cent in 2005. Banking supervision has been considerably strengthened while the National Bank has introduced a gradual increase in capital requirements and stricter limits on single party borrowing.

Recently, the National bank has improved the legal framework and further strengthened requirements for financial reporting from the commercial banks. Amendments to the Law on Commercial Bank Activities were made to improve the transparency of ownership and corporate governance of banks. In March 2006 the restriction under which one shareholder (or a group of joint shareholders) could not hold more than 25 per cent of voting shares in a bank was abolished. The rules for the proportion of shares that can be acquired in a bank with or without consent of the National Bank are currently under discussion. A new law has been drafted that would remove restrictions on the inflow of foreign capital and that would make it easier for foreign banks to enter the local market. A new law that regulates the activity of Micro-Finance Organizations came into force in August 2006.

However, while higher reserve requirements on foreign exchange have contributed to the decrease of credit in US dollars, the banking system remains vulnerable to exchange rate fluctuations with more than 70 per cent of credit still in US dollars. Despite ongoing consolidation the banking sector still contains a number of weak and undercapitalised banks.

Further strengthening of banking supervision and implementation of consolidated supervision of banks, as well as improvement of risk management are necessary to guard against the risks of current rapid credit growth. The current structure of the financial system where commercial banks are owners of insurance companies that can only invest in bank deposits, introduces other vulnerabilities in the system since a failure of commercial banks can affect the insurance sector.

Basic legislation and regulation of securities markets are in place but the regulator is not financially independent and intermediaries are not required to have internal control mechanisms in place. Insurance legislation and regulation fall short of IAIS standards. Capital markets and the insurance market remain small and leasing companies operating in the market are yet to be regulated. Private pension funds are virtually non-existent.

#### **3.2.4. Access to Capital**

In recognition of the reform progress in the country, in December 2005, the rating Agency Standard & Poor's assigned a B+ long-term and B short-term sovereign credit ratings to the government, with a positive outlook. This is the first time the country received a credit rating from a rating agency and it may help the country to get access to international finance.

Foreign direct investments have increased in the past two years mainly related to the construction of the oil and gas pipelines. The ongoing privatisation programme has also attracted some FDI in the mineral resource sector. Additional important investment sectors are hotels and restaurants, distribution companies, construction, and mining. FDI reached USD 503 million in 2004 and decreased to about USD 415 million in 2005 after the completion of BTC construction in May 2005. There is evidence however of increased diversification in the sectoral spread of FDI and the volume of non-BTC FDI increased by 32 percent during 2005.

Georgia has significant spending needs in infrastructure, including energy sector and physical infrastructure in support of poverty reduction. The government's reform efforts have received significant international support, with USD 1.1 billion in aid pledged by donors for 2004–06. In September 2005 Georgia qualified for inclusion in the US Millennium Challenge Account, and an agreement was signed for USD 295 million of investments, mainly in infrastructure, over the next five years.

Nevertheless, Georgia's creditworthiness continues to be constrained by inadequacies in the economic structure and capacity. This is also reflected in the increasing trend of the share of external debt from official creditors (also because of the IMF limit on zero borrowing on non-concessional terms) compared to debt from commercial creditors.

## **4. STRATEGIC ORIENTATIONS**

In response to the Transition Challenges identified, the Bank will concentrate on the following priority areas: (i) energy security and efficiency; (ii) support for critical municipal and other infrastructure and state-owned enterprises (SOEs); (iii) financing for the enterprise sector; (iv) expanding the Bank's presence in the financial sector (banking and non-bank microfinance institutions); (v) investment climate and policy dialogue. The Bank will continue to actively pursue implementation of the ETCI in Georgia. To this end, new funding instruments will continue to be designed and implemented, while donor support and collaboration remain critical to success.

### **4.1. Energy Security and Efficiency**

In view of the current situation in the energy sector and the on-going sector restructuring and far-reaching reform efforts of the authorities supported by the donor community, the Bank will focus on the following:

- Work will continue to complete the strategically important Enguri HPP Rehabilitation project in conjunction with donor community efforts to further improve the overall situation in the power sector. The Bank will also work to identify investment opportunities in renewable/alternative energy sources, including mini and small HPPs in the country's regions.
- Progress on power sector privatisation will be closely monitored with the objective of providing post-privatisation support.
- Work to support rehabilitation of Georgia's main (North-South) gas pipeline is progressing in close collaboration with the MCG. Assistance is already being considered to promote investment in the Tbilisi gas distribution system.
- Energy efficiency investment opportunities will be actively pursued in both the private and public sectors. The Bank will continue to support prospective clients addressing energy efficiency by arranging energy audits and other energy efficiency supporting activities (e.g., energy management training - funded by the Austrian Trust Fund). In particular the Bank will explore the possibility to finance small- and medium-sized entities in the industrial and residential sector through a dedicated credit line, subject to availability of TC and grant co-financing.
- Special emphasis will be placed on assisting Bank clients to take advantage of the Clean Development Mechanism (CDM) for investments that significantly reduce greenhouse gas emissions. The Bank can offer its clients technical assistance for the CDM from a Project Support Facility, which is funded by the ETC Multi Donor Fund (MDF).
- Further Technical Assistance may be considered to help increase leverage and efficiency of investments, as well as to support the authorities' efforts to reform regulation of the sector.

#### **4.2. Municipal and Other Infrastructure and State Owned Enterprises (SOEs)**

The Bank's involvement in infrastructure will concentrate on priority municipal projects and regional transit infrastructure. The government has increased its focus on municipal development as the long established Municipal Development Fund has recently been upgraded and is now taking an effective role in managing a range of municipal projects. The Bank will concentrate on the following:

- In view of the urgent need to rehabilitate the water supply system in a number of municipalities, including Tbilisi, investments will be processed, in parallel with grant financing from the Millennium Challenge Georgia (MCG), for the cities of Poti, Kutaisi, Rustavi and possibly other cities. Waste management and landfill projects will be considered for Batumi and Tbilisi.
- In transport, the Bank will strive to build on its past experience and focus on new business opportunities with the state-owned railways company, without sovereign guarantees. Opportunities will also be explored to help finance rehabilitation of rural roads. Priority will be given to projects with a regional focus and those forming part of the EU's TRACECA initiative.
- The Bank will also seek to replicate the experience gained in the financing of a concessionaire for the construction of new airport facilities at Tbilisi and Batumi Airports, where a 20 year Build Operate Transfer ('BOT') concession contract has been awarded. This was parallel financed with the IFC. Further opportunities will be sought in the port and airport sectors.



- Close monitoring of the BTC and SCP pipeline projects with a specific focus on social and environmental impact, revenue management transparency and the continued implementation of the EBRD-BP/BTC sponsored Regional Development Initiative. As with any large-scale infrastructure project there are always expectations within the community that are not met and issues that need resolving. Appropriate mechanisms are in place to ensure that these issues are dealt with.
- Privatisation or private sector participation opportunities will be pursued in (but not limited to) the fields of telecommunications and infrastructure services. Energy efficiency and environmental components should be considered as part of such investments.

Of note is the memorandum of understanding between EC, the EBRD and the European Investment Bank (EIB) on co-financing of regional infrastructure in the countries of Eastern Europe, the Caucasus and Central Asia, This is still subject to the European Council's approval of the EIB's proposed extended mandate but would provide for a more structured framework for co-operation in the region, focussing on cross-border infrastructure.

### **4.3. Enterprise Sector**

The Bank will work to directly or indirectly support private sector enterprise development and to further expand its micro business and SME financing. Given the importance of the enterprise segment to poverty reduction and the long-term sustainable development of the country, the Bank under its ETC initiative will continue to implement appropriate financing instruments, seeking further innovation and flexibility. More specifically, the Bank will:

- Work with local financial intermediaries to provide further support for MSMEs and micro enterprises through credit lines, and expanded trade guarantee facilities.
- Further promote the MCFF – risk sharing co-financing with local financial intermediaries to their best medium- and larger-sized private clients. TC will be provided, as may be required, to help overcome key bottlenecks identified and help increase the number of sub-projects to be co-financed.
- Identify business opportunities for the implementation of the Direct Lending Facility.
- Consider further equity investments in local enterprises through the Direct Investment Facility (DIF). Work to synergise between the DIF projects and the MCFF and DLF lending mechanisms to optimise project structuring.
- The Bank will work to take advantage of lending to micro and small rural businesses via specialised non-bank microfinance institutions, regional NGOs and the partner banks.
- Expand the outreach of the Bank's advisory services through TAM and BAS Programmes. Continue to work toward further synergies with the EBRD's and local banks' funding activities to achieve a multiplier effect and use TAM experts on our equity deals in local companies.

### **4.4. Financial Sector**

Support to the best performing local commercial banks in the form of senior, subordinated and syndicated debt, as well as equity in local banks, will continue with a view to strengthening the banking sector and improving financial intermediation. New banks will be targeted for expanding sector cooperation. The Bank will continue to play an active role in the development of non-bank financial activities, such as leasing, insurance and mortgage financing, including through taking equity positions. The Bank's operational objectives would include:

- Expansion of existing and provision of new lines of credit to local partner banks, while at the same time working to introduce client-orientated product flexibility. This would include the first EBRD mortgage loans in Georgia together with -associated technical cooperation.
- Build on the experience with the MCFF and provide targeted Technical Assistance to address shortfalls identified to promote sound and viable private sector medium-sized projects, and to enhance the services provided by the local banks in this market segment.
- Equity participations in selected banks. The Bank will continue to selectively consider taking equity in well-performing Georgian banks. Equity exits will be considered in banks where significant progress has been achieved and market opportunities arise. Appropriate technical assistance will be made available to support this activity.
- New FDI and merger opportunities will be examined and promoted as the Georgian banking sector is expected to continue consolidation encouraged by the regulator.
- As a means to promote regional co-operation, the Bank will continue to enhance implementation of its Trade Facilitation Programme by encouraging better utilisation and through inclusion of new participants.
- The Bank will continue to implement new projects in the non-banking financial sector (e.g. insurance, leasing and mortgage and consumer finance, micro and small business with non-bank microfinance institutions) and will seek to identify reliable and committed sponsors. Technical assistance will be provided both to set up proper legal and regulatory frameworks (in selected areas) and to structure investment projects.

#### **4.5. Policy Dialogue and Investment Climate**

In close co-ordination with other IFIs and bilateral donors, the Bank will expand its policy dialogue with the national authorities and with the local business community on actions needed to improve the investment climate, including legislative and regulatory reform, as well as institutional strengthening, both in the context of its operations and the government's plans for implementing the country's EDPRP. The Bank's efforts will specifically focus on the following:

- The Bank will continue the dialogue with the authorities over power sector reform and will monitor sector privatisation. Special attention will be devoted to reforms of the regulator and of tariff policies. The Bank will maintain its leading role in the donors' co-ordinating working group to enhance sector cooperation.
- SME policy dialogue initiated by the Bank will continue and the Bank will seek to leverage on past joint initiatives with other donors and participate in various local business association initiatives to help promote public-private sector dialogue.
- The Bank will continue to seek opportunities to provide legal transition assistance (e.g. improvements to the laws on secured transactions and insolvency, reform of concession laws, and improved corporate governance).

#### **5. CO-OPERATION WITH IFIs AND OTHER DONORS**

Co-operation with other donors is crucial in Georgia and the Ministry of Finance has taken an impressive lead in ensuring such co-operation.. The main fields of co-operation will include:

- **Policy dialogue:** close co-ordination will be maintained among donors in addressing the need to improve the investment climate. The Bank will seek donor support and active participation in efforts to further promote public-private sector dialogue and help address business concerns over aspects of the investment climate emerging from time to time.
- **Power sector:** the donors involved will continue their close co-operation in implementing the sector-wide Strategic Business Plan developed by the Ministry of Energy and privatisation promoted by the Government.
- Other essential **infrastructure:** the Bank will seek to synergise efforts to address critical bottlenecks in co-operation, with the assistance of the donor community. Technical Assistance and grant co-financing will be sought to help finance key public sector projects (e.g. municipal and transport infrastructure) as well as pre- and post-privatisation work
- **Financial sector:** within the framework of the Bank's ETCI apply higher leverage through the introduction and ongoing implementation of the funding instruments for the banking sector, where donors' TA support will be critical.

Annex 7 provides a summary of the assistance programmes under implementation from multilateral and major bilateral donors. The need for close co-operation between the donors, and with government programmes as defined in the EDRRP receives careful attention within the donor community. The US-funded Millennium Challenge Account which is advanced in implementation of its programme and the recently signed Action Plan under the EU European Neighbourhood Programme will provide key areas of focus for EBRD coordination efforts.

## **ANNEX 1: POLITICAL ASSESSMENT**

Georgia remains committed to and is making progress in applying the principles of Article 1 of the Agreement Establishing the Bank. Following the Rose Revolution of November 2003, the Georgian authorities demonstrated a strong commitment to democracy and market economy.

Since the last country strategy there have been sizeable achievements in economic reforms but major challenges still lie ahead, including further development of democratic institutions, further progress in the implementation of the rule of law, and unresolved territorial conflicts in Abkhazia and South Ossetia.

### **Political Environment**

Georgia's political crisis, following electoral fraud during the parliamentary polls and subsequent massive street protests, climaxed in the non-violent "Revolution of Roses" in November 2003. A subsequent presidential election on 4 January 2004 brought a landslide victory to Mikheil Saakashvili who received a broad mandate from the Georgian electorate to extricate the country from its difficulties. The March 2004 parliamentary elections further strengthened President Saakashvili's stance by bringing an overwhelming victory to National Movement-Democrats electoral bloc, led by the Georgian President.

Both sets of elections were assessed by international monitors as demonstrating commendable progress over previous elections and bringing Georgia closer to international standards for democratic elections, although some drawbacks were also noted.

The post-revolutionary government declared a wide-ranging reform programme aimed at reviving national economy, improving living standards of the Georgian population and reducing poverty. The anti-corruption campaign was put in the centre of the reform agenda, involving restructuring of the police, administrative reform and a creation of a streamlined and transparent public sector.

Three years after the Revolution of Roses, the Georgian authorities continue to adhere to their ambitious goals of combating corruption, improving governance, alleviating widespread poverty and resolving acute territorial conflicts. Tangible results have been achieved in fighting corruption and reforming police as well as in improving the country's overall economic performance. Reconstruction of the electricity system brought continuous electricity supply to the population, a big change to the past when electricity was limited to few hours a day. The civil service is undergoing significant reform as part of the government's programme of improving governance. The number of ministries has been reduced and many state agencies have been abolished. Georgia's qualification for the Millennium Challenge Account (MCA) was recognition of the progress made by the country on the reform path. At the same time, many daunting tasks remain, including restructuring of the judiciary, establishing the rule of law and restoring the country's territorial integrity.

Georgia is a presidential republic. There are many political parties, including opposition parties, and a vibrant network of NGOs. Georgia's Constitution, as amended, provides for separation of powers. The President is directly elected for five years and may serve for two consecutive terms. The President appoints the Prime Minister and gives consent to the appointment of other Ministers. .

Parliament amended the Constitution affecting its own composition, which will be coming into effect with regard to next parliament to be elected in 2008. According to the changes, the number of the MPs will be significantly reduced from 235 to 150. Up to 100 MPs will be elected through a proportional, party-list system, while up to 50 MPs will be elected in the first-past-the-post constituencies. Parliament also passed legislation reorganising local government. Under the new system, the law envisages direct elections to the councils. The head of the council or mayor will be elected among the new council members.

Strong executive powers of the presidency are not sufficiently balanced by parliament or judiciary, the latter being prone to corruption as well as pressure from the executive branch. It is important for future development of democratic institutions in the country not to concentrate power in the hands of a small elite which is not constrained by checks and balances.

### **Territorial Conflicts**

The resolution of the conflict in Adjara in May 2004 was a major victory for the Georgian government, leading to a peaceful restoration of Tbilisi's authority in the region. Georgian parliament confirmed autonomous status of the Adjara Republic in accordance with a constitutional law, which gives the Georgian President considerable powers over the Adjara structures.

Conflicts over South Ossetia and Abkhazia, which have erupted in the period following the break-up of the Soviet Union, remain unresolved and tension is likely to continue until the legal status of both entities have been agreed. Due to the two unresolved conflicts significant part of Georgia's territory remains beyond control of the Georgian authorities. The two conflicts have created thousands of internally displaced persons (IDPs).

A lack of trust between the sides has so far stymied significant progress toward a resolution. The resumption in May 2006 of the work of the Coordinating Council, serving as a forum for Georgian-Abkhaz dialogue, after a five-year suspension, brought some guarded optimism into the process. Previous experience showed that progress achieved during the negotiations on such issues as return of IDPs to their homes in Abkhazia is eventually blocked by a core political issue, that of the status of the territory. The peace plans, drawn both by Abkhazia and South Ossetia, envisage recognition of their sovereignty as independent states, while Tbilisi is not prepared to offer anything more than wide autonomy within Georgia. All parties must demonstrate their commitment to a peaceful solution of the conflicts with full respect of the territorial integrity of Georgia.

There is little doubt that the issue of restoration of territorial integrity of Georgia will continue to be the most challenging task facing the government. The UN and the OSCE has been actively involved in the resolution of both conflicts. The EU Special Representative for South Caucasus started to take more active role in the process and the European Commission is providing economic rehabilitation assistance to the conflict zones.

### **Human Rights and the Rule of Law**

Georgia has ratified the core UN Human Rights Conventions and the fundamental Conventions of the ILO. In the last three years the government's human rights record saw improvements in some areas but problems remain, as reported by human rights monitors.

The US State Department report on Human Rights Practices of March 2006, covering 2005, identified the following issues (similar problems were highlighted by other independent monitors such as Human Rights Watch): law enforcement officers tortured, beaten and otherwise abused detainees; inhumane and life-threatening prison conditions; corruption and impunity in law enforcement; arbitrary arrest and detention; lack of judicial independence; interference with citizens' right to privacy; government pressure on media; discrimination and harassment against some minorities; violence and discrimination against women and trafficking in persons. The report also indicated that during the year the government took a number of steps to improve the human rights situation, including measures reducing the amount of ill-treatment in pre-trial detention facilities. The status of religious freedom has also saw improvement through increased prosecution of harassers of non-traditional faiths.

As far as trafficking in persons is concerned, Georgia is a Tier 2 country, i.e. the country which is not fully complying with minimum standards for the elimination of trafficking but making significant efforts to do so, in accordance with the US Department of State 2005 Trafficking in Persons Report.

There are no major problems in the area of labour rights. The Constitution and respective laws allow the workers to organise and bargain collectively. The laws prohibit forced and compulsory labour. Georgia is party to a number of ILO conventions which provide for the abolition of child labour and non-discrimination in respect of employment and occupation.

### **External Relations**

A key foreign policy objective for Georgia is to capitalize on the country's strategic geographic location between the Caspian and the Black Sea, linking Asia and Europe. Major oil and gas pipelines, such as the BTC and South Caucasus pipeline, roads, railways and communications along the East-West corridor transit Georgian territory and are contributing factors to its future prosperity.

Georgia pursues a pro-Western foreign policy, while at the same time seeking to maintain balanced relations with its neighbours. Georgia is member of the Council of Europe and is in intensified dialogue with NATO. .

Relations with Russia have been strained since the first days of independence due to conflicts in Abkhazia and South Ossetia, timetable for the withdrawal of the Russian military bases from Georgia and Georgia's energy dependency on Russia. A major agreement with Russia envisages a complete close down of the two remaining Russian military bases by 2008.

Georgia has left the military structure of the CIS and is in the process of considering the option of leaving the organization altogether. The intention to leave the CIS was triggered, inter alia, by the ban on exports to Russia of Georgian wine and mineral water. Georgia is actively pursuing strengthening GUAM, a grouping currently comprising four countries - Georgia, Ukraine, Azerbaijan and Moldova.

## ANNEX 2: SELECTED ECONOMIC INDICATORS

### Georgia

	2000	2001	2002	2003	2004	2005 <i>Estimate</i>	2006 <i>Projection</i>
<b>Output and expenditure</b> <i>(Percentage change in real terms)</i>							
GDP	1.9	4.7	5.5	11.1	5.9	9.3	6.0
Private consumption	na	na	na	na	na	na	na
Public consumption	na	na	na	na	na	na	na
Gross fixed capital formation	na	na	na	na	na	na	na
Exports of goods and services	na	na	na	na	na	na	na
Imports of goods and services	na	na	na	na	na	na	na
Industrial gross output	5.3	-4.5	7.8	14.0	12.2	13.0	na
Agricultural gross output	-12.0	8.2	-1.4	10.3	-7.9	na	na
<b>Employment<sup>1</sup></b> <i>(Percentage change)</i>							
Labour force (end-year)	9.3	-2.2	-5.0	8.1	-4.4	0.7	na
Employment (end-year)	15.0	-2.1	-6.8	9.6	-6.3	-0.8	na
<i>(In per cent of labour force)</i>							
Unemployment (end-year)	10.4	10.3	11.9	10.7	12.5	13.8	na
<b>Prices and wages</b> <i>(Percentage change)</i>							
Consumer prices (annual average)	4.1	4.6	5.7	4.9	5.7	8.4	9.0
Consumer prices (end-year)	4.6	3.4	5.6	7.0	7.5	6.4	8.0
Producer prices (annual average)	5.8	3.6	6.0	2.3	3.8	7.2	na
Producer prices (end-year)	2.4	8.9	1.5	5.4	0.7	8.2	na
Gross average monthly earnings in economy (annual average)	7.1	30.8	20.5	10.4	19.9	22.5	na
<b>Government sector<sup>2</sup></b> <i>(In per cent of GDP)</i>							
General government balance	-4.0	-1.9	-2.0	-2.5	2.3	-1.5	-1.1
General government expenditure	19.1	18.2	17.8	18.7	19.7	24.9	na
General government debt	69.7	68.3	67.4	61.5	47.0	35.8	na
<b>Monetary sector</b> <i>(Percentage change)</i>							
Broad money (M3, end-year)	39.4	18.5	17.1	22.7	43.6	26.4	na
Domestic credit (end-year)	17.5	2.3	9.5	14.7	7.4	39.8	na
<i>(In per cent of GDP)</i>							
Broad money (M3, end-year)	10.3	11.1	11.6	12.4	15.5	16.6	na
<b>Interest and exchange rates</b> <i>(In per cent per annum, end-year)</i>							
Money market rate	18.2	17.5	27.7	16.9	11.9	7.7	na
Treasury bill rate (3-month maturity) <sup>3</sup>	26.0	29.9	43.4	44.3	19.2	na	na
Deposit rate (3-month) <sup>4</sup>	12.0	7.8	9.8	9.3	7.2	7.6	na
Lending rate (3-month)	32.8	27.0	31.8	32.3	31.2	21.6	na
<i>(Laris per US dollar)</i>							
Exchange rate (end-year)	2.0	2.1	2.1	2.1	1.8	1.8	na
Exchange rate (annual average)	2.0	2.1	2.2	2.1	1.9	1.8	na
<b>External sector</b> <i>(In millions of US dollars)</i>							
Current account	-136	-210	-196	-294	-430	-346	-739
Trade balance	-398	-486	-439	-598	-719	-932	-1,412
Merchandise exports	584	473	553	730	1,272	1,589	1,912
Merchandise imports	982	959	992	1,328	1,991	2,521	3,324
Foreign direct investment, net	153	80	122	335	503	415	390
Gross reserves, excluding gold (end-year)	109	161	198	191	383	474	na
External debt stock	1,582	1,712	1,858	1,954	2,039	2,137	na
<i>(In months of imports of goods and services)</i>							
Gross reserves, excluding gold (end-year)	0.9	1.4	1.6	1.3	1.8	1.9	na
<i>(In per cent of current account revenues, excluding transfers)</i>							
Debt service	16.7	19.3	7.4	10.0	10.2	8.9	na
<b>Memorandum items</b> <i>(Denominations as indicated)</i>							
Population (end-year, million)	4.6	4.6	4.6	4.6	4.5	4.5	na
GDP (in millions of laris)	6,043	6,674	7,456	8,565	9,824	11,592	13,000
GDP per capita (in US dollar)	658	697	741	877	1,139	1,416	na
Share of industry in GDP (in per cent)	17.3	16.6	17.6	17.7	16.1	15.6	na
Share of agriculture in GDP (in per cent)	20.2	20.7	19.3	19.3	16.4	14.8	na
Current account/GDP (in per cent)	-4.4	-6.5	-5.8	-7.4	-8.4	-5.4	-10.1
External debt - reserves (in US\$ million)	1,473	1,551	1,660	1,763	1,656	1,663	na
External debt/GDP (in per cent)	51.7	53.2	54.7	49.0	39.8	33.4	na
External debt/exports of goods and services (in per cent)	143.8	175.6	167.2	151.7	111.4	100.9	na

<sup>1</sup> Figures consistent with ILO methodology.

<sup>2</sup> General government includes the state, municipalities and extra-budgetary funds.

<sup>3</sup> Data relate to the average auction rates during the year.

<sup>4</sup> Data refer to average rates for local currency from international financial statistics.

## **ANNEX 3: LEGAL TRANSITION**

### **ASSESSMENT OF GEORGIA'S COMMERCIAL LAWS**

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws “on the books” (also referred to as “extensiveness”) and the actual implementation of such laws (also referred to as “effectiveness”). All available results of these assessments can be found at [www.ebrd.com/law](http://www.ebrd.com/law). This annex presents a summary of the results for Georgia, accompanied by critical comments of the Bank’s legal experts who have conducted the assessments.

#### **Capital Markets**

The primary legislation governing the securities market in Georgia is the Law on Securities Market adopted in December 1998 and last amended in August 2003.

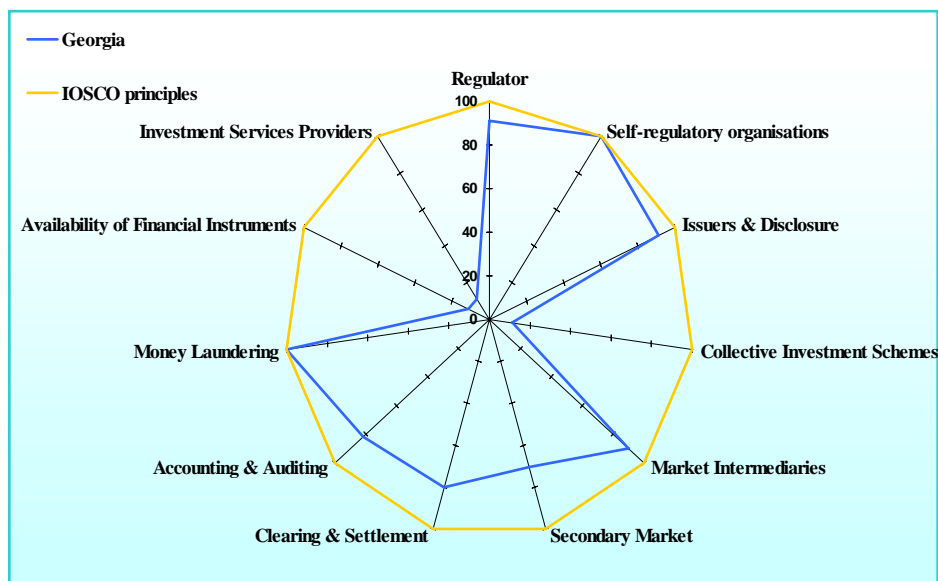
Pursuant to the Law on Securities Market, the National Securities Commission of Georgia (“NSCG”) was established in 1999 as an independent body in charge of the supervision, licensing and regulation of the securities market. The NSCG has five commissioners, who are appointed by the President and approved by the Parliament of Georgia.

The Georgian Stock Exchange (“GSE”) was established on 5 January 1999 and became officially operational in early 2000, pursuant to a license granted by the NSCG. The GSE was established as a self-regulatory non-profit organisation in the form of a joint stock company. In 2004, the number of trades executed at the GSE amounted to 1,094 with an overall volume of 30.51 million shares and overall value of GEL 46.68 million (around €20.83 million). The total number of trade sessions in 2004 was 102, with an average daily turnover of GEL 457,609 (around €204,204).

The Georgian Central Securities Depository (“GCSD”), in charge of central clearing and settlement of securities transactions, was set up in October 1999 and started activities in January 2000 after obtaining the license from the NSCG. All securities transactions conducted on the GSE are automatically forwarded to the GCSD for clearing and settlement. The GSE requires 100% pre-deposit of cash and securities through the GCSD prior to submitting offers to buy or sell securities on the GSE Trading System, in order to reduce execution risks.



## Quality of securities market legislation – Georgia (2005)



*Note:* The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in IOSCO's *Objectives and Principles for Securities Regulations*. The fuller the 'web', the closer the relevant securities market legislation of the country approximates

these principles.

*Source:* EBRD Securities Market Legislation Assessment 2005

In 2004, the EBRD benchmarked the Georgian securities markets legislation with the "Objectives and Principles of Securities Regulation" published by IOSCO. The results demonstrated that the national legislation is in "medium compliance" with international standards. As shown in the chart above, the major deficiencies were evidenced in the "Collective Investment Schemes", "Availability of Financial Instruments" and "Investment Service Providers" sections. This reflects gaps in the legal framework: collective investment schemes and investment service providers are not regulated by law and only a few regulated and defined financial instruments are available on the market. Large exposures are not monitored and there are no mechanisms to protect customers' trades and positions in case of an intermediary's insolvency.

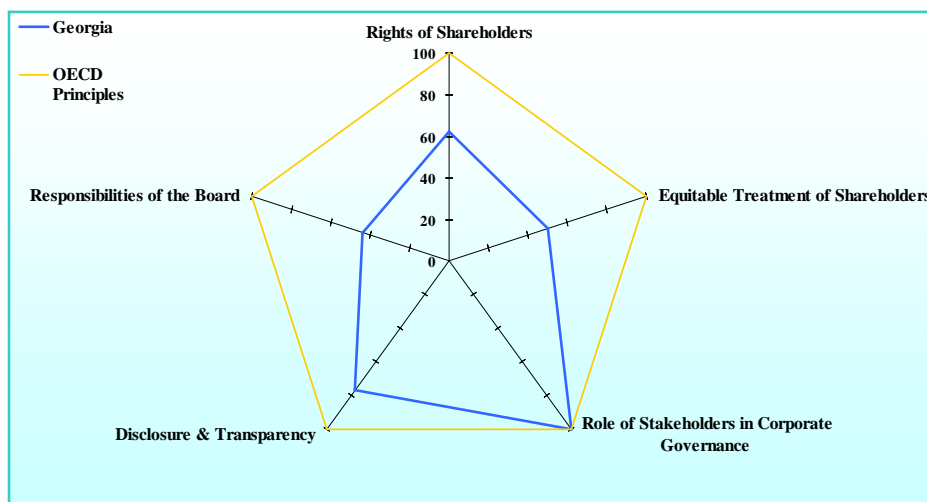
An update of the assessment has been recently prepared, which reports no substantial changes in the legal framework and confirms the "medium compliance" rating.

### Company Law and Corporate Governance

The principal Georgian legislation dealing with corporate governance is included in the Law on Securities Market – see section above – and in the Law on Entrepreneurs enacted in October 1994 and last amended in August 2003.

According to this law, enterprises can be organised as an individual enterprise, a joint liability company, a limited partnership, a limited liability company, a joint-stock company ("JSC") and a cooperative. Any enterprise - except a cooperative – having more than 50 partners is required to be established as a JSC.

## QUALITY OF CORPORATE GOVERNANCE LEGISLATION – GEORGIA (2004)



*Note:* The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles

*Source:* EBRD Corporate Governance Sector Assessment, 2004 assessment

According to the results of the EBRD's 2004 Corporate Governance Sector Assessment, under which corporate governance related “laws on the books” were assessed, Georgia was rated as having achieved “low compliance”, when compared to the OECD Principles of Corporate Governance. As shown in the chart above, weaknesses were found especially in the “equitable treatment of shareholders”, “disclosure and transparency”, “responsibilities of the board” and “rights of shareholders” sections.

*In the 2004 assessment, Georgia actually received an improved rating compared to that of 2002-2003 (“very low compliance”) as a result of the amendments made to the Law on Enterprises and Law on Securities Market. A major change introduced by these amendments was to make all JSCs into so-called “reporting companies”, thereby subjecting JSCs to stricter disclosure and reporting requirements.*

However, several flaws remain. Among those, the assessment evidenced that the Law on Entrepreneurs fails to appropriately provide for shareholder control over matters such as dividend payments or company auditors. Particular attention should be paid to giving the board more responsibility for monitoring conflicts of interest of management, board members and shareholders, including misuse of corporate assets; the board should also be entrusted with the monitoring of governance practices under which it operates; board independence should be introduced as a concept and properly monitored. Finally, there are no provisions for ensuring that conflicts of interests of company officials are disclosed to the company and monitored; in this context, the law should allow for transactions not done on fair market values to be made invalid upon request.

In 2005, the EBRD conducted a survey for testing the effectiveness of corporate governance (how the law works in practice). A case study dealing with related-party transactions was designed. The case study investigated i) the position of a minority shareholder seeking to access corporate information on a presumed related-party transaction was indeed entered into by the company and ii) how compensation could be obtained in case damage was suffered. Effectiveness of the system for both questions was assessed based on four principal variables: complexity, speed, enforceability and institutional environment.

There are a number of procedures for obtaining disclosure in Georgia, but their

effectiveness is undermined by their complexity and the difficulty of enforcement. The time needed to obtain an executable court order varies from 3 to 5 months. Complexity is also an issue when assessing the procedures for obtaining redress; the executable judgement is generally obtained in about one year, but then at least 6-8 months should be added for the enforcement procedure.

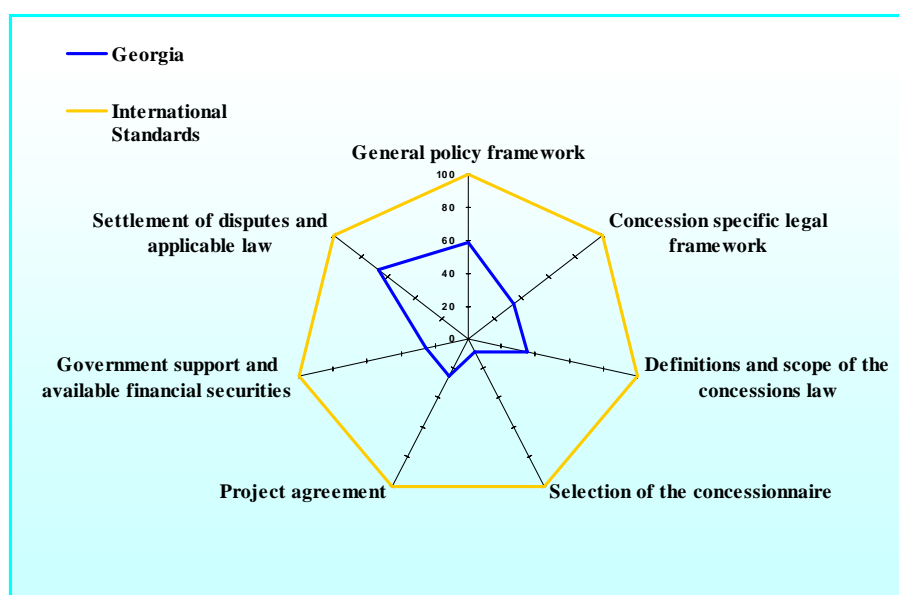
Regarding the institutional environment, the survey evidenced that company information is generally of good quality and statutory auditors fairly independent. Courts and market regulators are considered quite impartial, although their competence and experience need to be improved.

In summary, the complexity and length of the procedures and the difficulty of enforcement need to be tackled.

## Concessions

*The EBRD Assessment of Concession Laws undertaken in 2004/5 to evaluate applicable regime throughout the EBRD's 27 countries of operations (the laws on the books only rather than how they work in practice), revealed that Georgia's laws were in "very low compliance" with internationally accepted standards in this sector.*

### Quality of concession legislation –Georgia (2005)



*Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the 'web', the more closely concessions laws of the country approximate these standards.*

Source: EBRD Concessions Sector Assessment 2005

As can be seen from the above chart, rules governing nearly all dimensions need to be dramatically improved in order to meet the requirements of a modern legal framework facilitating private sector participation.

*The 1994 Law on Procedure for Granting Concessions to Foreign Countries and Companies" (the "Concessions Law") defines concession as a "leasing agreement" and seems to be limited to the natural resources sector. As can be seen from its name, the Concessions Law applies to foreigners only, discriminating against domestic investors and excluding them from concession arrangements.*

*Amongst the Concessions Law's numerous shortcomings, restrictions and omissions, the*

*following are of particular note. As far as definitions are concerned the Concessions Law contains a vague reference to “an authorised body as defined under legislation of Georgia” as the public authority to grant concessions. The selection procedure is very poorly defined, as is the disputes settlement procedure. There are numerous deficiencies with regard to the project agreement basic rules. The Concessions Law provides for the adoption of a list of objects that can or cannot be subject to concessions, but no such list seems to be publicly accessible. While containing very few concessionaire selection rules, the Concessions Law provides for the adoption of regulations in this respect; however, no such regulations are publicly available. Similarly, the Concessions Law refers to the establishment of a special register of concession agreements, but no such register seems to exist. Finally, the possibility of international arbitration is not clearly provided for.*

*Thus, the Law is very limited in scope, somewhat superficial in its nature, insufficiently clear, and lacks proper implementation.*

The Concessions Law does however contain a certain number of positive elements, e.g. the concessionaire’s right to appeal to the court or arbitration court “against public organs for their abuse of power”, reference to the obligation of the contracting authority to reimburse all damages suffered by the concessionaire due to “illegal acts of state organs” and provision of certain forms of government support/guarantees.

Overall, the Concessions Law does not constitute a sufficiently solid legal basis for the development of concessions or any other forms of public private partnerships and should be regarded as an early and outdated attempt to govern concession arrangements. As an immediate remedy pending full scale reform, certain elements of the Concessions Law might be improved by way of drafting regulations defining clearly rules and procedures for concessions application. However, the Concessions Law should, ideally, be fully revised in order to facilitate private sector participation in infrastructure, public utilities and services to meet the needs of a modern economy.

## **Insolvency**

|The process for commencing an insolvency proceeding continues to be quite slow – 45 days or more. During this time, there is an opportunity for significant erosion of the value of the assets of the estate. Forty-five or more days to hear and determine the merits of an application by a court is simply too long.

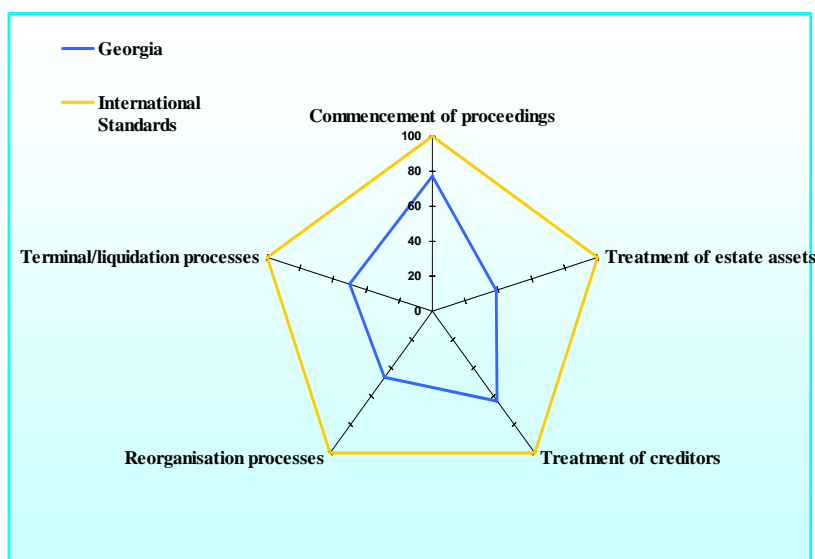
The definition of insolvency remains unclear and potentially open to abuse. The law further fails to establish any clear grounds that would enable a creditor to allege and establish that a debtor is insolvent.

A particularly disturbing provision of the Bankruptcy Law provides that the administrator is not obligated to return secured assets to secured creditors and, in fact, may sell such assets, deduct 25 per cent of the sale price for administrative costs and then remit the remaining proceeds to the secured creditor. This should have the effect of significantly increasing the cost of credit in Georgia as secured creditors will, upon bankruptcy, automatically be subject to this 25 per cent levy. Thereafter, the proceeds of assets realised upon are distributed first to employees, for a maximum of three months salary arrears and then, cryptically, to the appropriate parties for payment of taxes, fees and claims of international organisations. It is not clear what taxes and fees are claimed under this priority or what international organisations would enjoy priority. Only after these payments are made do ordinary trade creditors receive their distributions.

The Georgian government, with the technical assistance of the EBRD and financial assistance from the Canadian International Development Agency, drafted a new bankruptcy law in 2005 that can resolve these and other major problems. The new law can improve the insolvency system by providing greater certainty to creditors, adding transparency to the system and providing the rules necessary for the system to function efficiently.

Adoption and implementation of the new law can improve the investment climate in the country and the government is encouraged to make the relevant measures to bring this about.

### Quality of insolvency legislation – Georgia (2004)



*Note:* The extremity of each axis represents an ideal score, i.e., corresponding to the international standards such as the World Bank's Principles and guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on "Legislative Guidelines for Insolvency Law", and others. The fuller the 'web', the more closely insolvency laws of the country approximate these standards.

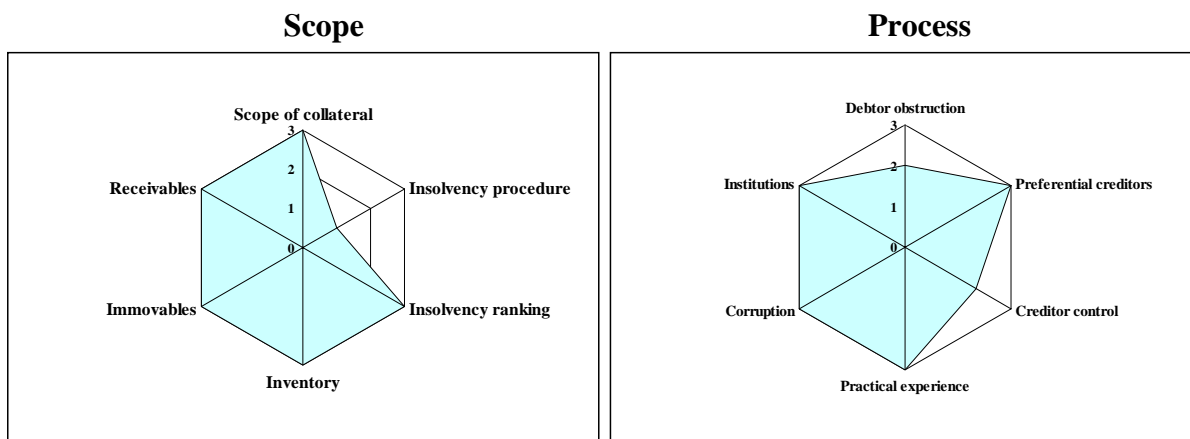
*Source:* EBRD Insolvency

Sector Assessment, 2003/4

### Secured Transactions

Secured transactions in Georgia have for a long time been recognised inadequate to support the development of a sound credit market (see chart below), and this is a serious impediment to access to credit and generally economic growth. For example, it does not seem possible to secure a credit line since the secured debt must be specifically described in the charging agreement; it is not possible either to offer as collateral assets which would be described in general terms (e.g., inventory or accounts receivable) or to pledge future assets, because the law provides very strict requirements. The registration system, where security over movable assets (pledges) must be recorded, does not function well and is being reviewed, although it is unclear when improvement can be expected. In addition, parties may decide to notarise their pledge agreement pursuant to the Civil Code, but since it is unclear whether the non-notarisation would have any consequence on the validity or enforcement of the pledge, parties must de facto proceed with notarisation. Enforcement procedures are not working well enough to provide the creditor a fair return upon realisation of the assets.

### Obstacles to charge enforcement process – Georgia (2003)



Note: The fuller the web, the more serious the problems are in each of the respective categories. “Process” factors measure the impact that specific obstacles would have on the enforcement proceedings. “Scope” factors give an indication of how effective enforcement would be when conducted on various types of collateral and in the case of debtor insolvency.

Source: EBRD Legal Indicator Survey 2003

Soon after the Rose revolution, the Ministry of Justice approached the EBRD to explore possibilities of technical assistance in this area. With EBRD and USAID assistance, new provisions of the Civil Code on pledge over movable property were prepared, and adopted in June 2005 (arts 254-285<sup>1</sup>). The new provisions provide for flexible, efficient and modern legal means for the creation, perfection and enforcement of a pledge, and are in line with the EBRD Core Principles for Secured Transactions Law. The new provisions rely on the institution of a new pledge registry and work is on-going on the development of such register, with the support of EBRD and USAID. Progress is slow and it is unclear when the institution will start functioning. The Civil Code provisions are deemed to have entered into force on 1 March 2006 but it is unclear whether they are operational.

Regarding mortgages, the Civil Code provisions that apply (art 286-310) have not been amended and present a number of shortcomings which seem to limit the development of an active mortgage market (especially residential). Registration of real estate, including mortgages, has been reformed in the last few years, with the development of a fully electronic database (albeit without a network between the different registration offices) and a streamline of the registration process. Some of the issues concern the enforcement of the mortgage, in particular the limitations to the right of eviction of occupants from the dwelling, as well as the ability that borrowers would have to severely delay and obstruct the enforcement process. EBRD is committed to help the government addressing some of these shortcomings.

### Telecommunications

The communications sector in Georgia is currently regulated by the Georgian National Communications Commission (the “GNCC”) and governed by the recently enacted Law on Electronic Communications, 2005. GNCC is an independent sector specific regulatory authority for communications, established in 2000. Its main functions relate to licensing, spectrum monitoring, tariff setting in regulated areas, the administration of universal service and other technical aspects connected to the communications sector. The Ministry of Economic Development is responsible for the development of sector policy.

The communications sector in Georgia remains underdeveloped. Fixed-line teledensity barely reaches 15%, with rural areas being particularly under-served. Two companies

control the incumbent fixed infrastructure inherited from the state: Sakartvelos Electrosvyaz (Georgian United Telecommunications Company) and Sakartvelos Telekom (Georgia Telecom). Both companies were recently fully privatised. These companies dominate the fixed market and the only other operator of any significance in the fixed marketplace is Egrisi (a privately owned cable TV based operator) holding approximately 25% share of the long distance/international market.

There are currently two main players competing in the Georgian mobile market, Magticom and Geocell. Mobile teledensity rate stood at just over 20%, with Magticom leading the market with approximately 55% share. Magticom also won public bids for new CDMA and 3G licences issued by GNCC in 2005. Two further 3G licences were issued this year following public competitions: one went to a new local entrant, Argotex, and the other to the Georgian arm of Russian Telecominvest.

All market segments including local, domestic long-distance, international long-distance, mobile, data and internet are formally liberalised. However, early relatively unchecked liberalising measures have resulted in a fragmented marketplace where, in reality, there appears to be little competition with fixed-line services being dominated by the incumbent operators. Much of the fixed network is now approaching obsolescence and is in need of significant upgrade going forward if the objectives of sector development are to be met.

While the sector suffered from the fragmentation resulting from early efforts at liberalisation, more recent developments are very encouraging. The completion of the privatisation of both incumbent fixed line operators should generate some badly needed investment for network upgrade and expansion. Privatisation should also finally mean an end to the old Soviet-style split between local/long distance and international, thereby facilitating more vigorous competition between the sector's main players. Also positive is the enactment of the 2005 Electronic Communications Law, moving Georgia well along the road to harmonisation with sector best practices.

Many challenges remain as Georgia moves forward with the development of its communications sector. To best achieve the goals that the government has set for the sector, vigorous and robust regulatory intervention will continue to be necessary for some time. Crucial to making this intervention a success is the full implementation of the revised regulatory framework envisaged in the 2005 Electronic Communications Law. This intervention will be best directed at ensuring that the incumbent dominated fixed market moves to a more competitive multi-operator environment and the deployment of the regulatory tools necessary to ensure that the new entrant mobile operators are able to successfully compete within the market. In this respect, interconnection, cost-orientation of tariffing and number portability (and in particular mobile number portability - MNP) will be a critical instrument in facilitating increasing competition and therewith access to communications services throughout the country. On the institutional side, while GNCC is one of the more progressive and independent regulators in the CIS, the government must continue to ensure that GNCC is afforded all resources necessary for them to fully implement the revised regulatory framework in the shortest appropriate timeframe.

#### **ANNEX 4: ENVIRONMENTAL DEVELOPMENTS**

Key environmental areas in need of further action, as defined in the National Environmental Action Plan (NEAP) adopted by the Government of Georgia in 2000, are as follows: rehabilitation and improvement of drinking water supply and sewage systems, improvement of public transportation and monitoring fuel quality, prevention of pollution by adopting best available technologies and clean production systems, efficient management of water resources by introducing economic instruments, introduction of integrated coastal zone management to address pollution issues in the Black Sea, and preservation of ecosystems including forest ecosystem. The latest Environmental Performance Review (EPR) 2003 from the UNECE recognises that the government has been trying to harmonise its environmental legislation with EU environmental directives. Georgia's environmental legislation is very elaborate and comprehensive; including sectoral environmental law, however further development of procedure law is required. The Georgian Ministry of Environment (GMOE) is the key agency in charge of implementation and enforcement of the environmental policy. Similar to many other countries in the region, Georgia has further potential to enforce the implementation of its environmental legislation and policies, and to enhance its institutional capacity.

In the Conference of EECCA Environment Ministers and Their Partners held in Tbilisi on 16-17 October 2004, Ministers emphasised that without institutional strengthening additional financial resources provided through international co-operation may be wasted, and that Ministries of Environment of EECCA need targeted support to become more effective and efficient. As a follow-up to the Tbilisi Ministerial Conference a new activity - a Policy Dialogue for Institutional Strengthening - was developed by the EAP Task Force Secretariat as a part of the 2005 work programme. The aim of a Policy Dialogue is to facilitate the efforts of the EECCA Ministries of Environment (MoE) to become more effective and efficient institutions. The objectives of a Policy Dialogue are:

- to support the selected MoE
- to identify critical institutional development needs to facilitate access of the selected MoE to relevant experience in OECD countries and new EU members, and
- to identify potential initiatives to address those institutional development needs.

The GMOE volunteered to participate in a pilot project on Policy Dialogue for Institutional Strengthening.

UK DEFRA and German Ministry of Environment are starting some follow-up activities on the Georgia Policy Dialogue Initiative. These activities include small short-term projects to be implemented by September 2006. One of the projects will assist the GMOE to develop a Corporate plan for Institutional Strengthening, to help them to manage and coordinate the different initiatives and projects and provide some hands-on advise and training to the selected staff of the Ministry. The second project will focus on providing some targeted and focused hands-on support on some aspects of the HRM. It would be good to discuss what are the activities planned under your projects in order to avoid overlaps.

In addition, the German Ministry of Environment (through CIM, the German Centre for International Migration and Development ) is also planning to finance a long-term expert (from 6 months- 2 years -the timing to be confirmed) to advise the management of the GMOE on issues related to the institutional strengthening.

Among other international financial institutions, the World Bank has been implementing Irrigation and Drainage Community Development Project and started the implementation of the Infrastructure Pre-Investment Facility (IPF) Project to facilitate infrastructure investments of strategic importance and/or special complexity, including Khudoni Hydropower project (HPP). UNDP has recently pursued 2 initiatives under GEF – a regional full size project for Control of Eutrophication, Hazardous Substances and Related Measures for Rehabilitating the Black Sea



Ecosystem, and a medium size project on Recovery, Conservation, and Sustainable Use of Georgia's Agrobiodiversity.

EBRD is about to start implementation of the Technical Cooperation project on providing Assistance to Ministry of Environment Protection and Natural Resources of Georgia. The key objective is to strengthen the capacity of the Ministry of Environmental Protection and Natural Resources of Georgia (MoE) in enforcing environmental legislation and introducing efficient project monitoring system and procedures. To achieve this objective, the Ministry should focus on formulation of policy and management plans and their subsequent implementation; as well as on monitoring of management plan, efficient control surveillance and enforcement procedures. This will require strengthening of the MoE through reorganization and staff training; assistance in preparation and implementation of management plans; developing and introducing monitoring, control, and surveillance system; and reform of the policy, legal and regulatory framework in the sub-sector to improve management, enhance private investment, and promote sustainable development and best environmental practice.

In order to efficiently coordinate the implementation of the project with other donor funded activities for the Ministry of Environmental protection and natural Resources, a Steering Group with participation of other international organisations and programmes will be established for this project.

Currently, the Bank is involved in significant investment activity in Georgia, in particular through the BTC project. The Bank continued the regular monitoring of environmental and social performance of the BTC and SCP projects through the use of the Independent Environmental Consultant, and through activities of staff in the Environment Department. The frequency of such monitoring will begin to be reduced as the projects move from construction into operation phase. Monitoring activities in the near future will have a strong emphasis on reinstatement activities.

In the electricity sector the Bank is involved in the rehabilitation of Enguri hydro power station where the investment focuses on improving the dam and power waterway operational safety, reducing environmental impacts and improving the occupational health and safety.

The Bank is putting a special emphasis on enhancing environmental and social risk management skills of the Financial Intermediaries in Georgia. The latest training was conducted in January 2006 under an EBRD/ETC Framework Contract to provide technical support for environmental due diligence (EDD) training for Financial Intermediaries (FIs). The objective of the assignment was to assist the FIs in developing and implementing appropriate environmental procedures based on EBRD's environmental procedures for FIs and to enable the EBRD to evaluate the extent to which the EBRD's environmental requirements for FIs are being complied with.

Specific tasks included:

- assessing the current environmental risk management procedures within existing selected EBRD FIs in Georgia;
- familiarise current and potential future FIs with recent changes in EBRD's environmental and social risk management policies (e.g. labour risks) and procedures (e.g., trade finance);
- to provide training to FIs in environmental risk management, and (iv) to update the Regulatory Overview for Georgia.

This assignment provided Technical Assistance to selected FIs in Georgia: Bank of Georgia (BoG), United Georgian Bank (UGB), TBC Bank (TBC), ProCredit Bank (PCB), and Bank Republic.

The Bank will continue to ensure that all EBRD operations in Georgia comply with the provisions of the Bank's Environmental Policy and incorporate, where appropriate, Environmental Action Plans into the legal documentation in order to address issues identified during due diligence, in line with the Bank's mandate to actively support environmentally sound and suitable development through its investment projects.

## ANNEX 5: BANK COMMITMENTS AND NET PORTFOLIO

(As at 31 October 2006, €million)

### by Sector

Sector Name	COMMITMENTS					NET PORTFOLIO				
	No. of projects	Total Project Cost	EBRD Funding	% of total EBRD	Disbursed	No. of projects	Portfolio	% of Portfolio	Undrawn commitment	Operating assets
<b>Financial Institutions</b>	<b>36</b>	<b>167.0</b>	<b>121.3</b>	<b>31.1</b>	<b>80.1</b>	<b>25</b>	<b>86.7</b>	<b>34.0</b>	<b>41.1</b>	<b>45.6</b>
<b>Infrastructure</b>	<b>7</b>	<b>147.5</b>	<b>63.2</b>	<b>16.2</b>	<b>36.4</b>	<b>6</b>	<b>43.8</b>	<b>17.2</b>	<b>26.8</b>	<b>17.0</b>
<i>Municip. &amp; Environmental Infr.</i>	3	23.3	8.6	2.2	3.0	3	8.3	3.3	5.6	2.7
<i>Transport</i>	4	124.2	54.6	14.0	33.4	3	35.4	13.9	21.2	14.2
<b>Energy</b>	<b>7</b>	<b>1574.6</b>	<b>157.7</b>	<b>40.5</b>	<b>130.7</b>	<b>4</b>	<b>96.2</b>	<b>37.8</b>	<b>27.0</b>	<b>69.2</b>
<i>Natural Resources</i>	4	1,320.8	89.5	23.0	66.4	2	72.2	28.3	23.1	49.1
<i>Power &amp; Energy</i>	3	253.8	68.2	17.5	64.3	2	24.0	9.4	3.9	20.1
<b>Specialised Industry</b>	<b>13</b>	<b>66.4</b>	<b>44.8</b>	<b>11.5</b>	<b>28.1</b>	<b>11</b>	<b>28.2</b>	<b>11.1</b>	<b>12.7</b>	<b>15.5</b>
<i>Agribusiness</i>	11	58.2	36.6	9.4	26.9	9	20.5	8.0	5.7	14.8
<i>Property &amp; Tourism</i>	2	8.2	8.2	2.1	1.2	2	7.7	3.0	7.0	0.7
<b>General Industry</b>	<b>1</b>	<b>17.1</b>	<b>2.5</b>	<b>0.7</b>	<b>2.5</b>	<b>0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Country Total</b>	<b>64</b>	<b>1972.6</b>	<b>389.5</b>	<b>100.0</b>	<b>277.9</b>	<b>46</b>	<b>254.8</b>	<b>100.0</b>	<b>107.6</b>	<b>147.2</b>

### by Portfolio Class and Investment Type

	COMMITMENTS					NET PORTFOLIO				
	No. of projects	Total Project Cost	EBRD Funding	% of total EBRD	Disbursed	No. of projects	Portfolio	% of Portfolio	Undrawn commitment	Operating assets
Private	57	1781.4	307.9	79.1	205.7	40	218.3	85.7	98.2	120.1
Public	7	191.1	81.6	20.9	72.2	6	36.5	14.3	9.4	27.1
<b>Country Total</b>	<b>64</b>	<b>1972.6</b>	<b>389.5</b>	<b>100.0</b>	<b>277.9</b>	<b>46</b>	<b>254.8</b>	<b>100.0</b>	<b>107.6</b>	<b>147.2</b>
Non-Sovereign	53	1812.9	306.4	78.7	204.2	39	217.9	85.5	98.2	119.7
Sovereign	11	159.7	83.1	21.3	73.7	7	37.0	14.5	9.4	27.5
<b>Country Total</b>	<b>64</b>	<b>1972.6</b>	<b>389.5</b>	<b>100.0</b>	<b>277.9</b>	<b>46</b>	<b>254.8</b>	<b>100.0</b>	<b>107.6</b>	<b>147.2</b>
Debt	38	1849.3	302.8	77.7	226.3	28	202.5	79.5	76.5	125.9
Equity	11	36.2	22.4	5.8	12.3	9	19.0	7.5	10.1	8.8
Guarantee (TFP)	6	29.1	27.7	7.1	7.4	5	27.7	10.9	20.3	7.4
Debt and Equity	9	57.9	36.5	9.4	31.9	4	5.6	2.2	0.6	5.0
<b>Country Total</b>	<b>64</b>	<b>1972.6</b>	<b>389.5</b>	<b>100.0</b>	<b>277.9</b>	<b>46</b>	<b>254.8</b>	<b>100.0</b>	<b>107.6</b>	<b>147.2</b>

ANNEX 5: BANK COMMITMENTS AND NET PORTFOLIO (CONTINUED)

(As at 31 October 2006, €million)

	Op Name	Total Project Value	EBRD Finance	Debt	Equity	Guarantee	Disbursed	Portfolio	Undrawn Commitment	Operating	Portfolio Class	
	<b>FINANCIAL INSTITUTIONS</b>											
	<b>Bank Lending &amp; Bank Equity</b>											
1	Absolute Bank Term Loan	1.5	1.5	1.2	0.3		1.5	0.0	0.0	0.0	Private	19/
2	Bank of Georgia - SME Loan	3.1	1.0	1.0	0.0		1.0	0.7	0.0	0.7	Private	23/
3	Bank of Georgia Capital Increase	0.8	0.8	0.0	0.8		0.8	0.0	0.0	0.0	Private	16/
4	Bank of Georgia Equity and Convertible Loan (debt & equity)	6.7	6.7	4.9	1.9		6.7	0.0	0.0	0.0	Private	16/
5	Bank Republic Equity	6.3	6.3	0.0	6.3		5.2	6.3	1.1	5.2	Private	15/
6	CBG Georgia (sub project of CBG FW) (equity)	4.0	0.5	0.0	0.5		0.5	0.0	0.0	0.0	Private	11/
7	Intellectbank (Sub Project of Georgia SME)	1.4	1.4	1.4	0.0		1.4	0.2	0.0	0.2	Private/Sov ereign	11/
8	MCFF - Bank of Georgia Full Recourse Portion	3.9	3.9	3.9	0.0			3.9	3.9	0.0	Private	14/
9	MCFF - TBC Bank JSC Full Recourse Portion	3.9	3.9	3.9	0.0		3.9	3.9	0.0	3.9	Private	13/
10	Regional TFP: Bank Republic (Guarantee & Pre-export)	2.4	2.4		0.0	2.4		2.4	2.4	0.0	Private	15/
11	Regional TFP: Bank of Georgia (Guarantee & Pre-export)	18.1	16.6		0.0	16.6	7.4	16.6	9.2	7.4	Private	29/
12	Regional TFP: TBC Bank (guarantee & pre-export)	2.1	2.1		0.0	2.1		2.1	2.1	0.0	Private	17/
13	Regional TFP: United Georgian Bank (UGB)	2.9	2.9		0.0	2.9		2.9	2.9	0.0	Private	24/
14	Regional TFP Cartu Bank	3.6	3.6		0.0	3.6		3.6	3.6	0.0	Private	28/
15	Regional TFP:TbilUniversalBank	0.0	0.0		0.0	0.0	0.0	0.0	0.0	0.0	Private	29/
16	TBC Bank (Sub Project of Georgia SME)	2.1	2.1	2.1	0.0		2.1	0.0	0.0	0.0	Private/Sov ereign	12/
17	TBC Bank - SME Credit Line	4.7	4.7	4.7	0.0		4.7	3.5	0.0	3.5	Private	19/
18	TBC Bank - Syndicated Loan	16.5	5.5	5.5	0.0		5.5	5.5	0.0	5.5	Private	20/
19	TBC Bank Mortgage Loan	11.8	11.8	11.8	0.0		5.9	11.8	5.9	5.9	Private	29/
20	TBC Bank SME Credit Line III	7.9	3.9	3.9	0.0		3.9	3.9	0.0	3.9	Private	26/
21	TbilComBank (Sub Project of Georgia SME)	1.9	1.9	1.9	0.0		1.9	0.2	0.0	0.2	Private/Sov ereign	12/

22	TbilcreditBank (Sub Project of Georgia SME)	2.4	2.4	2.4	0.0		2.4	0.0	0.0	0.0	Private/Sov ereign	12/
23	Tbiluniversalbanki (Sub loan of Georgia SME)	0.8	0.8	0.8	0.0		0.8	0.0	0.0	0.0	Private/Sov ereign	18/
24	Tbiluniversalbank Small and Micro-Lending Convertible Loan	1.7	1.7	1.1	0.6		1.7	0.0	0.0	0.0	Private	18/
25	United Georgian Bank (debt, equity)	5.9	5.9	4.1	1.8		5.9	1.8	0.0	1.8	Private	20/
26	United Georgian Bank Capital Increase	8.6	1.8	0.0	1.8		0.0	1.8	1.8	0.0	Private	09/
27	United Georgian Bank Credit Line 2004	7.9	7.9	7.9	0.0			7.9	7.9	0.0	Private	09/
		<b>133.0</b>	<b>104.3</b>	<b>62.5</b>	<b>14.0</b>	<b>27.7</b>	<b>63.4</b>	<b>79.2</b>	<b>40.9</b>	<b>38.3</b>		
	<b>Small Business Finance</b>											
28	Bank Republic - MSE Loan	2.4	2.4	2.4	0.0		2.4	2.4	0.0	2.4	Private	27/
29	ProCredit Bank Georgia	9.1	5.0	2.4	2.7		5.0	0.0	0.0	0.0	Private	30/
30	ProCredit Bank Georgia	11.8	4.7	4.7	0.0		4.7	2.4	0.0	2.4	Private	11/
31	ProCredit Bank Georgia: Add Senior Loan USD 3 million (FIISF)	2.4	0.0	0.0	0.0		0.0	0.0	0.0	0.0	Private	04/
		<b>25.6</b>	<b>12.1</b>	<b>9.4</b>	<b>2.7</b>	<b>0.0</b>	<b>12.1</b>	<b>4.7</b>	<b>0.0</b>	<b>4.7</b>		
	<b>Non Bank Financial Institutions</b>											
32	TBC Leasing - Equity Investment	0.1	0.1	0.0	0.1		0.1	0.1	0.0	0.1	Private	01/
33	TBC Leasing, Senior Debt	2.4	2.4	2.4	0.0		2.4	2.4	0.0	2.4	Private	21/
		<b>2.5</b>	<b>2.5</b>	<b>2.4</b>	<b>0.1</b>	<b>0.0</b>	<b>2.5</b>	<b>2.5</b>	<b>0.0</b>	<b>2.5</b>		
	<b>Equity Funds</b>											
34	Baring Vostok Private Equity Fund (Share for Georgia 3%)	4.1	1.9	0.0	1.9		1.6	0.3	0.2	0.1	Private	13/
35	First NIS Regional Fund (Share for Georgia 2%)	0.5	0.3	0.0	0.3		0.3	0.0	0.0	0.0	Private	21/
36	NIS Restructuring Facility (Share for Georgia 5%)	1.2	0.3	0.0	0.3		0.2	0.0	0.0	0.0	Private	16/
		<b>5.9</b>	<b>2.4</b>	<b>0.0</b>	<b>2.4</b>	<b>0.0</b>	<b>2.2</b>	<b>0.3</b>	<b>0.2</b>	<b>0.1</b>		
	<b>Total Financial Institutions</b>	<b>167.0</b>	<b>121.3</b>	<b>74.3</b>	<b>19.2</b>	<b>27.7</b>	<b>80.1</b>	<b>86.7</b>	<b>41.1</b>	<b>45.6</b>		

	Op Name	Total Project Value	EBRD Finance	Debt	Equity	Guarantee	Disbursed	Portfolio	Undrawn Commitment	Operating	Portfolio Class	
	<b>ENERGY</b>											
	<b>Natural Resources</b>											
37	Baku-Tbilisi-Ceyhan (BTC) Pipeline (Share for Georgia 50%)	1,020.6	49.1	49.1	0.0		49.1	49.1	0.0	49.1	Private	03/
38	Lukoil Overseas : South Caucasus Gas Pipeline (Share for Georgia 42%)	36.0	23.1	23.1	0.0			23.1	23.1	0.0	Private	28/
39	SOCAR - South Caucasus Gas Pipeline (Share for Georgia 42%)	40.0	7.1	7.1	0.0		7.1	0.0	0.0	0.0	Public/Non-Sovereign	04/
40	Frontera Resources (Share for Georgia 50%)	224.2	10.2	10.2	0.0		10.2	0.0	0.0	0.0	Private	15/
		<b>1,320.8</b>	<b>89.5</b>	<b>89.5</b>	<b>0.0</b>	<b>0.0</b>	<b>66.4</b>	<b>72.2</b>	<b>23.1</b>	<b>49.1</b>		
	<b>Power and Energy</b>											
41	Georgian State Electrosystem	75.7	30.4	30.4	0.0		26.5	19.8	3.9	15.9	Public/Sovereign	22/
42	Power Rehabilitation Project	18.6	14.2	14.2	0.0		14.2	4.2	0.0	4.2	Public/Sovereign	20/
43	AES Telasi	159.5	23.6	23.6	0.0		23.6	0.0	0.0	0.0	Private	30/
		<b>253.8</b>	<b>68.2</b>	<b>68.2</b>	<b>0.0</b>	<b>0.0</b>	<b>64.3</b>	<b>24.0</b>	<b>3.9</b>	<b>20.1</b>		
		<b>1,574.6</b>	<b>157.7</b>	<b>157.7</b>	<b>0.0</b>	<b>0.0</b>	<b>130.7</b>	<b>96.2</b>	<b>27.0</b>	<b>69.2</b>		
	<b>INFRASTRUCTURE</b>											
	<b>Municipal &amp; Environmental Infrastructure</b>											
44	Tbilisi Public Transport Project	3.2	3.1	3.1	0.0		3.0	2.8	0.1	2.7	Private	29/
45	Kutaisi Water Project	11.9	3.0	3.0	0.0			3.0	3.0	0.0	Public/Sovereign	15/
46	Poti Water Supply Project	8.2	2.5	2.5	0.0			2.5	2.5	0.0	Public/Sovereign	15/
		<b>23.3</b>	<b>8.6</b>	<b>8.6</b>	<b>0.0</b>	<b>0.0</b>	<b>3.0</b>	<b>8.3</b>	<b>5.6</b>	<b>2.7</b>		
	<b>Transport</b>											
47	Tbilisi International Airport	60.1	21.2	21.2	0.0			21.2	21.2	0.0	Private	17/
48	Georgia: Trans-Caucasian Rail Link Project	26.4	15.7	15.7	0.0		15.7	7.0	0.0	7.0	Public/Sovereign	22/
49	JSC Channel Energy Poti Port	27.5	9.1	9.1	0.0		9.1	7.3	0.0	7.3	Private	19/
50	Tbilisi Airport Refurbishment	10.2	8.6	8.6	0.0		8.6	0.0	0.0	0.0	Public/Sovereign	13/
		<b>124.2</b>	<b>54.6</b>	<b>54.6</b>	<b>0.0</b>	<b>0.0</b>	<b>33.4</b>	<b>35.4</b>	<b>21.2</b>	<b>14.2</b>		
		<b>147.5</b>	<b>63.2</b>	<b>63.2</b>	<b>0.0</b>	<b>0.0</b>	<b>36.4</b>	<b>43.8</b>	<b>26.8</b>	<b>17.0</b>		

<b>SPECIALISED INDUSTRY</b>												
<b>Agribusiness</b>												
51	DIF - Delidor	1.2	1.2	0.4	0.9		1.2	1.2	0.0	1.2	Private	17/
52	DIF - Georgian Hazelnut Production Ltd.	3.0	0.6	0.6	0.0			0.6	0.6	0.0	Private	26/
53	DIF - Iberia Refreshments	6.9	2.8	0.8	2.0		2.0	2.0	0.0	2.0	Private	25/
54	DIF - Lomisi	2.5	2.5	0.0	2.5		2.5	2.5	0.0	2.5	Private	20/
55	DIF - Teliani Valley	1.0	1.0	0.0	1.0		1.0	1.0	0.0	1.0	Private	20/
56	DLF - Georgian Hazelnut Production Ltd	2.5	2.5	2.5	0.0			2.5	2.5	0.0	Private	26/
57	Georgian Wines	3.9	3.9	3.9	0.0		3.9	0.0	0.0	0.0	Private	29/
58	Georgian Wines & Spirits Ltd.	7.3	5.7	5.7	0.0		5.7	5.7	0.0	5.7	Private	10/
59	MCFF - BoG Iberia Refreshments Sub-Loan (NRP)	2.5	2.5	2.5	0.0			2.5	2.5	0.0	Private	27/
60	MCFF - TBC Bank Lomisi Ltd Sub-Loan (NRP)	5.5	2.7	2.7	0.0		2.7	2.4	0.0	2.4	Private	03/
61	Borjomi	21.8	11.0	7.9	3.1		7.9	0.0	0.0	0.0	Private	25/
		58.2	36.6	27.1	9.5	0.0	26.9	20.5	5.7	14.8		
<b>Property and Tourism</b>												
62	MCFF TBC Bank - Nola Ltd Sub-Loan (NRP)	1.2	1.2	1.2	0.0		1.2	0.7	0.0	0.7	Private	22/
63	BSR Europe Co-Investment Facility	7.0	7.0	0.0	7.0			7.0	7.0		Private	14/
		8.2	8.2	1.2	7.0	0.0	1.2	7.7	7.0	0.7		
		66.4	44.8	28.3	16.5	0.0	28.1	28.2	12.7	15.5		
<b>GENERAL INDUSTRY</b>											Private	
64	Ksani Glass Packaging Factory	17.1	2.5	2.5	0.0		2.5	0.0	0.0	0.0		28/
		17.1	2.5	2.5	0.0	0.0	2.5	0.0	0.0	0.0		
<b>COUNTRY TOTAL</b>		1,972.6	389.5	326.0	35.7	27.7	277.9	254.8	107.6	147.2		

## ANNEX 6: PROJECT PIPELINE<sup>8</sup>

(as of 31 October 2006)

Sector	Million €	%	No. of Operations	%
<b>Financial Institutions, including:</b>	<b>36.2</b>	<b>24%</b>	<b>13</b>	<b>41%</b>
<i>Credit lines (MCFF)</i>	<i>15.4</i>	<i>10%</i>	<i>8</i>	<i>25%</i>
<i>Non Bank Financial Institutions</i>	<i>5.9</i>	<i>4%</i>	<i>3</i>	<i>9%</i>
<i>TFP</i>	<i>3.1</i>	<i>2%</i>	<i>1</i>	<i>3%</i>
<i>Equity</i>	<i>11.8</i>	<i>8%</i>	<i>1</i>	<i>3%</i>
<b>Specialised Industry (Agribusiness; Property &amp; Tourism; Telecoms Informatics &amp; Media)</b>	<b>31.9</b>	<b>21%</b>	<b>10</b>	<b>31%</b>
<i>DIF equity</i>	<i>5.8</i>	<i>4%</i>	<i>5</i>	<i>16%</i>
<i>DLF</i>	<i>2.2</i>	<i>2%</i>	<i>2</i>	<i>6%</i>
<i>Other Debt</i>	<i>12.1</i>	<i>8%</i>	<i>2</i>	<i>6%</i>
<i>Other Equity</i>	<i>11.8</i>	<i>8%</i>	<i>1</i>	<i>3%</i>
<b>Energy (Natural Resources, Power &amp; Energy)</b>	<b>39.2</b>	<b>26%</b>	<b>1</b>	<b>3%</b>
<b>Infrastructure (Municipal &amp; Environmental Infrastructure; Transport)</b>	<b>41.3</b>	<b>28%</b>	<b>8</b>	<b>25%</b>
<b>General Industry</b>	<b>0.0</b>	<b>0%</b>	<b>0</b>	<b>0%</b>
<b>Total</b>	<b>148.7</b>	<b>100%</b>	<b>32</b>	<b>100%</b>
<i>Of which:</i>				
<b>Private</b>	<b>101.2</b>	<b>68%</b>	<b>26</b>	<b>81%</b>
<b>Public</b>	<b>47.5</b>	<b>32%</b>	<b>6</b>	<b>19%</b>

<sup>8</sup> Projects having passed Concept Review or equivalent approval stage as of end-October 2006. This pipeline reflects only the current picture of projects in process and does not purport to represent the entire set of projects on which the Bank may be working over the next two years.

## ANNEX 7: TECHNICAL COOPERATION

Commitment Name	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Sector	Linked to Inv.
Procredit Bank of Georgia: Regional Expansion	589,021	468,732	25/07/05	Disbursing	Finance, Business	Y
Insolvency Law Reform in Georgia	275,109	200,731	29/10/04	Disbursing	Community/Social Services	N
Strengthening of the Georgian Insurance State Supervision Service (GISS)	178,100	49,501	10/11/04	Disbursing	Finance, Business	N
Georgia: Trade Finance Advisory Services	87,100	8,710	17/11/04	Disbursing	Finance, Business	N
Policy Dialogue and Support in the Georgian Wine Sector	156,972	0	25/01/05	Committed	Manufacturing	Y
Secured Transactions Law Reform in Georgia - Phase 1	77,400	58,400	25/01/05	Disbursing	Community/Social Services	N
Georgia: Trade Finance Advisory Services (Extension)	22,500	0	20/09/05	Committed	Finance, Business	Y
Secured Transactions Law Reform - Phase 2	244,000	91,445	06/10/05	Disbursing	Community/Social Services	N
TAM - Caucasautomagistrali	32,956	26,618	16/02/06	Disbursing	Manufacturing	N
Grain terminal	264,717	264,717	21/12/94	Closed	Transport, Storage	Y
EU TAM Programme in Georgia	403,075	403,075	30/08/02	Closed	Manufacturing	N
EU BAS Programme in Georgia	800,645	800,645	07/10/02	Closed	Manufacturing	N
Sea port grain import terminal - legal structure	237,331	237,331	08/12/95	Closed	Transport, Storage	Y
Bank of Georgia Institutional Building Programme	708,212	708,212	20/07/98	Closed	Finance, Business	Y
Trans-Caucasian Rail Link - assistance with project implementation	403,063	403,063	02/11/98	Closed	Manufacturing	Y
Georgia: Telecommunications Regulatory Development Programme	113,943	113,943	21/06/00	Closed	Telecommunications	N
Assistance with Implementing Restructuring Measures for Georgian Railways Ltd	500,000	500,000	16/08/00	Closed	Transport, Storage	Y
Telecommunications Regulatory Development Programme	7,165	7,165	11/12/01	Closed	Telecommunications	N
Georgia SME Line of Credit - Micro and Small Credit Advisors	650,000	641,334	06/08/03	Disbursing	Finance, Business	Y
Georgia SME Line of Credit - Micro and Small Credit Advisors Extension	550,000	481,598	17/12/04	Disbursing	Finance, Business	Y



SME Credit Line Regional Expansion - Micro Credit Adviser	92,319	92,319	11/02/03	Closed	Finance, Business	Y
Georgia SME Line of Credit - Micro and Small Credit Advisors	650,000	530,879	06/08/03	Disbursing	Finance, Business	Y
Georgia SME Line of Credit - Micro and Small Credit Advisors Extension	750,000	322,606	17/12/04	Disbursing	Finance, Business	Y
Poti Water Detailed Design Consultancy	49,850	0	09/05/06	Committed	Local Authority Services	Y
Georgia: Factoring Advisory Services for Banks & Factoring Companies	195,000	19,500	15/06/06	Committed	Finance, Business	Y
Tbilisi Public Transport Project: Project Preparation Services	160,000	132,070	04/02/05	Disbursing	Local Authority Services	Y
Judicial Capacity Building	95,000	14,000	31/05/05	Disbursing	Community/Social Services	N
Technical Assistance to Ministry of Environment - Georgia	250,000	0	06/10/05	Committed	Community/Social Services	Y
Kutaisi Water Company, IFRS Restatement and Audit	49,190	49,190	23/11/05	Committed	CEALs, CoFinancing Lines & RVF's	Y
Adjara Solid Waste Management, Credit Analysis	47,198	47,198	30/11/05	Closed	CEALs, CoFinancing Lines & RVF's	Y
Adjara Solid Waste Management, IFRS Restatement and Audit	49,800	0	13/02/06	Committed	CEALs, CoFinancing Lines & RVF's	Y
Tbilisi Public Transport Project - Regulatory Framework	200,000	0	13/02/06	Committed	Transport, Storage	Y
Georgia: Tbilisi Public Transport Project - Corporate Development Programme	450,000	40,950	13/02/06	Committed	Transport, Storage	Y
TAM - Elit Electronics	85,500	28,139	23/05/06	Committed	Manufacturing	N
Georgian Gas Transmission Pipeline Rehabilitation TC	313,842	35,963	12/07/06	Committed	Energy	Y
Bank Republic Credit Advisors	340,000	0	17/10/06	Committed	Finance, Business	Y
City of Kutaisi Municipal Water Project/City of Poti Municipal Water Project.	957,000	0	17/10/06	Committed	Local Authority Services	Y
Road Sector Financing and Institutional Study	175,000	0	23/10/06	Committed	Construction	Y
Georgia Regional Roads Project - Pre-Feasibility Study	198,000	0	23/10/06	Committed	Transport, Storage	Y
Georgia: TBC & Bank Republic - Assistance in Mortgage Lending	300,000	0	23/10/06	Committed	Finance, Business	Y
SME line of credit - project implementation	194,218	194,218	03/03/97	Closed	Finance, Business	Y
United Georgian Bank - institutional strengthening	257,205	257,205	30/03/98	Closed	Finance, Business	Y
SME Credit Line - Project Pipeline	66,627	66,627	06/09/96	Closed	Finance, Business	N

Development						
SME line of credit - project implementation	157,216	157,216	19/12/96	Closed	Finance, Business	Y
Institutional Support to TBC Bank - Resident Adviser	72,240	11,228	07/12/04	Disbursing	Finance, Business	Y
Microfinance Bank of Georgia ('MBG') Credit Advisor	398,985	398,985	29/05/01	Closed	Finance, Business	Y
SME line of credit - project implementation	48,787	48,787	10/12/98	Closed	Finance, Business	Y
Georgia SME Credit Line Project Implementation	94,190	94,190	16/08/99	Closed	Finance, Business	Y
Bank of Georgia Institutional Building Programme	112,732	112,732	14/12/00	Closed	Finance, Business	Y
Georgia Banking Supervision Assistance	106,574	106,574	13/03/01	Closed	Finance, Business	Y
United Georgian Bank - Institutional Support	85,719	85,719	26/04/01	Closed	Finance, Business	Y
Bank of Georgia Institutional Building Programme	47,914	47,914	05/06/01	Closed	Finance, Business	Y
Georgia SME Credit Line - Micro Credit Advisers	160,222	160,222	03/11/01	Closed	Finance, Business	Y
Institutional Support for Georgian Banks	140,684	140,684	30/11/01	Closed	Finance, Business	Y
United Georgian Bank Institutional Support II	65,037	65,037	19/07/02	Closed	Finance, Business	Y
Institutional Support for Georgian Banks	79,962	79,962	06/12/02	Closed	Finance, Business	Y
United Georgian Bank Institutional Support III	37,072	37,072	14/04/03	Closed	Finance, Business	Y
Institutional Support to Georgian Banks framework - extension: Bank of Georgia	126,019	126,019	31/03/04	Closed	Finance, Business	Y
Sakenergo Tariff Study	8,792	8,792	04/07/95	Closed	Energy	Y
Poti port grain terminal - extension of consultancy service	88,941	88,941	24/04/96	Closed	Transport, Storage	Y
Geothermal project	29,971	29,971	01/04/94	Closed	Energy	N
Trans-Caucasian rail link project identification	48,304	48,304	04/08/97	Closed	Manufacturing	Y
Turnaround Management Programme - Azertrans	15,213	15,213	10/05/99	Closed	Manufacturing	N
Georgia Banking Supervision Assistance	34,142	34,142	30/04/01	Closed	Finance, Business	Y
Institutional Support for Georgian Banks	58,303	58,303	05/02/03	Closed	Finance, Business	Y
Institutional support to Georgian Banks - BoG and TBC	11,498	11,498	31/03/04	Closed	Finance, Business	Y

TurnAround Management Programme - EBAS SA	9,704	9,704	06/05/99	Closed	Community/Social Services	N
TAM Programme - JSC Tbilvino	70,058	70,058	23/05/02	Closed	Manufacturing	N
Food distribution and marketing	230,866	230,866	01/11/94	Closed	Manufacturing	Y
Development of Sakenergo's commercial management system	427,000	427,000	01/03/95	Closed	Energy	Y
Tariff study - Sakenergo	159,813	159,813	01/07/95	Closed	Energy	Y
Absolute Bank	193,364	193,364	01/10/95	Closed	Finance, Business	Y
Project Evaluation Department's special studies on large investment and TC operations - Tbilisi Airport refurbishment	14,711	14,711	06/10/97	Closed	Transport, Storage	N
TurnAround Management Programme - Marjanishvili Department Store	20,344	20,344	28/10/97	Closed	Manufacturing	N
Preparation and monitoring of Enguri rehabilitation project - tender and services for project implementation and monitoring	150,990	150,990	29/12/97	Closed	Energy	Y
TurnAround Management Programme - Imperial Ltd.	48,267	48,267	17/08/98	Closed	Community/Social Services	N
Georgia SME credit line project implementation	94,200	94,200	31/03/99	Closed	Finance, Business	Y
Georgia Wholesale Electricity Market	978,122	978,122	19/08/00	Closed	Energy	Y
Georgia SME Line of Credit - Micro Loan Credit Advisers	599,993	599,993	17/10/00	Closed	Finance, Business	Y
Regional TAM Programme - EBAS	15,146	15,146	20/07/01	Closed	Community/Social Services	N
TAM Programme - JSC Tbilvino	13,920	13,920	30/09/02	Closed	Manufacturing	N
Margherita Legal Due Diligence	9,534	9,534	29/03/04	Closed	Finance, Business	Y
Technical Assistance to State Procurement Agency of Georgia	20,555	20,555	14/04/04	Closed	Community/Social Services	N
Georgia SME Credit Line Resident Consultant	187,406	187,406	04/10/00	Closed	Finance, Business	Y
SME line of credit - project implementation	88,141	88,141	20/06/97	Closed	Finance, Business	Y
SME line of credit project implementation	40,836	40,836	23/12/98	Closed	Finance, Business	Y
SME line of credit - Tbilcreditbank	167,531	167,531	18/12/96	Closed	Finance, Business	Y
Enguri Dam emergency project	40,438	40,438	18/08/95	Closed	Local Authority Services	Y
Preparation and monitoring of Enguri rehabilitation project - feasibility study	206,142	206,142	27/03/97	Closed	Energy	Y
Enguri Hydro Power Plant Rehabilitation Project Panel of Experts	87,671	7,904	18/03/03	Disbursing	Energy	Y

Enguri Hydro Power Plant Rehabilitation Project Panel of Experts	92,315	58,642	18/03/03	Disbursing	Energy	Y
Enguri hydropower plant (tied portion)	55,924	55,924	20/06/96	Closed	Energy	Y
SME line of credit - project implementation	89,525	89,525	24/06/97	Closed	Finance, Business	Y
Margherita Financial Due Diligence	3,745	3,745	14/08/03	Closed	Finance, Business	Y
Debt restructuring and management	54,917	54,917	17/10/96	Closed	Energy	Y
SME line of credit - Tbilcreditbank sub-project	14,863	14,863	01/01/97	Closed	Finance, Business	Y
United Georgian Bank - institutional strengthening: - credit advisor	141,388	141,388	09/12/97	Closed	Finance, Business	Y
SME line of credit project implementation - specialised short-term institution building support	162,985	162,985	15/01/98	Closed	Finance, Business	Y
TurnAround Management Programme - Marjanishvili department store	31,236	31,236	17/11/98	Closed	Manufacturing	N
United Georgian Bank - financial manager	141,086	141,086	09/04/99	Closed	Finance, Business	Y
United Georgian Bank Institutional Support	114,095	114,095	07/04/00	Closed	Finance, Business	Y
DIF - Georgia Engineering Environmental Due Diligence	11,460	11,460	09/11/01	Closed	Finance, Business	Y
Teliani Valley Financial Due Diligence	9,000	9,000	04/12/03	Closed	Finance, Business	Y
Teliani Valley Legal Due Diligence	9,422	9,422	12/01/04	Closed	Finance, Business	Y
United Georgian Bank Institutional Support III	33,093	33,093	21/06/04	Closed	Finance, Business	N
Collaboration with the Foreign Investment Advisory Service	64,243	0	12/03/03	Committeed	Community/Social Services	N
Iberia Refreshments Legal Due Diligence	12,787	12,787	04/07/03	Closed	Finance, Business	Y
Georgia SME Credit Line - Micro & Small Credit Advisors	259,371	259,371	07/08/02	Closed	Finance, Business	Y
Microfinance Bank of Georgia Regional Branch Expansion	614,288	614,288	07/08/02	Closed	Finance, Business	Y
Georgia SME Credit Line - Micro & Small Credit Advisors	87,690	87,690	12/08/02	Closed	Finance, Business	Y
	<b>20,133,761</b>	<b>14,964,093</b>				
	<b>20,133,761</b>	<b>14,964,093</b>				
<b>No of Commitments:</b>	<b>110</b>					

## **ANNEX 8: MULTILATERAL AND BILATERAL ASSISTANCE**

### **Multilateral Assistance**

#### **International Monetary Fund (IMF)**

The IMF has supported the Government of Georgia's economic reform programme with resources provided under the General Resources Account (GRA), the Poverty Reduction and Growth Facility (PRGF), and the Enhanced Structural Adjustment Facility (ESAF). These resources have been provided since 1994. The total amount of drawn resources made available under these arrangements so far is USD 515 million. The Fund has also provided technical assistance in the areas of payments system reform, banking supervision and regulation.

IMF loan facilities were suspended in early 2001 due to poor fiscal revenue performance. Following somewhat improved fiscal performance and the passage of a reduced budget for 2001, disbursements was resumed in November 2001, only to be suspended again in August 2003 for the same reason. On 4 June 2004 following the Rose Revolution political developments in Georgia and significantly improved fiscal revenue performance, as well as a strongly enhanced financial management approaches from the Government, a resumption of the PRGF was agreed. Most recently, on September 29, 2006, the IMF Executive Board completed the fourth review of Georgia's performance under the three-year programme supported by the PRGF.

#### **World Bank (WB)**

After Georgia joined the WB in 1992 and IDA (International Development Association) in 1993, WB's strategy has been focussed on poverty alleviation, transition to market economy, rehabilitation of infrastructure, improved public sector management, human resource and institutional development, strengthening the social safety net, promoting regional environmental initiatives and on health and education system reforms. To date World Bank commitments to Georgia total some USD 830.8 million under 39 IDA credits, of which 19 are ongoing.

The new World Bank Country Partnership Strategy (CPS) for FY06–09 builds on the government Economic Development and Poverty Reduction Program (EDPRP), as well as emerging government strategic thinking on the country's development framework. The CPS envisages assistance of USD 143 million in total for the period 2006 – 2009. It targets several goals: i) generating growth and job creation by removing barriers to private sector development and improving infrastructure, finance and markets; ii) enhancing human development and social protection through improved education, health, social protection, and community services; and iii) strengthening public sector management and budgetary processes to enable Georgia to better plan and meet its own development goals. A key component of the CPS is a series of Poverty Reduction Support Operations (PRSO). The PRSO has four pillars:

- Strengthening public sector accountability, efficiency, and transparency.
- Improving electricity and gas sector services.
- Improving environment for private sector development.
- Improving social protection, education, and health care services.

#### **International Finance Corporation (IFC)**

Georgia became a shareholder and a member of IFC in 1995. Since then IFC has invested over \$120 million for 13 projects in the financial, power, oil and gas (including the regional BTC oil pipeline), and manufacturing sectors. The IFC's strategy in Georgia focuses on strengthening of the financial sector through promotion of domestic and foreign competition; promoting micro-enterprise and SME development and supporting investment in the food processing and industrial sectors. In 2005, IFC made its first investment in the leasing sector with a loan to TBC Leasing, which complemented an extensive TA program to promote the growth of leasing. Future investments in Georgia are likely to be in the financial, transport and industrial and in support for

the SME sector (including local currency financing) and non-bank financial institutions. IFC has included Georgia in the list of countries covered by the Private Enterprise Partnership. In this context, it has provided technical assistance projects in the fields of financial leasing and corporate governance practices.

### **Black Sea Trade and Development Bank (BSTDB)**

Georgia became a member of BSTDB in 1998 and cumulative approvals to date total USD 43 million.. These include a one year working capital facility to a local flour mill, pre-export finance facilities to two local banks, two trade finance lines of credit to another two local banks, and an SME line of credit with a fifth local bank. The main objectives of BSTDB in Georgia are to promote cooperation impact among member countries (inter-regional projects) and to promote development of projects that would have significant impact for the country such as power projects, manufacturing, agribusiness and food processing. At this stage BSTDB does not offer equity participation. The BSTDB seeks co-financing opportunities and other possible cooperation with the IFIs active in the region.

### **European Commission**

The EC assistance to Georgia for the period 1992-2006 has amounted to almost €502 million. [The Revised Country Strategy Paper](#) for Georgia 2003-2006 identifies three areas on which a coordinated use of all EU/EC policy and assistance instruments would be focussed: 1) promoting rule of law, good governance and respect for human rights and democratic institutions, including the strengthening of civil society actors; 2) reducing poverty; 3) enhancing stability and security through confidence building measures aiming at the prevention and settlement of internal conflicts and actions in favour of the affected populations. The European Commission is in the process of establishing a new CSP/IP for the period 2007-13, which will be mostly funded under the new ENPI instrument, and that will most probably include an increase financial assistance envelope as compared to the 2003-06 period.

[Humanitarian assistance](#) (notably ECHO and Food Aid Operations through the European Agricultural Guarantee and Guidance Fund, EAGGF) has accounted for €160 million and has in particular contributed to alleviating the very serious humanitarian situation in the mid 1990's. TACIS national allocations represent more than €110 million and the Food Security Programme has disbursed over €70 million.

Since Georgia's independence, the [TACIS](#) programme has contributed to the transition towards a market economy, notably by providing assistance in the fields of legal and regulatory reform, support for Georgia's WTO accession and the approximation of Georgian legislation to that of the EU. High levels of corruption and weakness in respect for the rule of law have, in the past, limited the impact of EU support for Georgia. Under the TACIS regional programmes, assistance in the field of transport has been delivered through TRACECA and in the field of energy through INOGATE. Support to these areas will continue through these channels under the new funding instrument, the ENPI. Support has also been provided from the EU TACIS Water initiative, the JEP and the Black Sea Investment Facility to improve municipal water and waste water services.

The [Macro-Financial Assistance](#) programme has provided balance of payments and budgetary support (€110 million in loans, and €55 million in grants, of which €31.5 million have actually been disbursed) and has assisted in Georgia's debt reduction strategy. In addition, a new package of macro-financial assistance of €33.5 million was granted in January 2006.

The EU is also active in supporting Georgia's regional integration including in energy and transport infrastructure via the Baku Initiative and the TEN-T extension exercise.

The [European Initiative for Democracy and Human Rights](#) has provided support for Georgian civil society and has funded joint EC-Council of Europe programmes in Georgia, including in the area of judicial reform. The EU has also provided support for Georgian security and for settlement of its internal conflicts through the rehabilitation instrument (Abkhazia and

Tskhinvali region/South Ossetia) and [CFSP Joint Actions](#) (support to Georgian border guards and support to the Joint Control Commission of the Georgian - S. Ossetian conflict settlement process).

Following the “Rose Revolution” in November 2003, the EU has offered its support to the new Georgian authorities in developing and implementing their ambitious reform plans. Immediate support for the Presidential and parliamentary elections in January and March 2004 was provided through the Rapid Reaction Mechanism. FSP disbursements assisted Georgia during the difficult winter months following the Rose Revolution.

In June 2004, the Commission co-chaired, with the World Bank, a **donors’ conference** on Georgia at which a total of €50 million was pledged for the period 2004-2006. The EC, for its part, pledged a total of €125 million taking total EC assistance to Georgia for the period 2004-2006 to €137 million, a doubling of assistance compared with 2001-2003. Particular emphasis has been placed by the EC on assisting Georgia, through the [Rapid Reaction Mechanism](#) and Tacis, in reform of the judicial and rule of law sectors as well as in capacity building in key institutions including the Georgian parliament.

The ENP Action Plan for Georgia which has recently been finalised includes the following priority areas:

- *Strengthen rule of law especially through reform of the judicial system;*
- *Improve the business and investment climate, including a transparent privatisation process, and continue the fight against corruption;*
- *Encourage economic development, poverty reduction and promote sustainable development;*
- *Enhance cooperation in the field of justice, freedom and security, including in the field of border management;*
- *Strengthen regional cooperation;*
- *Promote peaceful resolution of internal conflicts;*
- *Transport enhancement and energy security.*

## **Major Bilateral Assistance**

### **USA**

The total US Government assistance to Georgia since independence in 1991 is some USD 1.45 billion, higher than that provided to Israel and Egypt on a per capita basis.

The main focus areas of the United States Agency for International Development (USAID) activities in Georgia include projects targeted at: private sector strengthening; agriculture and agribusiness development; economic restructuring; energy and the environment; democracy and good governance; rule of law; humanitarian response; social transition; healthcare reform; aid to the Eurasia Foundation; NGO and media development; SME development and micro-credit.

The total assistance pledged for 2004-5 included USD 166 million with the following main streams: USD17 million for general security; USD12 million for the military Train and Equip Programme; USD15 million for market reform; USD11 million for rule of law; USD9 million wheat monetisation; USD8 million for power sector reform; USD5 million for democratic reform; and USD4 8 million for social programmes.

The recently established MCC has qualified Georgia as one of the initial group of countries for its operations. The five-year Compact agreement signed with the Georgian side has earmarked USD 295.3 million (including the administrative, monitoring and evaluation cost) for Georgia with the following priority areas:

- **Regional Infrastructure Rehabilitation.** The project totals \$211.7 million and includes the following three activities:
  - \* **Samtskhe-Javakheti (S-J) Road Rehabilitation-**The \$102.2 million activity will fund rehabilitation and construction of approximately 245 kilometers of main road traversing the S-J region.
  - \* **Energy Rehabilitation-**The \$49.5 million activity will be used to rehabilitate the North-South Gas Pipeline that fuels electric power generation and provides heat to homes and businesses, and to further develop and implement the Georgian government's energy sector strategy.
  - \* **Regional Infrastructure Development Facility-**The \$60 million activity will fund regional and municipal physical infrastructure for water supply, sanitation, irrigation, municipal gasification, roads and solid waste in regions outside of Tbilisi.
- **Enterprise Development.** The project totals \$47.5 million and includes the following two activities:
  - \* **Georgia Regional Development Fund-**The \$32.5 million activity will fund a professionally and independently managed investment fund to provide long-term risk capital and technical assistance to SMEs, primarily in the regions outside of Tbilisi, and will identify legal and policy reforms needed to improve the investment environment.
  - \* **Agribusiness Development Assistance-**The \$15 million activity will be used for technical assistance and grants to farmers and agribusinesses that supply agricultural products to the domestic market.

## **Germany**

German development cooperation with Georgia began in 1993. With commitments of more than €275 million for Financial and Technical Cooperation, Germany is the second largest bilateral donor for Georgia's social and economic development. In addition to bilateral development cooperation, Germany has supported measures under the government's Caucasus Initiative since 2001 that encourage closer regional cooperation between the three countries of Armenia, Azerbaijan and Georgia.

Acting on behalf of the German Federal Ministry for Economic Cooperation and Development (BMZ), KfW Entwicklungsbank (KfW development bank) uses FC funds and additionally its own funds to finance investments and to provide accompanying advisory services in Georgia. Most of the funds totalling about €260 million – of which more than €30 million are KfW's own funds – are provided as low-interest loans with IDA conditions; above one-quarter of the funds are provided as non-repayable grants.

KfW Entwicklungsbank finances projects primarily in the following areas in Georgia: energy; sustainable economic development and municipal infrastructure. With a financing volume of €130 million, Germany, through KfW, is the largest donor in the Georgian energy sector. Besides supporting sector reform and privatisation, KfW finances the rehabilitation of central substations and transmission lines, also between Georgia and Armenia. By supporting the installation of about 120,000 electricity meters, KfW improves the collection rate and hence the



liquidity and sustainable operation of the sector. Small hydropower stations are given loans at favourable conditions for use in rehabilitation and investment.

In the field of sustainable economic development, Germany is strengthening the financial sector with a focus on micro, small and medium-sized enterprises as well as consumers. KfW Entwicklungsbank has been a central actor in founding the “Microfinance Bank of Georgia” (now ProCredit Bank) and has set up a credit guarantee fund that assumes default guarantees for loans granted by international commercial banks to three local banks. In addition, German FC is advising four Georgian partner banks on how to improve their retail banking procedures.

KfW Entwicklungsbank’s most ambitious programme in the municipal infrastructure sector is the rehabilitation and partial new construction of the water supply and sanitation facilities in the city of Batumi for 200,000 inhabitants.

Moreover, Germany is one of the leading donors in the field of nature conservation. Through KfW Entwicklungsbank, Germany has supported the establishment of Bojormi-Kharagauli and Javakheti National Parks as well as the Transboundary Joint Secretariat to improve regional cooperation in this field. Germany has made the largest contribution in establishing the Caucasus Protected Area Fund, the first regional fund worldwide to support complete transboundary conservation area systems.

DEG, a member of KfW Bankengruppe, is also financing projects in Georgia. It is currently supporting TBC Bank and the Bank of Georgia with equity or loans and is thus helping to strengthen the activities in the financial sector.

## **Netherlands**

Georgia is a member of the Netherlands’ constituency group at both the World Bank and the IMF and a partner country for Development Cooperation for the Netherlands Government. The Netherlands Government provides assistance to Georgia via central budget lines within the Ministry of Foreign Affairs and delegated funds at Embassy level.

The overall objective of the delegated development cooperation programme in Georgia is poverty reduction. In 2006, delegated funds amounted to € 6 million. The focus of the Netherlands’ interventions, given its specific constituency relationship, is on good economic governance; i.e. strengthening the public sector; stimulating the transition towards a democratic form of government with a particular focus on the rule of law, human rights and peace building efforts; strengthening the creation of a sound macro-economic climate and promoting a further transition towards a functioning market economy. Under the budget line for small projects aimed to strengthen civil society initiatives, the Embassy has allocated €70000.

Support to Georgia via central budget lines in 2005 was, among others, given to the EBRD (Trade Facilitation Programme and the ETC fund), ODIHR (regional activities in the area of election technical assistance, increased participation of women in democratic processes, etc), HALO Trust Fund for demining activities, Center for International Legal Cooperation (rule of law), the Avalon Foundation to support the development of organic agriculture and to Milieukontakt, a Dutch NGO working in the area of elimination of obsolete pesticides in the region/solid waste management. The Netherlands’ support in the area of environment is increasing with funds and/or support via the Netherlands’ Ministry of Environment and Dutch environmental institutions.

Since June 2004, Georgia is eligible for funds aimed to stimulate sustainable economic development in emerging markets (PSOM and ORET) financed by the Dutch Government. ORET financing has been given to the Poti Breakwater Project and the transport sector in cooperation with the EBRD financing. On-going consultations are taking place for further

investments of PSOM/ORET/FMO finance into the financial sector –water supply and sanitation, and other potential areas.

In 2006, the Netherlands will co-finance the Poverty Reduction Support Operation (PRSO-II) of the World Bank with an amount of € 5000000. This programme is geared towards the improvement of 1) the financial accountability and effectiveness of the public sector; 2) electricity and gas supplies; 3) the enabling environment to further develop the private sector and 4) social services with a particular emphasis on health and education.

As of January 1 2006, Georgia is eligible for the MATRA support programme – a Non-ODA instrument to stimulate societal transformation via non-state actors..

## **UK**

Georgia is one of the focal countries for DFID's work in the South Caucasus and Central Asian region. DFID will commit a total of £11 million to Georgia during 2004-08. Key areas of work are as follows:

Support for the Ministry of Finance's work within the framework of the World Bank administered Public Sector Financial Management Reform Support Project.

Support for work with a range of other partners on health, statistics, sustainable livelihoods, strengthening civil society and competitive grant schemes (focusing on support for small and micro credit enterprises and livelihoods support).

Since independence, Georgia has suffered from unresolved internal conflicts in Abkhazia, South Ossetia and, until recently, Adjara. DFID's contribution to seeking peaceful resolution of these conflicts is made through the Global Conflict Prevention Pool (GCPP).

Future DFID assistance will focus on a stronger emphasis on improving governance by supporting financial discipline, and anti-corruption and institutional reform. DFID is also concerned with assisting the government coordinate and manage donor aid, facilitating better-targeted and focused programmes by donors.

## **Canada**

The Canadian International Development Agency (CIDA) has provided over CAD 26 million in official development assistance to Georgia since 1991. In 2005/06, CIDA's disbursements to Georgia totalled CAD 4.6 million.

Programming is focused on promoting good governance: encouraging democratization, building institutional capacity in the public sector, enhancing respect for human rights, furthering the rule of law, and preventing conflict. Gender equality and youth are integrated as cross-cutting issues into programming wherever possible.

Through its current programming, CIDA is assisting Georgia to: strengthen the policy and decision-making capacity of its government, develop more efficient and transparent business practices, build trade policy capacity, and further the participation of women in democratic processes. CIDA is also actively supporting Georgia through regional initiatives in the South Caucasus in the areas of private sector development, environmental security, HIV/AIDS harm reduction, and cross-border human security issues related to migration, human rights, and gender equality. CIDA recently approved CAD \$8 million for a new technical cooperation untied fund with the EBRD to support activities in the areas of private sector development, the environment and municipal governance. CIDA also provides support to Georgia through its contribution to the EBRD's Early Transitions Countries (ETC) multi-donor fund and through a TAM Program Fund.

**ANNEX 9: MAP OF GEORGIA**

