DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR GEORGIA

As approved by the Board of Directors at its meeting on 9 February 2010

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EXECUTIVE SUMMARY

Georgia is committed to the principles of multi-party democracy, pluralism and market economics in accordance with the conditions specified in Article 1 of the Agreement Establishing the Bank, although application of these principles has been uneven.

While the presidential election in January 2008 was generally in line with OSCE standards, subsequent parliamentary polls in May 2008, according to OSCE – ODIHR, did not fully conform to international standards for free and fair elections. Further development of democratic institutions, reinforcement of checks and balances between the branches of power, the strengthening of the rule of law, independence of the judiciary and protection of human rights are essential to overcome multiple challenges faced by Georgia today.

Georgia's macroeconomic performance and general progress with reforms in the past five years have been strong. Georgia achieved significant economic growth mainly driven by the large foreign capital inflows. Foreign investments across different sectors of the economy have contributed to broadening the economic base. Domestic credit grew rapidly, supported by increased confidence in the banking sector and access to international financial market, and the level of dollarisation in the sector gradually decreased. Progress with structural reforms has also been significant. The main achievements include significant improvements in the legal and regulatory framework for business creation and operations including liberalisation of the customs regime, reducing corruption, simplifying the tax system and completion of large-scale privatisation across different sectors of the economy.

However, the Georgian economy has been significantly affected both by the conflict with Russia in August 2008 and the international financial crisis. The August conflict undermined investor and consumer confidence, put stress on public finances, damaged physical and other infrastructure and put pressure on the banking system because of large deposits withdrawal. The intensification of the international financial crisis has put further pressure on the currency and foreign investments, affected the quality of the loan portfolio and the recovery of bank deposits while the international financial markets remain closed. Bank lending has decreased significantly and remains very limited. Remittances from workers living abroad have declined since the beginning of 2009 due to the economic slowdown, in particular in Russia which still accounts for two-thirds of the source of remittances. This negative impact is partly offset by large-scale international financial support, amounting to about USD 4.55 billion over three years, pledged in October 2008. The IMF emergency 18-month stand-by programme of USD 750 million that started in mid-September 2008 (augmented by additional USD 424 million and extended by 14 months in August 2009) also helped with the stabilisation process after the conflict. The ongoing internal political uncertainty has further lowered investor confidence.

Challenges

While progress in structural and institutional reform has been robust in recent years, Georgia continues to face significant transition challenges:

- The international financial crisis revealed important weaknesses in the financial sector. Strengthening of banking sector, improvements in risk and portfolio management including through increase in local currency lending, as well as improvements in supervision and confidence in the banking sector, are important for financial sector stability.

- The rehabilitation of decaying physical infrastructure is a major challenge in Georgia and part of the government's own anti-crisis stimulus plan. Further investments, regulatory reforms and private sector participation in infrastructure and municipal utilities are important for improving efficiency, quality of services, and long-term financial sustainability.

- The crisis has also highlighted the need to further diversify and widen the economic base. Although the economic base has broadened significantly in recent years, growth is mainly driven by financial services and the construction sector. Developing the tradable sector, by supporting exports and improving competitiveness, especially in manufacturing, and developing import substitution, in particular in agribusiness, are important for long-term sustainable growth. In the context of ongoing discussions with the EU on setting up a Deep and Comprehensive Free Trade Area (DCFTA), further progress is needed with establishing a sound regulatory framework in trade-related areas that is aligned with international and EU laws and standards.

- Further improvements of the business climate are necessary to boost confidence and attract more foreign investments. These include improvement in property rights, independence of the judiciary, and a further reduction in corruption.

Strategic Directions

In response to the transition challenges amid the ongoing economic crisis, the strategic direction of the Bank's activities will focus in the short term on supporting the economy to minimise the effects of the crisis, and later to support recovery and progress with reforms. The Bank will concentrate on the following priority areas:

- ***Financial Sector:*** A key priority is to support the stability of the financial sector in general and banking sector in particular. The Bank's focus will be on ensuring adequate levels of capital and supporting resumption of lending by existing clients in the financial sector. The Bank will support restructuring, strengthening of risk, liquidity, and portfolio management, increase in the share of local currency lending, and adjustment of funding models, which are essential for the banks' long-term sustainability.

- ***Infrastructure Sector:*** Infrastructure rehabilitation and modernisation, and improvement of regional transit infrastructure are important for the economic recovery.

    - Power & Energy Security & Efficiency: The Bank will support rehabilitation, construction and expansion investments in the power sector that will help Georgia achieve security of energy supply while facilitating trading of electricity in the region. There will be an increased focus on industrial and residential energy efficiency, at the same time special emphasis will be made to promote and assist the Bank's industrial clients to take advantage of the Clean Development Mechanism (CDM).

- MEI: Rehabilitation and support of long-term financial sustainability of the key municipal infrastructure sector will remain a strategic priority. The Bank will continue to strengthen its involvement in the municipal sector by capitalizing on its expertise and strong portfolio of projects, such as municipal water supply, waste water and solid waste management as well as the rehabilitation of urban transport.

- Transport: The Bank will continue to give priority to infrastructure investments linked to the enhancement of the main East-West corridor. This is important to enable the country to take advantage of its geographic position as a major transit link between the South Caucasus, Central Asia and Europe. The Bank will focus on commercial financing to private operators.

- ***Enterprise Sector:*** As an integral part of the crisis response, a strong emphasis will be given to supporting the enterprise sector. Support to enterprises in general, and micro, small and medium-sized enterprises (MSMEs) in particular, will address their financing needs, support competition through innovation, and development of the tradable sector, in particular manufacturing and agribusiness. The Early Transition Countries Initiative (ETCI) will remain the principal driver for the Bank's activities in the enterprise sector, allowing the Bank to invest in equity and provide debt through the available range of instruments.

Investment Climate

During the past Strategy period, Georgia has made significant progress towards improving the business climate, introducing reforms and further promoting privatisation. The Bank had a very good co-operation with donors and IFIs in supporting the authorities in the aftermath of the August conflict. It actively participated in the Joint Needs Assessment (JNA) effort sponsored by the World Bank as an immediate post August 2008 conflict crisis response with particular focus on ensuring stability of the banking sector. The Bank will continue its fruitful and regular policy dialogue with the authorities with a special focus on energy and agriculture, in close coordination with the local business community, other IFIs and international donors. It will aim at addressing critical bottlenecks to local private sector investments and help to boost the return of confidence among foreign investors. The Bank will continue to promote active policy dialogue between the government and the business community.

ABBREVIATIONS

ADB	Asian Development Bank
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 and Etwicklungsgesellschaft
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	Nederlanse 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 of Activities to Date

Since 1994 till end of September 2009, the Bank has signed 122 projects in Georgia accounting for a net cumulative business volume of EUR 662.3 million and a total project value of about EUR 3.2 billion. During the past strategy period, the annual business volume increased by 88% from EUR 114 million in 2006 to EUR 215 million in 2008 and the number of projects was maintained through 2007-2008 at the high level of 24 reached in 2006. The total portfolio in Georgia reached EUR 464.1 million as at the end of September 2009. Georgia has been the biggest driver in the growth of the EBRD activities under the ETCI.

Table 1: Commitments and Portfolio at 30 September 2009 (€ million)

Sector Name	CUMULATIVE COMMITMENTS					CURRENT PORTFOLIO [1]		
	No. of Projects	Total Project Cost	EBRD Funds	% of total EBRD	Disbursed	No. of Projects	Portfolio	% of total Portfolio
Financial Institutions	**65**	**478.9**	**314.6**	**47.5**	**278.3**	**47**	**257.1**	**55.4**
Infrastructure	**11**	**191.9**	**62.5**	**9.4**	**53.8**	**10**	**32.9**	**7.1**
Municip. & Environmental Infr.	*7*	*53.9*	*15.6*	*2.3*	*6.9*	*7*	*13.7*	*3.0*
Transport	*4*	*138.0*	*46.9*	*7.1*	*46.9*	*3*	*19.2*	*4.1*
Energy	**10**	**2258.8**	**148.5**	**22.4**	**148.4**	**7**	**72.3**	**15.6**
Natural Resources	*5*	*2040.7*	*82.1*	*12.4*	*82.1*	*3*	*55.7*	*12.0*
Power & Energy	*5*	*218.1*	*66.4*	*10.0*	*66.3*	*4*	*16.6*	*3.6*
Corporate	**36**	**286.6**	**136.7**	**20.7**	**106.3**	**29**	**101.8**	**21.9**
Agribusiness	*21*	*81.1*	*65.0*	*9.8*	*62.8*	*16*	*34.8*	*7.5*
General Industry	*7*	*46.2*	*21.1*	*3.2*	*20.5*	*6*	*18.0*	*3.8*
Property & Tourism	*7*	*138.4*	*29.7*	*4.5*	*23.0*	*6*	*28.1*	*6.1*
Telecoms Informatics & Media	*1*	*20.9*	*20.9*	*3.2*	*0.0*	*1*	*20.9*	*4.5*
Country Total	**122**	**3216.2**	**662.3**	**100**	**586.8**	**93**	**464.1**	**100**

[1.] Details of commitments and net portfolio are provided in Annex 6.

In line with the strategic priorities identified in the past country strategy, financial institutions, infrastructure, and renewable energy have been the main focus of the Bank.

In 2008 the Bank signed three operations for municipal and environmental infrastructure development, namely: water supply rehabilitation in the cities of Kobuleti and Borjomi for EUR 1.5 million each and Batumi Public transport (EUR 2.5 million).

The Bank supported investments in renewable energy with USD 27 million made available to three leading Georgian partner banks through the Caucasus Energy Efficiency Programme.

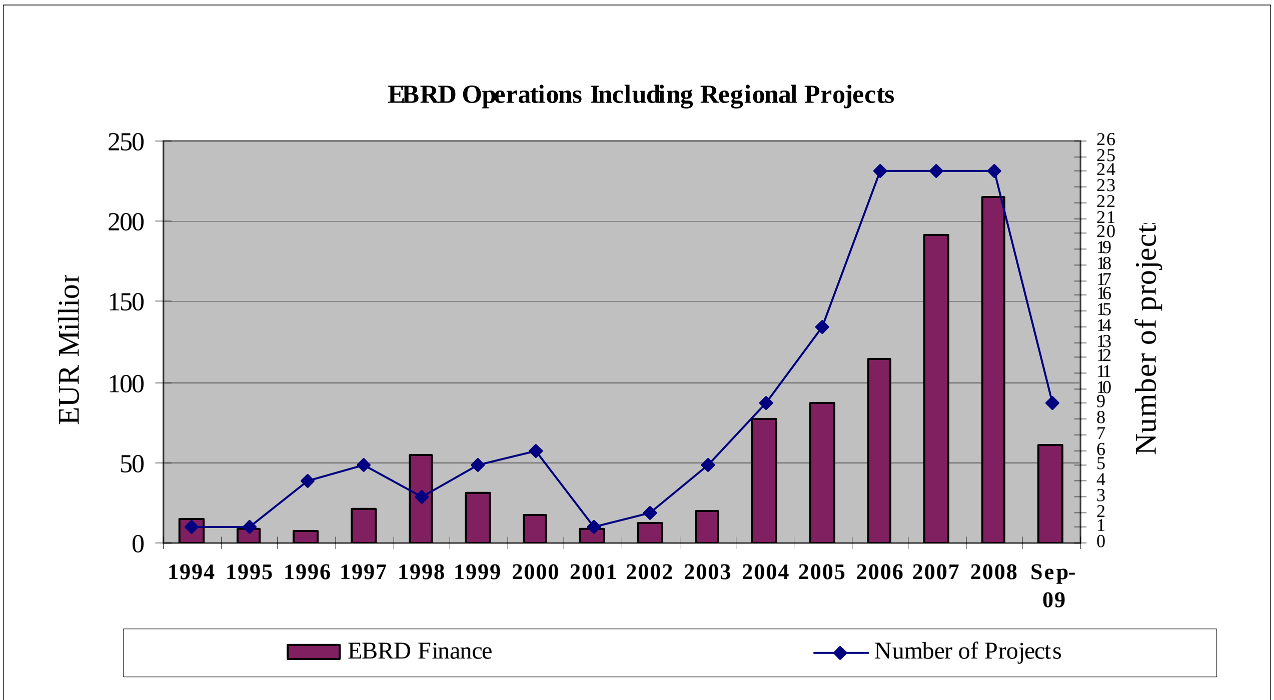
Throughout the last strategy period the Bank has provided continuous and stable support to all its partner banks using the full range of financing instruments. The Bank made equity investments in Basis Bank and Cartu Bank and provided equity increase and subordinated debt (USD 5 million) to Republic Bank. SME credit lines have totalled to USD 35.5 million; during the last 3 years, fifteen MCFF sub loans were signed and disbursed in support of the enterprise sector of the Georgian economy.

In addition, in order to support Georgia's financial system after the August 2008 conflict, and as a response to the global financial crisis, the Bank, along with the IFC provided Bank of Georgia and TBC, its two largest partner banks, with equity and loan facilities comprising convertible subordinated, non-convertible subordinated and senior loans, aggregating USD 170 million.

Over the last strategy period there was a significant increase in GI sector investments with EUR 22.9 million loans. Georgia's telecommunication sector has also benefited from a USD 30.6 million investment into the main internet service provider, Caucasus Online, to finance the laying of a submarine fibre optic cable between Georgia and Bulgaria. In the Property and Tourism sector the Bank has invested EUR 22.9 million via six projects.

The distribution of business volume by sector was much less balanced during the last strategy period than initially anticipated. Financial Institutions projects have accounted for 55.9% of the total business volume while the corporate sector represented 41.5%, Energy 1.1% and Infrastructure 1.5%. The distribution of business volume of the corporate sub-sectors was: Agribusiness 15.2%, General Industry 14.7%, Property and Tourism 56.1%, Telecoms Informatics and Media 14.0%.

Historical Review



1.2. Implementation of 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 and further investments into energy efficiency, renewable and power energy sector). During the last strategy period, the EBRD has committed a total of € 375.86 million for 56 projects excluding TFP operations.

- **Enterprise Sector**: Two significant transactions were signed in 2008, involving the first Telecom sector financing for Caucasus-on-line (EUR 21.8 million) and the largest GI sector investment in Georgia, in the steel industry, Geosteel (EUR 10 million). Using the instruments and approaches provided under the ETCI, the Bank further expanded its funding of local enterprises, including MSMEs and larger private enterprises. Support for the real economy was provided both directly and through local banks. 2 DIF equity and 3 DLF transactions were made with respective total investments of EUR 1.2 million and EUR12.5 million. Local partner banks were assisted via the extension of 10 SME/MSME credit lines, 15 MCFF risk participation agreements, 1 syndicated loan and some TFP support. TAM and BAS Programmes were actively promoted, with TAM implementing 5 projects and BAS carrying out 182 consultancy projects of which 23 were implemented under Women in Business Initiative. 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**: The Bank has invested in public transport in Batumi and for water supply in two cities in Kutaisi and Poti, and waste water rehabilitation projects in Borjomi and Kobuleti. This has been achieved by working closely with donors such as the Netherlands, the US Millennium Challenge Corporation, Sweden and the European Commission. While the city of Tbilisi may support investments on a non-sovereign basis, in the smaller cities the Bank works with the state Municipal Development Fund and utilises Technical Co-operation to handle implementation efficiently. While technical Co-operation funds dedicated to the preparation phase of the projects are disbursed immediately, a large proportion (in excess of 70%) used for implementation and institutional strengthening, would typically be spent over a longer period averaging approximately five years. EBRD has also been actively cooperating with BP (British Petroleum) on MEI projects to utilise their funds allocated for Corporate Social Responsibility Initiative. In June 2009 EBRD has financed the construction of a new landfill for the disposal of solid waste in the city of Rustavi with a EUR 1.6 million loan. BP provided an additional support through a USD 1 million grant. EBRD has also worked with BP to promote residential energy efficiency. Helping Georgian households to reduce their energy bills and consumption, EBRD has extended USD 1 million credit line through TBC Bank, and 15% of the capital expenditure of the loan will be covered by BP.

- **Financial Sector**: The EBRD extended further support to partner banks in Georgia and took the lead in the crisis response to rescue the Georgian financial sector starting from August 2008. During the past strategy period, the Bank signed ten new

SME/MSME credit lines, fifteen MCFF risk participation projects, three bank equity transactions, one syndicated loan to a local bank and the first equity investment into a local insurance company. Donor-funded technical assistance was provided for institutional strengthening and insurance regulation enhancement. Since August 2008, total commitments to the banking sector in response to the financial crisis have aggregated USD 237 million. The two largest partner banks, BoG and TBC, were supported with a total financing of USD170 million, while a further USD 67 million has been extended to other partner banks in form of SME/MSME, Mortgage, Energy Efficiency and MCFF credit lines. Total financing provided to the banking sector over the last strategy period amounts to USD 329 million, not including non recourse MCFF lines amounting to USD 90 million, of which USD 40 million was approved post crisis.

- **Early Transition Countries Initiative (ETCI)**: The last strategy period substantial increase in portfolio and the large number of transactions, were made possible through the ETCI and the increased TC support provided by donors under the ETC Multi-Donor Fund and bilaterally. Support was provided both directly with three Direct Investment Facilities (DIF) equity transactions and three Direct Lending Facility (DLF) project. Two local banks have effectively been using the Bank's Medium Sized Co financing Facility (MCFF) risk participation agreements and one additional facility has been put in place with a new partner bank. In total, during the last three years, thirteen MCFF sub loans were signed and disbursed in support of the enterprise sector.

- **Investment Climate:** Policy dialogue with the authorities and in close coordination with other IFIs and the international donor community was broadened with a focus on the power sector, effective regulation of railways, water utilities and the promotion of MSME development. The Bank actively participated to the Joint Needs Assessment (JNA) effort sponsored by the World Bank as an immediate post August 2008 conflict crisis response.

  - The Bank together with the Prime Minister's office set a Business Advisory Council to encourage private/public dialogues with a strong focus to private sector development and improvement of the investment climate. The main purpose was to identify key impediments to investment by local and foreign enterprises and seek the feedback of relevant authorities/bodies, the private sector, as well as international financial institutions and other donor organisations;

  - The Bank carried out advisory sessions with the Central Bank's Financial Services Authority on anti-money laundering actions, as well as to facilitate the development of a policy paper on corporate governance in the banking sector.

  - The Bank has assisted the Government of Georgia by providing a consultant to advise on the health sector reform, improve quality of care and access to the health system.

  - The EBRD has also been involved in the improvement of the regulatory framework of the telecommunication sector, conducting discussion sessions with the Georgia National Communications Commission on the governing principles of independence and transparency.

  - Georgia has also been nominated as one of the pilot countries where the training of commercial court judges was to be implemented.

- The JNA 30 June 2009 Progress Report outlines EBRD's contributions to the overall donors' efforts in respect of the Transport, Energy, Municipal and, with special emphasis, Banking sectors.

1.3. Project Pipeline

The active project pipeline for the new strategic period is currently estimated at € 414 million. It includes three DIF and four DLF investments in property, food manufacturing, retail trade and renewable energy sectors. Two new MCFF facilities with local banks are presently contemplated, as well as eight new MCFF projects. The FI pipeline also includes an additional energy efficiency credit line, two new senior loans, one credit line and one equity investment. Capitalising on the successful implementation of the first solid waste management project, the MEI team is considering another solid waste management project and two additional water and waste water projects. The development of the Poti Port in cooperation with a private investor as well as the rehabilitation of the Tbilisi Railway are priority projects in the Transport sector. In the Power and Energy sector, the emphasis is on hydro power plants and the Black Sea energy transmission system that would facilitate energy trading in the Caucasus region.

1.4. Portfolio Performance

As at 30 September 2009 the current EBRD portfolio in Georgia has a weighted project risk rating of 6.42 (vs. 5.79 at the time of the last strategy review) compared with the Bank's average of 6.71 for the Eastern Europe and the Caucasus countries, and 6.05 (vs. 5.43) for the Bank as a whole. As the effects of the crisis tend to spread from the financial to the corporate sector, a further deterioration of the portfolio quality should be expected in the earlier part of the strategy period.

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

1.5.1 The Financial Sector

Banking **–**The Bank had invested convertible loans and equity in two of the largest Georgian banks, VTB (previously United Georgian Bank (UGB), before 2005) and Bank of Georgia (BoG) and had provided TC to the NBG on banking sector regulation. Later, TBC Bank joined the TFP which was increasingly utilised during the period 2000 - 2005. Extensive TC supplemented the Banking operations to improve the client's skills and performance in credit assessment, MIS, microfinance activities and human resource management. More recently, a Medium Co-Financing Facility (MCFF) was put in place and started disbursements with BoG and TBC. ***A lesson learned*** from the Bank's activities with BoG is that the client bank management can be influenced through a strong equity position. This proved to be important in an environment of prevailing lack of transparency (PEX02-176).

NBFI **–** The Bank's involvement was limited to a TC project for insurance regulation and later in 2005 a senior loan to TBC Leasing, a specialised leasing subsidiary of TBC Bank. Overall, the non-bank financial sector in Georgia remains weak with sub-sectors, such as insurance in need of development.

SME & MSME **–** The Bank provided credit lines to TBC, BoG and VTB, and supported the creation of a dedicated microfinance bank, Procredit Bank Georgia. The pre-2000 SME credit lines (five in total with three considered successful) were restructured to be part of a micro-lending programme, and have since disbursed over

12,000 loans, with good portfolio quality. Competition among banks is currently active. Through a convertible loan to TbilUniversalBank (TUB), a small private bank specialised in SME lending, since then acquired by the Bank of Georgia, the Bank has strengthened this market segment. A ***lesson learned*** from the SME Credit Lines provided by the Bank is, that the careful design of covenants is of vital importance. The inclusion of portfolio concentration, related party lending limits and prudential bank ratios was helpful to improve local management's understanding of banking risks, and provided a useful additional tool for performance monitoring and business planning (PE02-225).

Private Equity - The Bank has been present on the country's private equity market only through a few transactions, including Georgia Glass and Mineral Water by the NIS Restructuring and the First NIS Regional funds. The private equity market in Georgia is small and still at an early stage of development.

1.5.2 The Enterprise Sector

Agribusiness – In 1997 the Bank's first private sector industrial project in the country was for the Borjomi mineral water company (together with the IFC). The Bank also intervened in the wine sector by restructuring the Georgian Wines and Spirits (GWS) Limited. The project achieved its objectives and carried good transition impact, since the Bank helped to substitute local by corporate shareholding, the latter being majority controlled by the western sponsor. Most recently, EBRD made a number of equity investments through the direct investment facility (DIF), for instance in Georgian Hazelnut production Argonut. A ***lesson learned*** from the Bank's project with GWS is, that integrating of the upstream raw material supply sources into the project concept and design - as investment and/or TC component - is essential for risk mitigation in agribusiness projects (PEX01-150).

Natural Resources –The Bank had disbursed equity under the Frontera resources project, and supported the drafting of the production sharing agreement and the environmental action plan. Since 2000 EBRD's incremental exposure in Georgia has been associated with the BTC (Baku-Tbilisi-Ceyhan Pipeline/ oil) and SCP (South-Caucasus Pipeline/ gas) operations. In addition, TC was provided under the Early Transition Country Fund (ETCF) for carrying out a detailed technical survey of the pipeline operated by the state-owned Georgian Gas International Company (GGIC) to supply natural gas from Russia to Georgia and Armenia. The projects supported regional co-operation and the improvement of environmental and business standards and helped to solidify Georgia's position as a key transit country for hydrocarbons. A ***lesson learned*** from the BTC/SCP project is the need to design sustainable development programmes for the local community. In fact, the willingness of project sponsors to fund community investments and to involve NGO's in design and implementation has become best practice standard (PE07-369).

General Industry – The 1998 investment into the glass bottle manufacturer Ksani (nowadays JSC Mina) supported the foreign investor with the restructuring of the company and the modernisation of glass packaging facilities. The Project was affected by the Russia crisis and the difficult situation in Georgia. It was completed after long delay and, wisely, at a smaller scale than planned. The operation allowed the Bank to support the project while exiting without loss. In 2008, the Bank approved the Geo Steel project, for the construction and operation of a steel mini-mill company in the industrial area Rustavi, some 40 km from Tbilisi. Whilst there is a potentially significant demonstration effect of this large foreign investment, it is too early yet for a realised transition impact. A ***lesson learned*** from the project with Ksani is the importance to reach clarity on arrangements between sponsor and borrower, such as off-take agreements and risks of transfer pricing, early during project appraisal (PEX03-189).

Property & Tourism - EBRD activities in this sector started only recently with equity investments in the Georgian Property Debt Facility-Green Building and the Georgian Reconstruction and Development Company N.V. approved in 2006 and 2007 respectively. The Green Building project finances the construction, refurbishment and operation of four commercial properties, including two office buildings, one shopping centre and the renovation of a train station, all located in the capital Tbilisi.

***Telecommunications* –** Apart from some legal advisory work provided through TC, there has been no substantive EBRD activity taken place in the Georgian telecom sector.

1.5.3 Infrastructure

Power **-** The Bank played a very active role in the privatisation of the Telasi power distribution company early on. Results of the project were mixed. Significant transition was achieved in terms of payment discipline through remetering, implementation of electronic billings and effective cash collection enforcement. However, a very negative demonstration effect resulted from institutionalised corruption. The support to the privatisation of the Enguri hydro power plant has stalled since the end of the 1990s due to the Abkhazia conflict. Its management is currently subject to Georgian-Russian negotiations on highest political level. Thus, EBRD's involvement in the project has been limited to improving the dam safety. A ***lesson learned*** from the Bank's project with Telasi is, that an institutional framework may not be relied upon until it is actually tested (PE03-254).

***MEI* –** The Bank approved a loan in May 2005 to the Tbilisi Bus Company, a joint stock municipal company owned by the City. A number of ETCF funded TC operations have provided complementary capacity development and regulatory strengthening that is seen as critical to achieving the wider objectives of the capital investment. The projects are not fully implemented and thus, not yet 'evaluable' in terms of transition impact. The same applies to a number of projects signed with water companies in the recent years for the cities of Kutaisi, Poti, Kobuleti and Borjomi. The objectives pertain to rehabilitation of water and wastewater networks, construction of a wastewater treatment plant, and improvements of the companies' financial and operational performance. A significant transition impact is expected in the future.

Transport* –** The Bank's Tbilisi Airport Refurbishment project focused on rehabilitation and not on institutional reforms, with the exception of the introduction of management information systems. The transition rationale of the Trans-Caucasian Rail Link project and related TC support has been more ambitious, and appears to have generated some positive changes in the Georgian Railway's business conduct and development of new standards. In 2002, the Channel Energy Poti Port was signed. While the project has underperformed and finally required rescheduling of the loans, one of its achievements is particularly significant: that the Bank's uncompromising attitude in environmental aspects was instilled in the Borrower. A ***lesson learned from the Bank's operation with the Poti port is that an appropriate methodology and comprehensive market research should have been applied to avoid an overly optimistic traffic forecast. The appraisal due diligence should have included an appropriate "modal split" analysis (PEX05-262).

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, and to be especially responsive in light of the current global economic crisis. The Bank has had the most significant impact in the Enterprise sector while its efforts during the past two years particularly in the Municipal and Infrastructure sectors have started yielding results despite slower pace of reform in these segments. The Bank played an essential role in stabilising the banking sector and in the period of crisis.

From 2005 to the end of Q2 2009, the portfolio of operations in Georgia that are monitored for transition impact by the Chief Economist Office included a sample of 38 rated projects. At signing, 89 per cent of these projects were expected to achieve either "Good" or "Excellent" transition impact.

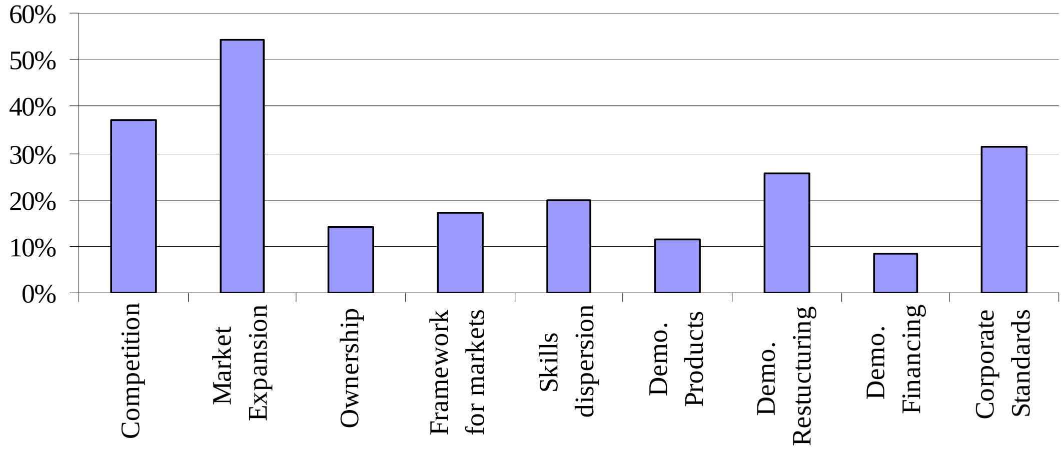
Despite the financial crisis and the Russian-Georgian conflict, projects seem to have been on track to achieving their transition impact. The table below compares the original board ranking of projects to their current ranking (as of September 2009) and shows that rank upgrades (on the top half of the table in red) outweigh downgrades (bottom half of the table in blue).

		Original Board Ranking								
		1	2	3	4	5	6	7	8	Total
Current TIMS Rank	1									
	2					1				**1**
	3				1	1				**2**
	4				4	3				**7**
	5				1	23				**24**
	6						3			**3**
	7									
	8					1				**1**
	Total				**6**	**29**	**3**			**38**

Note: Transition Impact Monitoring System (TIMS) defines the rank as expected transition impact equal to a numerical combination of transition impact potential rating (*marginal, satisfactory, good and excellent*) and transition impact risk (*low, medium, high, excessive*).

Project downgrades occurred in the MEI and Small Business Finance sectors and are linked to the difficult market conditions, especially in the aftermath of the conflict. Upgrades were achieved in the SME, Bank Lending, Non-Bank Financial Institutions and Transport. As far as SME lending is concerned, the EBRD's strong presence in the sector as well as client commitment and in particular of well functioning NGOs dedicated to commercial MSE lending have allowed credit lines to swiftly disburse and achieving part, if not all of the intended transition impacts.

Transition challenges identified by the Assessment of Transition Challenges (ATC) Georgia in 2005 were large across different sectors with exception of telecommunication, power and energy, and small business finance where such gaps were medium. Transition objectives pursued by EBRD reflect the sector mix in Georgia and concentrate on developing market structure and market-based conduct and skills with less emphasis on market-supporting institutions in line with the findings presented in the Transition Impact Retrospective (TIR) 2009 that covers the period 2005-H12009. Interestingly, as chart below shows, all transition objectives have been addressed in Georgia contrary to some countries of similar size.



In terms of materialised Transition Impacts[1], the latest TIR (CS/FO/09-21) found that during the past five years the Bank has the largest impact in the corporate sector and in particular had significant impact in the Property and Tourism and Agribusiness sectors[2].

In property and Tourism, the Bank expanded its activities in the past five years, including an equity investment in a Georgian real estate investment vehicle and property debt facility and several direct investments through the MCFF (i.e., construction of a new private hospital and Sub-loan to a construction company, Nola Ltd.). These projects had significant positive demonstration effects in terms of attracting other institutional investors to the local market, increasing competition and improving business standards in the sector. However, it should be noted that the achievement of some of the related transition impact objectives which are still to be achieved is currently at risk due to the worsened market conditions due to the combined impact of the Russian-Georgian conflict and the impact of the global financial crisis.

In Agribusiness, the EBRD has supported seven clients under the MCFF engaged in non-durable trade and food and beverage production. Direct investments using ETCI

[1] Note that there might be a slight difference between the TIMS results presented and the impacts according to the latest TIR. This is due to the fact that (i) some projects counted in TIMS are new, hence no impact has yet materialised and (ii) projects in frameworks such as DIF, DLF, MCCF are not counted in TIMS (as they are monitored as facilities), thus the Corporate sector emphasis might be slightly underestimated.

[2] For full methodology, ref. annex 1.2 of the Transition Impact Retrospective (CS/FO/09-21; 16/10/2009)

instruments DIF and DLF took place across various segments from Georgian wine production to hazelnut production and along the value-chain from food processing to retail. Most transition impact was achieved via introduction of new products, and improvements in backward linkages to local producers.

In 2005, it was assessed that strengthening additional players in a highly concentrated MSME finance market would offer more consumer choice and foster competition. In 2009, given the EBRD's past successes in providing MSE finance through the Georgian banks, and the strong presence of well functioning NGOs dedicated to commercial MSE lending, transition gap was assessed as small in this sector in Georgia.

1.6. Private/State Sector Ratio

At the end of September 2009, 86.6% of total EBRD commitments were in the private sector. Over the new strategy period 2010-2012, the Bank will focus, in terms of number of operations, on private sector financing while also considering selected public sector operations individually requiring large commitment from the Bank (e.g. Black Sea Energy Transmission System, Tbilisi Railway Bypass project, transport) and MEI projects. Preference will be given to operations not requiring sovereign guarantees. Where sovereign guarantees are required, donor co-funding on a grant basis will be sought.

2. OPERATIONAL ENVIRONMENT

2.1. General Reform Environment

2.1.1. Political Environment

The basis for the current political system in Georgia was established by the Rose Revolution of November 2003. Successive post-revolutionary governments have pursued a wide-ranging reform programme aimed at reviving the national economy, improving living standards of the population and reducing poverty. The fight against corruption was put at the centre of the reform agenda.

Six years after the Rose Revolution, the Georgian authorities continue to adhere to their declared goals of combating corruption, improving governance, alleviating poverty and resolving territorial conflicts. However, the outbreak of the August 2008 conflict with Russia over South Ossetia and the subsequent declaration of independence by Abkhazia and South Ossetia have contributed to a polarised domestic political environment. The consequences of the conflict have galvanised the opposition's resolve to pursue changes in the political set-up of the country.

While rejecting early presidential and parliamentary elections, as demanded by the opposition, the authorities have agreed to pursue constitutional changes aimed at reducing the powers of the presidency. A set of new reform measures announced in July 2009 included an offer to hold early local elections, to directly elect Tbilisi Mayor and to amend the country's electoral legislation.

A detailed political assessment is provided in Annex 1.

2.1.2. 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. The recently implemented changes include amendments to various laws dealing respectively with the financial sector, entrepreneurial activities and tax law. In particular, the Law on the Activities of Commercial Banks has removed certain restrictions on the inflow of foreign capital and made it easier for foreign banks to enter the local market. The Law on Global Competitive Capacity of the Financial Sector adopted in 2008 is aimed at facilitating integration of the financial system of Georgia into the worldwide financial system as well as at making it compatible with the regulatory framework of worldwide financial system.

However, in practice the country continues to face considerable challenges in entrenching of the legal rules and strengthening of legal institutions. Although significant improvements in the legal and regulatory framework for business creation and operations have been made in the recent years, including liberalisation of the customs regime and reducing corruption, insufficient understanding (especially at local authorities level) and respect for the rule of law does not yet allow for adequate and fair enforcement and results in poorly functioning judiciary.

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

2.1.3. Social and Demographic Environment

Demographics

At the end of 2008, the population of Georgia was approximately 4.4 million, with a small positive growth rate of 1.4 per cent since 2005. External migration, mostly prompted by economic reasons, still remains a key factor in the falling population rate. The average life expectancy at birth in 2008 was 74.2 years. The urban population comprises 52.5 per cent of the total. 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

Despite the significant growth, according to the annual household surveys, the level of poverty has not changed significantly since 2005, remaining in the range 30 to 31 per cent. Nevertheless, according to the World Bank, non-income dimensions of poverty have improved, including significantly improved access for the poor to electricity, natural gas, safe water, health services, and higher education.

The current focus of government reform is the social sector. In the autumn of 2006 the government introduced a well-designed targeted social assistance program. While before the social assistance programs were based mainly on social status (disability, old age), the new targeted social assistance is targeted to the extreme poor, based on household surveys that utilize consumption data. The government has increased the budget for social spending in particular after the August conflict, from 6.7 per cent of GDP in 2008 to an estimated 7.8 per cent of GDP in 2009. The targeted social assistance system now covers about 700,000 people or about 16 per cent of the population. A programme for stimulating job creation in rural areas was initiated in February 2008, but unemployment remains high at about 16.5 per cent in end-2008 and recently has further increased due to the economic crisis.

Heath care system is poor. Although officially state-owned the health care has been operating as private. While government expenditure on health care has increased over year, the current financing system is inefficient, mainly based on out-of–pocket payment. Since 2007, the government has started implementing a very ambitious health care system reform that involves the privatisation of heath care system and establishment of an efficient financing system. The reform envisages the construction of 100 new private hospitals. While the majority of state-owned hospitals have been sold (mainly to real estate developers) the international financial crisis has affected real estate and the construction sector, delaying completion of hospital construction. In parallel, the government is developing a system for the health sector finance. The government is introducing a health insurance scheme base on mandatory health insurance for the military, public services and state employees. The introduction of government health insurance for the poor which will be implemented through voucher scheme in private insurance companies is largely completed.

The government has made some progress with the return, reallocation and resettlement of around 137 000 IDPs that resulted from the August conflict, mainly financed by the donor support that reached about US$144 million as of mid-2009. About 106,000 IDPs have returned to the Shida Kartli region and have received assistance for rehabilitation of damaged houses, restoration of food security and household items. About 18,000 IDPs originating from South Ossetia, Akhalgori and Abkhazia have been resettled in 38 newly-built settlements. Nevertheless, about 8,000 people remain displaced country-wide and all these groups are heavily dependent on government and international aid for meeting necessary nutritional needs.

The newly displaced persons from South Ossetia, in combination with the 210,000 Georgian citizens who fled from Abkhazia in the 1990s, represent close to 5% of Georgia's total population.

Equal Opportunities and Gender

The Constitution recognizes that all citizens should be considered equal before the law. However, in practice, discrimination remains an issue. While the law prohibits sexual harassment in the workplace, in practice incidents are rarely investigated. Some progress has been achieved regarding improving women's rights. As part of implementation of the Action Plan 2007-2008 on domestic violence, an inter-institutional Council on elimination of domestic violence was created at the end of December 2008. Georgia is currently working on a draft law on gender equality.

Labour Issues

Georgia is an ILO member state and has ratified all eight ILO core conventions and its labour Code is relatively liberal. Nevertheless, the current Labour Code is considered somewhat discriminatory to the employees. Currently, the government states that it is working on amending the Labour Code. In October 2008, the government agreed with the Trade Unions and the ILO to make changes to the Labour Code formulating a plan for implementation in December 2008. Consequently, the EU extended till 2010 Georgia's status of beneficiary under the special EU unilateral trade preferential regime aimed at partner countries engaged in sustainable development and good governance (GSP+). The foreseen changes to the Labour Code may include increased payment for overtime and compensation payment in case of firing.

2.1.4. Environmental Conditions

Located in the Caucasus, on the Silk Route between Europe and Asia, Georgia has always been an important North-South and East-West link. Covering 69,700 km² of varied landscape, its dominant features are mountains and national parks housing over 1000 protected animal species, which paired with a rich cultural history make the country a high potential tourist destination. Favourable climate and fertile land give Georgia strong agricultural growth potential that includes fruits and vegetables, livestock, dairy products, wine, nuts and tea. Natural resources potential include hydropower, manganese, iron, coal, copper, gold, granite, limestone, marble, mineral waters and forestry.

The Ministry of Environmental Protection (MoEP) is working on the elaboration of an Environmental Code, due by early 2010, in order to unify and simplify the current legislation. Four priority areas are identified in its Action Plan for 2009: (i) improvement of the legislative base, (ii) institutional optimisation, (iii) long-term strategy for environmental protection and management of natural resources, (iv) raising public awareness for environmental protection.

Progress is seen in the harmonisation process for Georgia's legislation alignment with EU standards, particularly in the devise and implementation of policies to protect the environment. The EU-Georgia Action Plan for 2004-2009 states as objectives to encourage economic development and enhance poverty reduction efforts and social cohesion; to promote sustainable development including the protection of the environment and further convergence of economic legislation and administrative practices. Priority areas include institutional capacity building, biodiversity conservation and protection, waste management and conservation and urban development and tourism. The United Nations Development Assistance Framework (UNDAF) for 2006-2010 seeks to mainstream Millennium Development Goals (MDG), with focus on five areas: (i) poverty and economic growth, (ii) governance, (iii) basic social services, (iv) volatility and instability, (v) environment. The United Nations Development Program (UNDP) has targeted assistance within environmental and natural resource management, amongst other areas, with human rights, gender equality and environment responsibility all mainstreamed into its projects.

Climate change scenarios for Georgia comprise rising average temperatures, increased risk of heat waves, random heavy downpours as well as decreased rates of annual average precipitation and reduction of water resources. Georgia joined the United Nations Framework Convention on Climate Change (UNFCCC) and is signatory to the Kyoto Protocol.

The EBRD's Country Strategy for Georgia identifies high-level operational priorities of the Bank's activities for the strategic period 2010-2012. The table in Annex 4 identifies some potential environmental and social issues associated with each of these priorities.

The Bank will continue to identify opportunities for environmental development in Georgia, such as the current Technical Assistance program for administration capacity building in the field of environmental management and inspection within the Ministry of Environmental Protection and Natural Resources.

All EBRD operations in Georgia are subject to the Bank's Environmental and Social Policy (2008) and incorporate, where appropriate, Environmental and Social Action Plans into the legal documentation in order to address issues raised during due diligence, in line with the Bank's mandate to actively support environmentally sound and sustainable development through its investment projects.

Annex 4 provides further analysis of environmental developments in Georgia.

2.2. Macroeconomic Conditions

Georgia achieved significant economic growth since the last strategy with real GDP reaching on average about 11 per cent during 2006-2007 driven mainly by the large foreign capital inflows. Foreign investments at about 15 per cent of GDP distributed across different sectors of the economy have contributed to broadening the economic base. Domestic credit grew rapidly from about 21 per cent of GDP in 2005 to about 31 per cent of GDP in end-2008, supported by increased confidence in the banking sector and access to international financial market. The level of dollarisation in the sector gradually decreased with the portion of loans in foreign currency decreasing from 77 per cent in end-2005 to 65 per cent in July 2008 (before the conflict)

The fiscal position improved significantly through a number of measures to improve tax legislation, tax administration and broadening of the tax base. Budget revenue increased from 23 per cent of GDP in 2005 to about 31 per cent of GDP in 2008, improving the government's ability to increase both social and capital spending needed in particular in infrastructure. The large current account deficit due to both a slower increase in exports related to the Russian embargo and increase in demand for imports was largely financed by foreign investments and remittances from workers abroad. The National Bank followed a strict monetary policy concerned with increased pressure on inflation due to larger foreign inflows and increase in energy and food prices.

However, the Georgian economy has been significantly affected both by the conflict with Russia in August 2008 and the international financial crisis. The August conflict undermined investor and consumer confidence, put stress on public finances, damaged physical and other infrastructure and put pressure on the banking system because of large deposits withdrawal (estimated at about 13 per cent). The National Bank of Georgia took a number of emergency measures to ease liquidity in the banking sector after the conflict, including reducing refinancing rate, reducing reserve requirements and liquidity ratio, as well as introducing direct liquidity support to banks.

The deepening of the international financial crisis put further pressure on the currency and foreign investments. The lari was eventually allowed to depreciate by 17 per cent in the first week of November. The crisis also affected the quality of the loan portfolio and the recovery of bank deposits while the international financial markets remain closed. Bank lending has decreased significantly and remains very limited. At the same time dollarisation of banks' portfolio has increased to more than 77 per cent, increasing the foreign exchange risks. Remittances from workers living abroad declined by about 20 per cent on an annual basis in July 2009 due to the economic slowdown, in particular in Russia which still accounts for more than half (decreasing from two-thirds in 2008) of remittances from abroad. The economy is estimated to have contracted by 10.7 per cent in the second quarter of 2009 after a contraction of 5.9 per cent in the first quarter of 2009, due to much lower investments both foreign and domestic and very limited bank lending. The construction, services and manufacturing sectors all experienced significant falls in activity during the first half of 2009. During the first half of 2009 foreign investment flows fell by about 80 per cent relative to the same period in 2008. Bank lending at end-August 2009 contracted by 4 per cent year on year.

This negative impact is partly offset by large-scale international financial support, amounting to about USD 4.55 billion over three years, pledged in October 2008. This has helped to finance the fiscal economic stimulus as about US$1.7 billion of the donor money has already been contracted up to now and an expected US$1.6 billion will be allocated by end-2009. The IMF emergency 18-months stand-by programme of USD 750 million that started in mid-September 2008, which was augmented by additional US$424 million and extended to June 2011, has also helped with stabilisation process after the conflict. The exchange rate has remained relatively stable despite the increase in flexibility of the exchange rate by the National Bank since May 2009. This is due to lower import demand related to decreased consumption.

Georgia faces an economic contraction in 2009 only recovering to a small positive growth in 2010. This is due to much lower domestic and foreign investments and a significant decrease in bank lending. The public economic stimulus mainly financed by the large pledged international financial support will provide some offsetting effect. Remittances from workers living abroad, although significant, are expected to continue to decline due to the recession in neighbouring countries, in particular in Russia, which in turn will affect consumption. International financial support is expected to largely cover the current account deficit, which could remain in double digits as export revenue are affected by lower demand and the export base remains small. The augmented IMF support will cover expected balance of payments financing needs in 2010-11. International aid inflows will help to alleviate the pressures on the currency. International financial support to the banking sector will help to limit the shrinking of bank balance sheets and improve their lending capacity in the short term as well as improve investors' confidence in the long run. The non-performing loans in the banking sector are expected to further increase due to the economic slowdown, particularly for its impact on the real estate sector, while foreign currency risks remain large due to high dollarization in banks assets (more than 70 per cent of loans).

Selected economic Indicators are provided in Annex 2.

2.3. Progress in Transition and Transition Challenges

2.3.1. Progress in Transition

During the past strategy period, progress with structural reform has been significant despite some slowdown in the past year. Progress has been made in particular with respect to completion of large-scale privatisation, further improvement in the business environment through liberalisation of the tax and customs regime, and financial sector reform. Tangible results have been achieved in fighting corruption, as reflected by Georgia's ranking on Transparency International's Corruption Perception Index 2009. Georgia ranks 66 among 180 countries with a score of 4.1, which is above the transition country average of 3.5. Georgia also acceded to the United Nations Convention on Corruption in November 2008.

Notwithstanding significant progress, government effectiveness and regulatory quality, although in line with or slightly above the transition country average, still falls well below the standards of the advanced countries. Regional instability had a perceived impact on the functioning of state institutions and almost 80 per cent of Georgian firms in the 2008/2009 Business Environment and Enterprise Performance Survey (BEEPS) report that political uncertainty is an obstacle to their operations.

As indicated by the EBRD's Assessment of Transition Challenges in 2009 much more remains to be done to advance progress with the reforms that focus on institution building, corporate governance, and infrastructure sector reform that are more difficult and require more time to implement. Major challenges remain in trade and investment climate, in particular in regulatory and institutional reform, including improvement in property rights, independence of judiciary, reinforcing the rule of law, further modernisation of the bureaucracy and administrative reform, and further reduction in corruption. See Annex 5 for ATC ratings by sector.

2.3.2. Transition Challenges

Transition challenges remain similar to challenges during the previous strategy period, with some of them further highlighted by the impact of the ongoing international financial crisis on the banking sector and the real economy. The main transition challenges are summarized as follows:

- Strengthening of the banking sector remains a key challenge. Measures to further boost depositors' confidence in the sector, improved supervision, and improvements in risk, and portfolio management by banks are important for banking sector development and stability.
- Improvement in physical infrastructure, in municipal utilities, and power generation, are essential for further improvement of conditions for doing business and sustained economic growth. Investments for infrastructure rehabilitation, changes in the regulatory framework, and private sector participation are essential to ensure its long-term financial sustainability.
- Development of the MSME sector is important for development of exports and import substitution, such as in the agribusiness sector. This sector accounts for only about 10 per cent of GDP. Although access to finance for MSMEs had improved significantly in the recent years, lending to this segment of the market

has been disproportionately affected by bank lending contraction related to the international financial crisis.

- Promoting energy efficiency across the economy and developing the regulatory framework for energy efficiency and renewable energy.
- Improving further the investment climate through effective implementation of legal reforms, the improvement of property rights, and further reduction in corruption.
- Strengthening domestic competition across the economy, supporting restructuring, and increase in productivity in key sectors through innovation and use of technology. By assisting domestic businesses to be more efficient and improve product/service quality, as well as by aligning trade-related regulatory framework with the international and EU laws and standards, Georgia's export potential can be boosted.

In particular, the remaining challenges in different sectors are the following:

Financial Sector

Banking sector supervision and regulation and the legal framework for transparency of ownership and corporate governance of banks were improved significantly since the last strategy. The National Bank of Georgia continued to consolidate the banking sector, for instance by increasing minimum capital requirements. The entry of foreign banks and the listing of the largest bank, Bank of Georgia, on the London Stock Exchange in 2007 have contributed to strengthening of the banking system, increased competition and improved the range of financial service offered by banks. Domestic credit to the private sector rose rapidly in the past four years doubling from 15 per cent of GD in 2005 to 30 per cent of GDP in 2008, albeit from a low base. A range of banks and specialist institutions offer microfinance. Bank lending to MSME sector has increased with the rapid growth of Procredit Bank contributing to a significant competitive pressure in this segment of the market. Nevertheless, only some financial intermediaries have developed sustainable MSME lending, forcing MSME's to rely on the capital of their owners and retained earnings.

The August 2008 conflict and the international financial crisis both led to a dramatic slowdown in bank lending. Serious vulnerabilities have since been exposed, in particular with respect to the need for improvement in risk and portfolio management. Since about 77 per cent of loans are denominated in foreign currency, possible currency depreciation poses large risk for banks' portfolio. The Financial Supervisory Agency established in 2008 operates under the national bank since the beginning of 2009. In the light of the financial crisis, the national bank is acquiring back more power for financial sector supervision and regulation with the aim of supporting financial stability and transparency as well as ensuring protection of rights of consumers and investors.

The insurance market remains relatively small (with premia-to-GDP ratio of less than 1 per cent), and the legislation and regulation fall short of the IAIS standards. The scale of private pension funds operations is very limited. Leasing operations are being gradually developed but from a very low base with only three leasing companies operating in the market.

Energy and Infrastructure

Municipal and Environmental Infrastructure

The service level and quality of municipal utilities has recently improved supported by grants from the international community. Nevertheless, most utilities remain in poor financial state, tariffs are insufficient to cover costs, while operational performance is poor and network losses substantial. The regulatory rights (e.g. tariff setting) were transferred from municipalities to an independent regulator and related legislation is in place, but regulatory capacity remains weak and consequently most water companies remain loss making. The private sector is active in urban transport, mostly in deregulated competition, but poor regulation translates into low quality services. The major challenges ahead across all municipal services are the rehabilitation of physical infrastructure, tariff reform and restructuring to improve efficiency.

With the help of IFIs the government has designed and is currently implementing a reform agenda in the municipal sector aimed at development of the water infrastructure and improvement of water quality. In June 2009, the government passed the resolution on merger of the state water-distributing companies. Two regional companies were established after the merger - West Water Ltd and East Water Ltd. West Water Ltd. consolidated 29 regional water-distributing companies, water supply and sewage systems of West Georgia. East Water Ltd includes 33 regional water-distributing companies, water supply and sewage systems of West Georgia. Merger of the state water-distributing companies will help to improve management and attract investments in the sector.

Power and Sustainable Energy

Georgia's electricity sector has been radically liberalised and partly privatised, but remains weakly regulated. Distribution is fully privatised to foreign strategic investors. Generation is in private hands with the exception of the largest HPP Enguri plant that supplies around half of the country’s electricity needs. Retail tariffs for residential customers are set close to full cost recovery but significant cross-subsidisation persists and prices do not include environmental costs. Since 2006 there has been a substantial reduction in network losses, which however remain high by international standards. Power outages still occur due to network failures. Collection rates increased to 95 per cent in 2008. However, weak transparency in the tariff setting process persists. For small scale renewable projects there is no feed-in tariff but simple deregulation and in most cases the price depends on the negotiating skills of the project developer. Energy standards in building codes are rarely followed in practice.

The country has a great potential for renewable and hydro generation in particular. The cost of developing green field power plants will be largely off-set by export to Turkey that Georgia is actively working on. The export capacity will also be beneficial at regional level, as it will enhance trading and facilitate cross support among countries in the region.

Transport

The government in cooperation with IFIs has accelerated the railway reform process, especially work to prepare the sector for privatisation. However, the railways are still operated as a state owned, vertically integrated company controlling core railway businesses (infrastructure, passenger, freight, etc.). Third party access has been granted and there are a number of private operators running businesses associated with the railway infrastructure. In roads, the state department for roads (SDRG) is only a semi-independent entity under the ministry. Most of the construction and maintenance units have already been divested, and some competitive pressures are present. Concession legislation was adopted in 2006 but so far no PPP project in roads has materialised.

Road user charges are enough to cover maintenance and rehabilitation costs. Tbilisi International Airport is privately run on a BOT basis. The port of Poti was also privatised in 2008 as was the port of Batumi.

Enterprise Sector

Agriculture is an important component of GDP still accounting for about 9 per cent in 2008 and for about 55 per cent of employment. Georgia has made notable improvements in price liberalisation across commodities and agricultural inputs. The latest land reform has set the institutional framework for functioning private land markets and consequently a large portion of agricultural land has been privatised, including to foreigners. The sector has nevertheless not been able to attract notable FDI. The privatisation of agro-processing has made some progress, but restructuring is still at an early stage and new owners still need to improve efficiency and upgrade hygiene and quality standards in order to become internationally competitive. The government has recently prepared a Strategy for the Agricultural Development of Georgia covering the period 2009-12 accompanied by an implementation programme. To this end, with EU support many workshops aimed at exchanging experience on best practices and international standards were organised. The government also launched a state programme of "Cheap Credit" aimed at supporting agriculture farms and agribusiness, while entrepreneurs can purchase state-owned agricultural land at concessional prices.

Significant progress has been made in the privatisation of state-owned enterprises in the manufacturing sector. Privatisation and the improvement in the administrative procedures for starting a business have attracted a large amount of FDI. This has resulted in improved productivity and some improvements in business standards. The challenges are to further improve the enforcement of competition legislation and enhance corporate governance and business standards. Despite the recent fast growth in the real estate market, the property market is at relatively early stages of development and there is an undersupply of modern commercial property in all commercial sub-segments. The biggest gap is observed in the warehouse and logistics market, where almost no western-type Class A facilities exist.

In the telecommunication sector, the fixed line market is dominated by United Telecom of Georgia (Sakartvelos Elektrokavshiri), while competition comes from alternative operators Akhali Kselebi, Akhteli and Telecom Georgia (Sakartvelos Telekomi). The government sold United Telecom to a Kazakh-Georgian consortium in 2006, while U.S. group Metromedia raised its stake in Telecom Georgia to 100 per cent in 2007. Mobile network coverage is provided to virtually the whole of Georgia, and mobile communication systems have become increasingly important, as the fixed-line networks are outdated in many places. Third mobile network operator Mobitel launched commercial services in March 2007. Internet uptake is suffering from inadequate networks and investment into improvement of the network. The Internet market is in its nascent stage and could benefit from the successful implementation of WiMAX.

2.4. Access to Capital

Prior to international financial crisis, Georgia's access to the international capital markets although improved, was limited to the banking sector. The government successfully issued its first Eurobond in April 2008. IFIs remain the main source of international finance for Georgian enterprises and financial institutions. Foreign direct investments, on the other hand, have increased significantly in the past few years, being a major contribution to economic growth. FDI increased from 8.3 per cent of GDP in 2005 to about 15.1 per cent in 2007 due partly to privatisation and was distributed across different sectors of the economy. Foreign investments were significantly affected by the August conflict and the international financial crisis decreasing to 9.2 per cent of GDP in 2008. Foreign investments in the first half of 2009 reached US$217 million a drop of about 80 per cent compared with the same period a year ago.

Once crisis conditions ease, foreign private capital inflows are expected to increase provided the uncertainty in the internal political situation is resolved, and credit growth will gradually resume. However, given the projected slow recovery in western economies, the return of foreign investments will be slow while the policy of supporting development of the export sector and improve competition will take some time to show results. Therefore, only gradual increase in growth is expected for the remainder of the strategy period. Throughout the strategy period the Bank's clients will likely operate under restricted access to international capital and credit markets. Foreign direct investments and domestic credit provided by the banking sector will only gradually start to grow, with lack of term lending remaining a major constraint.

3. STRATEGIC ORIENTATIONS

In response to the Transition Challenges identified, the Bank's main priorities will include: (i) Strengthening of the banking sector and non-bank microfinance institutions by means of selected incremental equity investments, local currency lending and use of technical assistance to further improve risk and portfolio management, as well as increasing the use of MCFF with a proven track record of channelling investments to the real economy and contributing to effective credit training of domestic banks; (ii) rehabilitation of decaying physical infrastructure where further investments will go along with regulatory reforms and private sector participation in infrastructure and municipal utilities to improve their efficiency, the quality of service, and their long-term financial sustainability (iii) enhancing Georgia's energy security, reliability and independence through investments in such critical areas as power transmission and generation from still untapped hydro resources, thereby broadening power tradability with foreign partners and diversifying the geographical source of power generation; (iv) further diversifying and broadening of the economic base through development of the tradable sector, by supporting exports and improving its competitiveness especially in manufacturing, as well as developing import substitution, in particular in agribusiness. 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.

3.1. Financial Institutions

Support to local banks, with a focus on existing core partners and systemic commercial banks. Financing in the form of senior, subordinated and syndicated debt, as well as equity, will be made available with a view to further strengthening the banking sector and rejuvenating basic financial intermediation. New banks may be targeted on a very selective basis in order to expand sector cooperation. The Bank will continue to play an active role in the development of non-bank financial activities, such as leasing and insurance, including through taking equity positions. In addition, 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's operational objectives will include the following:

- Given the Bank's already extensive exposure to the Georgian financial sector, especially after the crisis response activity in 2008/9, proactive monitoring and management of the existing portfolio will be the overarching priority. Specifically, this will include focussing on and providing support to partner banks in the areas of problem loan management, re-engineering of funding models in favour of domestic deposit-taking and increasing local currency lending. The aim of this approach should be to promote sector stability by ensuring that the lessons of the crisis are learnt and reinforced and that mistakes are not repeated in the future.

- Equity participations in banks whose fundamentals have proved strong enough to weather the current crisis will continue to be critical. The Bank will continue to selectively consider taking equity in financially sound Georgian banks where such an investment will trigger incremental lending to the real economy and generate confidence in the sector as a whole. Appropriate technical assistance will be made available to support the strengthening of Asset and Liability Management as well as Risk Management.

- In an environment where many banks have lost the appetite for lending to the real economy, and particularly to MSMEs, the Bank will aim to stimulate that activity by offering targeted long-term credit lines to banks demonstrating a commitment to re-engage in this market.

- In the context of dollarisation and general concern over FX risks, the Bank will strive to offer competitively priced local currency funding in order to match demand from end clients and reduce partner banks' currency mismatches. In the absence of a sufficiently developed capital market, the bank's only available alternative at present is to provide a synthetic hedge mechanism through its affiliate specialised vehicle TCX. Competitive pricing should be achievable on short term rollovers as the government has started a T bills placement programme through auctions, thus creating market benchmarks for rates up to six months in local currency. TCX has indicated its willingness to use similar benchmarks for pricing in neighbouring countries.

- Building on the experience with the MCFF and providing 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. In order to stimulate domestic lending, the Bank will also actively use the recently amended MCFF to take participations in credits extended to existing clients of its partner banks. It is important to note that MCFF also contributes to institutional strengthening in banks through dissemination of best practices in analysis and documentation of such credits.

- Examining the possibility of the introduction of a specialised agricultural finance programme for local banks, incorporating funding and technical assistance. Such an experimental programme will initially focus on ProCredit, the single most active institution in the primary agricultural sector.

3.2. Infrastructure

In order to address the massive need to replace ageing infrastructure the Bank will promote investment in the transport, municipal/environmental sectors by mainly using concession mechanisms and public private partnership structures, as well as attracting government and sub-sovereign co-financing and private sector finance in order to construct or rehabilitate airports, ports, roads, bridges, multi-modal logistic centres; improve rail infrastructure and rolling stock; and develop waste processing, district heating, public transport, water treatment and housing.

Municipal and Environmental Infrastructure (MEI): Lack of investments and mismanagement of municipal utilities 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. Improvement of water supply in the regions is one of the priorities of the government's poverty reduction strategy. The central government has increased its focus on municipal development spearheaded by the Georgian Municipal Development Fund, which is taking an effective role in managing a range of municipal water projects. The Bank is actively supporting the government's strategy of merging small local water utilities into several regional entities thereby achieving significant economies of scale and strengthening management. The Bank will further build on its successful model of cooperating with the Georgian Municipal Development Fund to identify high priority projects, seek sovereign guarantees and co-finance the investments with capital grants. Co-financing with other financial institutions remains a crucial element in the modernisation and rehabilitation of the key municipal and infrastructure sector. 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. 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. Building on the successful experience of the Rustavi waste management project, the Bank will seek to optimise its cooperation with the government, municipalities and donors, including BP, which is committed to support regional development and community initiatives.

Transport: One of the principal drivers for Georgia's economic development is the East-West rail/road link, which runs for 924 km across the Caucasus, connecting the Caspian Sea (Baku) to the Georgian Ports of Poti and Batumi. The Bank will look for opportunities to be present in the development of this important transit corridor, however, while lending is expected to be primarily on a sovereign basis, the Bank will focus on Public Private Partnership ('PPP') initiatives to finance projects that are viable and tendered on a competitive basis. In the rail sector, the Bank will prioritise projects that can be financed on the strength of Georgian Railway balance sheet, showing a positive Economic Rate of Return. This includes the Tbilisi railway bypass, a major project to be financed jointly with the EIB. In addition, the Bank will continue to support Georgian ports, with the focus expected to be on the development of Poti Port, one of the principal ports in Georgia.

3.3. Energy Security and Efficiency and Natural Resources

Power and Energy: The Bank will continue to work on the rehabilitation and construction of generating plants, the modernisation and expansion of the transmission grid and rehabilitation of the distribution networks. Through these projects, the Bank will also contribute to help Georgia achieve energy security of supply while facilitating trading of electricity in the region. The Bank will actively support projects targeting the enhancement and/or establishment of new energy transit gateways with neighbouring countries, such as the 500 kV Black Sea Transmission Line, the critical backbone to the country energy strategy to be co-financed with KFW and the EIB. Strengthening the transmission capacity will also increase the system reliability and contribute to the establishment of competitive and efficient electricity market in Georgia. The Bank will in parallel pursue investment projects in the low voltage electricity distribution grid to reduce technical losses and improve quality of supply. The Bank will support investment in the rehabilitation of existing hydropower plants and the construction of new green field facilities promoting the implementation of best international practices in terms of environment, social responsibility and procurement. Combined with the improvement in the distribution system, these investments of a regional dimension will optimise the tradability of power generation between Georgia and Turkey as well as improve the load balance of the domestic grid and markedly reduce the country's energy dependency

Energy Efficiency and Renewable Energy: 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, Clean Development Mechanism (CDM)). In particular the Bank will explore the possibility to finance small and medium sized entities in the industrial and residential sector through dedicated credit lines, subject to availability of TC and grant co-financing. Policy dialogue will aim at providing technical support to develop a comprehensive legal base for EE/RE development. It will be reinforced with associated regulatory development support to the government and regulators to help with development and implementation of regulatory frameworks for energy efficiency and renewable energy. Technical support will also be provided for assessing Georgia's potential for renewable energy sources. The Bank will also provide support to projects in renewable energy sources. A sectoral approach to Industrial Energy Efficiency projects will determine the eligibility of technologies based on minimum performance criteria, including such key sectors such as metallurgy, chemicals and building materials.

Natural Resources: the Bank will focus on investments which increase private sector participation and sectoral transparency, demonstrate operational and energy efficiency benefits and improve environmental standards. It will continue to work on identifying opportunities to support the ongoing rehabilitation of Georgia's main (North-South) gas pipeline. The bank will seek to provide assistance in support of the future expansion of the BTC and SCP projects as well as other projects of regional energy cooperation/integration and of strategic importance to the country.

3.4. Corporate Sector

While the Bank's crisis response in the wake of the 2008 conflict followed by the impact of the financial crisis primarily centred on the rescue and promotion of the country's key financial institutions, the new strategy will address the critical issue of channelling funds to the real economy. The corporate sector in its diversity is a key target for the Bank to meet this challenge. It can be addressed by using both the sectoral expertise present in the Tbilisi hub and in London and the range of instruments provided under the ETCI. The strategy will prioritise (i) facilitating adequate access of medium and small enterprises to working capital (ii) providing refinancing and restructuring support to existing and new clients; and (iii) support resumption of foreign direct investment. More systematic use of MCFF will induce local banks to resume corporate sector financing thus enhancing the momentum of domestic lending.

The Agribusiness sector will become a new priority for the Bank to take maximum advantage of its fertile agricultural land and most importantly to support and improve (i) the development of the modern format retail chains promoting better quality of products, better hygiene standards and improved format of stores; (ii) the development of sophisticated distribution systems, high quality storage (including cold and freezing), logistics and quality control systems; (iii) processing companies to introduce modern technologies, ensuring the transfer of the know-how and improving the input quality by using the quality certificates of the production and management. In the new strategy, the bank will use both equity and debt instruments to foster FDI with strategic Western investors.

In the General Industry sector, the Bank will actively seek other opportunities of financing projects involving FDI or local entrepreneurs for projects where General Industry's sectoral expertise is available, such as building materials, steel and forest products. The main focus will be for transactions that may be processed through ETCI framework products while larger transactions will also be sought, particularly in support of foreign strategic investors. Starting from a very low base, the significant increase of the GI portfolio over the last two years is indicative of under-explored opportunities. In addition to co-operation with partner banks through MCFF, the Bank will seek to maximise referrals from TAM BAS with a proven active track record in this sector in Georgia.

In the Property and Tourism sector**,** the Bank will use its leverage to reinstate the application of international best practices in terms of integrity and environmental, social and energy efficiency standards. The Bank will continue to consider selected bankable projects: (i) in commercial development (offices, retail and logistics) in cases where clear demand is present; (ii) in the hospitality sector, particularly in the 4-5* category aiming at business travellers, involving reputable developers and professional international operators; and (iii) with an aim to improve the country's tourism infrastructure and accommodation quality in the 2-3* segment. In addition, the Bank will assist in the dissemination of residential energy efficiency best practice, introducing/upgrading energy efficiency standards and transferring skills and know-how.

In the Telecoms Informatics and Media sector, the development of the overall industry is lagging far behind in establishing or supporting the full chain of information communication technologies (ICT) required in a competitive market place. Georgia's low scoring on the ICT Development Index as established by International Telecommunications Union (ITU) is indicative of development opportunities over the next strategy period. The Bank's investment priority will be with private companies primarily focused on building and operating infrastructure, delivering media and content and promoting ICT services and usage. This will most likely result in an increasing use of equity-based investment structures and further work in collaboration with the Bank's Legal Transition Team to strengthen the implementation and enforceability of the regulatory and legal frameworks currently established.

3.5. Policy Dialogue and Investment Climate

In close co-ordination with other IFIs and bilateral donors, the Bank will expand its policy dialogue with the authorities and local business community on actions needed to improve the investment climate, including legislative and regulatory reform, as well as institutional strengthening. The Bank's efforts will specifically focus on the following:

- Support to the GoG's initiative to reform municipal water services by restructuring the water sector and consolidating smaller companies into regional ones. TC funds will be channelled to facilitate the implementation of the following reform objectives: institutional strengthening, assessment of priority investments, regulation and tariff reforms as well as encouragement of private sector participants.

- Providing further legal transition assistance, including improvements to the laws on secured transactions and insolvency, reform of concession laws, improved corporate governance and judiciary reforms.

- Promoting energy efficiency across the country and leading policy dialogue on improving the regulatory framework for energy efficiency and renewable energy.

- Maintaining dialogue with the government to improve fair and transparent implementation of tax policies and audits as well as the independence of the judiciary in dealings with businesses in order to improve the investment climate.

4. CO-OPERATION WITH IFIs AND THE EUROPEAN COMMISSION

Co-operation with other donors is crucial in Georgia, and the Ministry of Finance has taken an impressive lead in ensuring a much needed co-operation in the context of the aggregate USD 4.5 billion donors pledge secured in October 2008. The main framework of the donor and IFI cooperation and synergies of support to Georgian economy in the three years post-conflict period where set out in the Joint Needs Assessment document prepared by international institutions for the donor conference in October 2008.

At the Brussels conference in October 2008, donor pledges were made for about USD 4.5 billion over three years: pledges for budget support ($586 million), social needs (USD 450 million) and infrastructure (USD 2.6 billion) totalled USD 3.7 billion. An additional set of pledges of USD 800 million to support the private sector, including USD 750 million for the banking system, were made.

The largest bilateral pledges were from the United States (USD 1 billion), the European Commission (almost EUR 500 million), and Japan (USD 200 million). International financial institutions announced contributions of a total of USD 2.4 billion – this group encompasses the ADB (USD 300 million), EBRD (USD 927 million), EIB (USD 330 million) and the World Bank Group (USD 880 million).

During the period of October 2008 to March 2009, donors entered commitments to public sector of USD 1 billion, includingUSD $418 million for budget support, USD 250 million for social needs and USD 340 million for infrastructure and municipal. Of the USD 1 billion committed, USD 564 million has actually been disbursed over this period, including nearly 100 per cent of budget support, and 30 per cent of social and investment support. In the private sector, commitments during this period were USD 636 million. Disbursement reached USD 447 million mainly in the banking sector, out of which about USD 279 million (EUR 210 million) were from the EBRD.

The EBRD will continue to play a significant role in its response to the Joint Needs Assessment with a particular focus on financial institutions, along with the IFC, and on the enterprise sector as well as selected public sectors of the economy with all IFIs and donors. 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 and trade-related regulatory framework. 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. The Bank will further its cooperation with the EIB and other development institutions such as KFW to co-finance power generation and transmission.

• Other essential **infrastructure**: the Bank will seek to synergise efforts to address critical bottlenecks in co-operation and 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. In particular, the Bank will co-operate with the USAID and MCC on developing a water sector programme in Georgia. The Bank will make full use of BP's Social Responsibility and Regional Development Investment programmes to facilitate MEI and Energy Efficiency financings by the Bank. The Bank will work closely with the European Investment Bank (EIB) on transport infrastructure projects falling within its mandate, in accordance with the Memorandum of Understanding between the EBRD, EIB and EC signed in 2006. The Bank also anticipates working closely with other IFIs, including the International Finance Corporation (IFC), the World Bank and the Asian Development Bank (ADB).

• **Financial sector**: the Bank will continue to play a leading role with other IFIs and more particularly with the IFC in providing innovative solutions to keep the sector alive. Furthermore, within the framework of the ETCI, the Bank will apply higher leverage through introduction and ongoing implementation of the funding instruments for the banking sector, where donors' TA support will remain critical.

ANNEX 1: POLITICAL ASSESSMENT

Compliance with Article 1

Georgia is committed to the principles of multiparty democracy, pluralism and market economics in accordance with the conditions specified in Article 1 of the Agreement Establishing the Bank, although application of these principles in the previous Strategy period has been uneven.

Since the last country strategy there have been sizeable achievements in economic reforms despite the impact of the global economic and financial crisis but many challenges still lie ahead, including further development of democratic institutions, reinforcing checks and balances between the branches of power and strengthening the rule of law.

The basis for the current political system in Georgia was established by the Rose Revolution of November 2003. Successive post-revolutionary governments have pursued a wide-ranging reform programme aimed at reviving the national economy, improving living standards of the population and reducing poverty. The fight against corruption was put at the centre of the reform agenda, involving restructuring of the police, administrative reform and the creation of a streamlined and transparent public sector.

Six years after the Rose Revolution, the Georgian authorities continue to adhere to their declared goals of combating corruption, improving governance, alleviating poverty and resolving territorial conflicts. However, the outbreak of the August 2008 conflict with Russia over South Ossetia and the subsequent declaration of independence by Abkhazia and South Ossetia have contributed to a polarised domestic political environment. Although there are differing views among the opposition, the consequences of the conflict have galvanised its resolve to pursue changes in the political set-up of the country.

Political Accountability

Georgia is a presidential republic. The President is elected under a majoritarian system 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. The parliament in Georgia consists of 150 members and is elected for a four-year term on the basis of a mixed electoral system, with seventy five members of parliament elected under a list-based proportional system in one nationwide constituency and another seventy five in single-mandate constituencies.

The most recent presidential election – the second one after the Rose Revolution of 2003 - took place on 5 January 2008 against a background of extreme political polarisation. On 7 November 2007 demonstrations organised by a bloc of opposition parties were violently dispersed by the police. The protesters demanded the resignation of President Mikheil Saakashvili, the rescheduling of parliamentary elections from autumn to spring 2008 and constitutional changes aimed at transforming Georgia into a parliamentary republic. To diffuse political tensions, the President proposed to shorten his mandate from five to four years, thus enabling parliament to call a pre-term presidential election on 5 January 2008.

The election was monitored by an International Election Observation Mission (IEOM), consisting of OSCE/ODIHR, the Parliamentary Assembly of the Council of Europe and the European Parliament. The observation mission concluded that the election was consistent with most OSCE and Council of Europe commitments but it also revealed significant shortcomings, including allegations of intimidation and pressure, the blurring of the distinction between state activities and the election campaign of the ruling pro-presidential United National Movement (UNM), and shortcomings in the vote count, tabulation and post-election complaints procedures.

These shortcomings were repeated in the parliamentary elections in May 2008. Initially planned for later in 2008, the parliamentary elections were brought forward following a plebiscite held simultaneously with the 5 January presidential election. Although following the events of November 2007 and polarised January 2008 presidential election, the opposition managed to consolidate its ranks, it has remained fragmented during the parliamentary elections. The election took place in a tense political environment, characterised by mistrust in the election administration and a lack of confidence in the electoral process. The overwhelming majority of parliamentary seats – 119 of the total 150 - went to the ruling UNM. The United Opposition won 17 seats in the legislature. Two more opposition parties crossed the 5 per cent threshold required for representation in parliament: the Labour Party with 7.4 per cent and the Christian-Democrats with 8.7 per cent.

The international observers who monitored the parliamentary elections concluded that the authorities made efforts to conduct these elections in line with the OSCE and Council of Europe commitments but the elections were uneven and incomplete in their adherence to international standards. The Constitution and the Unified Election Code had been amended only two months before the elections with changes creating an unequal playing field in favour of the ruling party – the United National Movement.

The opposition (with the exception of the Christian Democrats) decided to boycott the newly-elected parliament by non-participation in its work. While united behind the government in supporting Georgia’s sovereignty and territorial integrity in the conflict with Russia, the extra-parliamentary opposition is in disagreement with the authorities over their handling of the situation in the period leading to the conflict. The extra-parliamentary opposition, including political parties that were not elected to parliament and those who decided not to take their seats in the legislature, was the force behind protest rallies (of varying intensity) which have been taking place since April 2009.

Although the opposition decided to stop protest rallies in July, it has confirmed its commitment to pursue changes of the current political model based on strong executive powers concentrated in the presidency and not sufficiently balanced by parliament, dominated by presidential supporters, or the judiciary, with the latter being prone to corruption and pressure from the executive branch.

While rejecting early presidential or parliamentary elections, the authorities have agreed to discuss constitutional changes that would reduce the powers of the presidency. In July 2009 President Saakashvili reiterated earlier made proposals and announced a set of new reform measures, including an offer to hold early local elections on 30 May 2010 (instead of planned autumn 2010 date); to hold direct elections of Tbilisi Mayor (instead of the current indirect election by the City Council); to amend the Election Code by the end of 2009; to introduce changes regarding the chairman and the composition of the Central Election Commission; to reduce presidential powers by limiting the president’s rights to dissolve parliament; and to initiate constitutional amendments allowing ethnic Georgians living abroad greater access to Georgia’s political life. President Saakashvili also reiterated his earlier proposal for the opposition to take part in the work of National Security Council. A large-scale dialogue with the public was also promised.

Rule of law and protection of human rights

A member of the Council of Europe and the OSCE, Georgia has made sizeable progress in its transition towards a rule-of-law-based society. The country has developed a strong legal basis for protection of human rights by ratifying the core UN Human Rights Conventions and the fundamental Conventions of the ILO. The events of November 2007 and subsequent political developments in the country highlighted the need to continue advancing in the direction of consolidation of democratic institutions, increased media freedom and enhanced rule of law.

During the strategy period the government's human rights record saw improvements in some areas but problems remain, as reported by independent monitors. The main human rights violations included cases of excessive use of force by law enforcement officers, police impunity, lack of access for average citizens to defence lawyers and poor conditions in prisons and pre-trial facilities. Some progress was reported in the implementation of the legal framework for criminalising torture and ill treatment but inhuman and degrading conditions in prisons remain a concern. Numerous violations of the laws of conflict were reported, on both sides, during the August conflict over South Ossetia, causing civilian deaths and destruction of civilian property.

The independence of the judiciary needs to be further improved. The Council of Europe provided assistance in the elaboration of disciplinary proceedings against judges. The Georgian President announced plans to initiate legislation envisaging stricter punishment for those who attempt to influence court decisions. The introduction of the jury system would also help to increase transparency of the judiciary. The jury system is initially planned to be launched next year in Tbilisi and with regard to court cases related to homicide.

Georgia ratified the Council of Europe's Criminal Law Convention on Corruption in January 2008, which entered into force in May 2008. In March 2008 the Government amended the Law on Conflict of Interest and Corruption in the Public Service, which includes a code of conduct for public servants and prosecutors. The Anti-Corruption Interagency Coordination Council was established under the responsibility of the Ministry of Justice. Regular dialogue with civil society organisations and the public in monitoring implementation of the anti-corruption strategy remains a priority.

ANNEX 2: SELECTED ECONOMIC INDICATORS

	2003	2004	2005	2006	2007	2008 *Estimate*	2009 *Projection*
Output and expenditure			*(Percentage change in real terms)*				
GDP	11.1	5.9	9.6	9.4	12.4	2.1	-5.5
Private consumption	3.2	7.6	0.1	29.1	9.8	na	na
Public consumption	4.1	64.2	27.2	-3.6	7.8	na	na
Gross fixed capital formation	20.9	9.0	12.0	-0.4	14.8	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	14.0	12.2	13.0	16.2	15.0	na	na
Agricultural gross output	10.3	-7.9	12.0	-9.6	6.0	-2.1	na
Employment[1]			*(Percentage change)*				
Labour force (end-year)	-2.5	-0.5	-0.8	-0.1	-2.8	-2.4	na
Employment (end-year)	-1.3	-1.7	-2.2	0.2	-2.5	-6.0	na
			(In per cent of labour force)				
Unemployment (end-year)	11.5	12.6	13.8	13.6	13.3	16.5	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	4.9	5.7	8.4	9.2	9.3	10.0	1.2
Consumer prices (end-year)	7.0	7.5	6.4	8.8	11.0	10.0	3.0
Producer prices (annual average)	2.3	3.8	7.2	9.6	10.2	12.0	na
Producer prices (end-year)	5.4	0.7	8.2	10.9	16.9	1.4	na
Gross average monthly earnings in economy (annual average)	10.4	24.5	30.2	36.1	29.5	40.3	na
Government sector[2]			*(In per cent of GDP)*				
General government balance	-2.5	2.3	-1.5	-3.0	-4.2	-6.4	-9.4
General government expenditure	18.7	19.4	24.9	29.2	33.5	37.1	na
General government debt	61.5	47.0	36.6	28.9	22.9	na	na
Monetary sector			*(Percentage change)*				
Broad money (M3, end-year)	22.7	42.6	26.4	39.3	50.3	14.0	na
Domestic credit (end-year)	14.7	7.4	39.8	34.5	28.8	34.0	na
			(In per cent of GDP)				
Broad money (M3, end-year)	12.4	15.2	16.4	19.3	23.5	23.9	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Money market rate	16.9	11.9	7.7	9.5	7.8	na	na
Treasury bill rate (3-month maturity)[3]	44.3	19.2	na	na	na	na	na
Deposit rate (3-month)[4]	9.3	7.2	7.6	11.4	9.5	10.4	na
Lending rate (3-month)	32.3	31.2	21.6	18.8	20.4	21.2	na
			(Laris per US dollar)				
Exchange rate (end-year)	2.1	1.8	1.8	1.7	1.6	1.7	na
Exchange rate (annual average)	2.1	1.9	1.8	1.8	1.7	1.5	na
External sector							
			(In millions of US dollars)				
Current account	-294.0	-430.0	-628.0	-1,069.0	-2,005.8	-2,904.6	-1,720.7
Trade balance	-598.0	-719.0	-1,214.0	-2,019.0	-2,895.7	-3,894.4	-2,669.6
Merchandise exports	730.0	1,272.0	1,472.0	1,667.0	2,088.3	2,420.3	1,933.9
Merchandise imports	1,328.0	1,991.0	2,686.0	3,686.0	4,984.0	6,314.8	4,603.5
Foreign direct investment, net	335.0	420.0	529.0	1,115.0	1,740.1	1,561.1	887.1
Gross reserves, excluding gold (end-year)	190.9	383.0	473.9	881.0	1,361.0	1,480.0	na
External debt stock	1,954.0	2,039.0	2,137.0	2,000.0	3,136.0	4,555.2	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	1.3	1.8	1.8	2.5	2.9	2.6	na
			(In per cent of current account revenues, excluding transfers)				
Debt service	10.0	10.2	5.6	10.5	9.0	14.4	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	4.6	4.5	4.5	4.5	4.4	4.4	na
GDP (in millions of laris)	8,565.0	9,969.8	11,621.0	13,789.9	16,998.6	19,069.6	17,925.4
GDP per capita (in US dollars)	877.0	1,155.9	1,419.5	1,722.2	2,312.7	2,908.1	na
Share of industry in GDP (in per cent)	17.7	16.1	15.7	14.9	14.2	13.5	na
Share of agriculture in GDP (in per cent)	19.3	16.4	14.8	11.3	9.2	8.9	na
Current account/GDP (in per cent)	-7.4	-8.3	-9.8	-13.7	-19.7	-22.7	-16.1
External debt - reserves (in US$ million)	1,763.1	1,656.0	1,663.1	1,119.0	1,775.0	3,075.2	na
External debt/GDP (in per cent)	49.0	39.2	33.3	25.7	30.8	35.6	na
External debt/exports of goods and services (in per cent)	151.7	111.4	106.9	77.8	106.0	127.9	na

[1] Figures consistent with ILO methodology.

[2] General government includes the state, municipalities and extra-budgetary funds.

[3] Data relate to the average auction rates during the year.

[4] Data refer to average rates for local currency from international financial statistics.

ANNEX 3: LEGAL TRANSITION

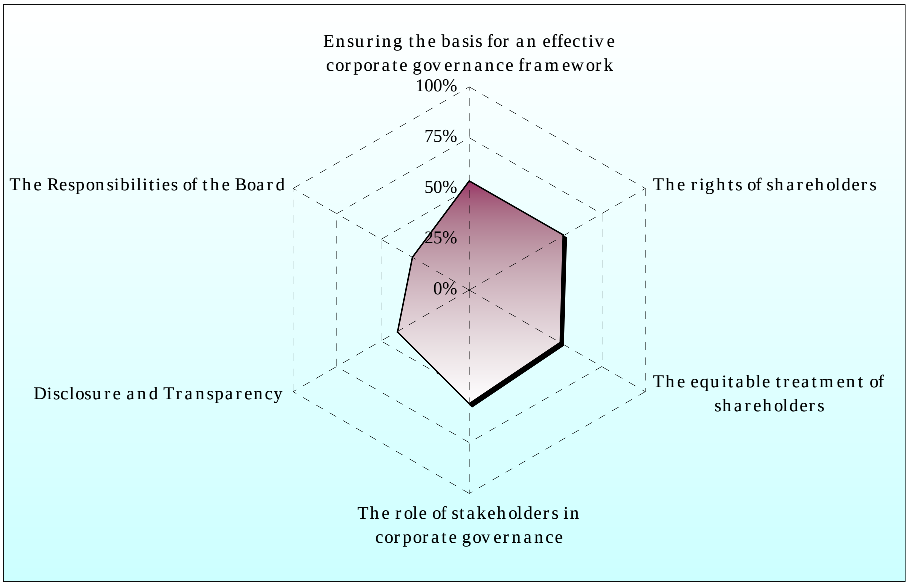
ASSESSMENT OF GEORGIA'S COMMERCIAL LAWS

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. 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.

Company Law and Corporate Governance

The principal Georgian legislation dealing with corporate governance is included in the Law on Entrepreneurs enacted on 28 October 1994, as amended. Apart from this law there is currently no voluntary corporate governance code in the country, but a new set of recommendations on corporate governance of banks to be applied on a comply or explain basis is being developed by the Association of Banks of Georgia.

Quality of Corporate Governance Legislation – Georgia (2007)



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, 2007 assessment

According to the results of the EBRD's 2007 Corporate Governance Sector Assessment[3] (see chart above) under which the quality of corporate governance legislation in force in November 2007 was assessed, Georgia resulted to be in "very low compliance" with the OECD Principles of Corporate Governance, showing a framework under an urgent need for reform. When considering the effectiveness of corporate governance legislation, the 2005 EBRD's Legal Indicator Survey[4] revealed that various avenues are available to

[3] For more information see: http://www.ebrd.com/country/sector/law/corpgov/assess/index.htm

[4] For more information see: http://www.ebrd.com/country/sector/law/corpgov/lis/index.htm

minority shareholders for obtaining disclosure from a company but their effectiveness is undermined by their complexity and the difficulty of enforcement. Complexity is also an issue when assessing the procedures for obtaining redress. Executable judgements are generally obtained in about one year, but then at least 6-8 months need to be added for the enforcement procedure. Courts and market regulators are considered impartial, although their competence and experience should be improved.

Authorities should consider reforming the procedures in order to make them less burdensome and the enforcement more effective. The legislator should also assess the compliance of national legislation with international standards and consider improving both the framework and the capacity of institutions in effectively implementing the legislation.

Concessions

A number of governmental statements refer to the task of improving the legal environment for and promoting private sector participation which implies the existence of some PPP policy framework in Georgia.

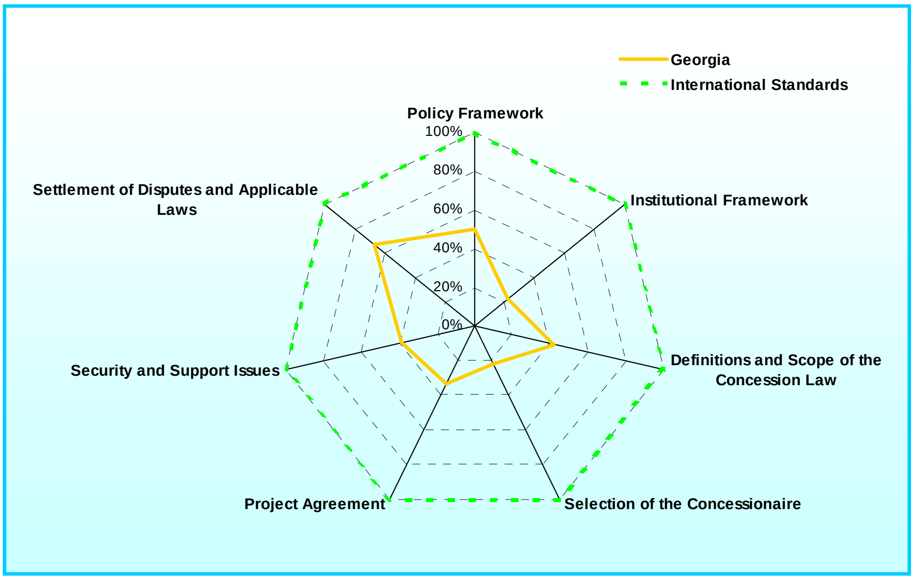
The 1994 Law on Procedure for Granting Concessions to Foreign Countries and Companies (the "Concessions Law") is very limited in its scope, somewhat superficial and insufficiently clear. It defines concession as a "leasing agreement" and seems to be restricted to natural resources only. As implied by its name, the Concessions Law applies to foreigners only, discriminating against domestic investors and excluding them from concession arrangements.

Amongst the major deficiencies of the Concessions Law the following are of worth noting. The public authority to grant concessions is not defined and only vaguely referred to as "an authorised body as defined under legislation of Georgia". The rules governing the selection procedure are inadequate and insufficient, as are the disputes settlement procedure and the project agreement rules. The Concessions Law provides for the adoption of a list of objects (assets) that can or cannot be subject to concessions, but no such list seems to be publicly accessible. The Concessions Law provides for the adoption of regulations on concessionaire selection, 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.

There are some positive features in the Concessions Law, e.g. the concessionaire's right to appeal to the court or arbitration "against public bodies 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 bodies" and the provision for certain forms of government support/guarantees.

Overall, the Concessions Law is generally outdated and does not constitute a sufficiently solid legal basis for the development of concessions or any other forms of public private partnerships. 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, especially in the current circumstances of limited financing opportunities.

Quality of Concession Legislation – Georgia (2007/8)



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 2007/8

According to the EBRD Concession Sector Law Assessment 2007/8 the overall rating of Georgia laws governing PPP/concession was "low compliance with the internationally accepted standards". As can be seen from the chart, rules governing nearly all dimensions of Concession/PPP legal regime have much room for improvement, ideally to be complemented by the formulation of a clear PPP general policy including the institutional framework

Insolvency

Insolvency in Georgia is governed principally by a new Law on Insolvency, dated 2007 (the "Insolvency Law"). Based on a preliminary review, it appears that the Insolvency Law has improved in a number of areas noted as deficient in previous EBRD assessments. In particular the definition of insolvency is clearly spelt out and the regime for the claims of secured creditors is closer to the best international practice.

Despite being relatively new, the Insolvency Law has omitted to reflect on a number of issues which could impede its efficiency in practice. The Insolvency Law fails to provide for an interim relief to protect the assets of the debtor upon filing the insolvency application. This may create an opportunity for significant erosion of the value of the assets of the estate. Furthermore, the Law does not provide for individual notification of all creditors which would allow them to lodge their claims in a timely manner upon commencement, nor is there a requirement to notify relevant regulatory authorities.

The recovery of assets might be significantly impeded by the failure of the Insolvency Law to require the debtor to deliver all of its assets to the appointed office holder, nor are third parties obliged to deliver assets of the debtor or any information relevant to the discovery of debtor's assets. On top of this the Insolvency law has unclear rules on avoidance of transactions that may reduce the opportunity for the recovery of assets on one side and unreasonably increase the risks that creditors may perceive in insolvency proceedings.

The viability of reorganisation proceedings as provided for in the Insolvency Law is questionable. Thus, there is no prohibition on termination of essential contracts for the operation of a business (e.g. gas, electricity supply, telecommunications contracts). Similarly, there is no mechanism to incentivise post commencement financing, which may prevent recovery in many cases. Further, the creditors' ability to make an informed decision on the reorganisation plan is limited as there are no requirements to supply them with enough information and undertake an independent analysis of the reorganisation plan.

Another impediment to the efficient discharge of the insolvency proceedings is the underdevelopment of insolvency office holders' profession and the law fails to lay down basic principles for its development. The office holders do not need to hold a licence or authorisation to practice the profession based on educational and other quality screening criteria. There is no regulatory body to supervise or discipline the office holder or to hear complaints of administrator malpractice. There are no codes of professional and ethical conduct of insolvency office holders and they are not required to hold an insurance to protect third parties against negligence, breach of duty or fraud by the office holder.

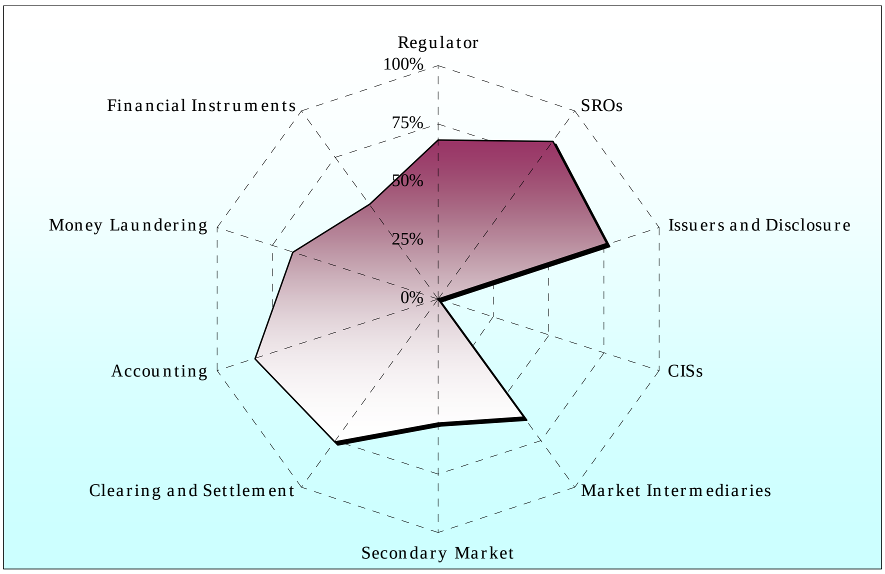
In conclusion the Insolvency Law would benefit from further improvement with a view to its practicability and objectives. Similarly, the institutions meant to support the implementation of the Law must be continuously developed.

Securities Markets

In Georgia the principal legislation on the securities markets is entrusted in the Law on Securities Market, dated 24 December 1998 (as amended), which regulates securities, public offers, the stock exchange, the central depositary, brokers and details the requirements for companies placing their securities through public offering and/or admitting them for trading on a stock exchange.

The Georgian Financial Supervisory Agency is the market regulator, created on 24 April, 2008 as the sole entity responsible for supervising the financial sector. It replaced both the National Security Commission and the State Supervisory Service of Insurance. The Agency is in charge for the supervision of the banking sector, securities markets and insurance sector.

Quality of Securities Market Legislation – Georgia (2007)



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 2007

In 2007, the EBRD benchmarked the Georgian securities markets legislation against the "Objectives and Principles of Securities Regulation" published by IOSCO. The assessment showed that Georgian securities markets legislation is in "low compliance" with international standards (see chart above). Among the major flaws, it is worth noting the lack of specific legislation regulating collective investment schemes and derivatives.[5] In order to understand how securities market legislation works in practice, in the same year the EBRD undertook a Legal Indicator Survey asking practitioners in the region to comment on a hypothetical case study.[6] The Survey concentrated on effectiveness of prospectus disclosure requirements, private and public enforcement mechanisms and authority of the market regulator. The Survey revealed that IPOs are not common in Georgia. Information included in the prospectus is not considered reliable for the absence of transparency in the market, the lack of IPO practices and the shortages of qualified professional resources. Private enforcement mechanisms allow for some course of action but they are burdensome. The new structure of the securities markets regulator has improved the legal framework but is too early to see the positive effects of the reform. The legislator should assess the compliance of national legislation with international standards and consider improving both the framework and the capacity of institutions in effectively implementing the legislation.

Telecommunications

Institutional framework: The Georgian National Communications Commission (GNCC) was established by the 1999 Law on Communication and Post (the "1999 Telecom Law"), and regulates Georgia's communications sector. GNCC is governed by comprehensive rules on independence, transparency, consultation and conflict of interest avoidance. The Ministry of Economic Development is responsible for sector policy development. Much of the detail of the current regulatory framework is contained in the 2005 Law on Electronic Communications (the "2005 EC Law").

Regulatory independence: The 1999 Telecoms Law established GNCC as a formally independent institution. The President of Georgia appoints its members for the period of six years and only these commissioners can select, appoint or dismiss employees of the organisation. Funding for GNCC comes directly from regulation fees paid by sector operators. This serves to ensure that GNCC remains independent from the government and also provides the necessary resources to fully perform its tasks. A strict set of rules is in place to avoid conflicts of interest. For instance, an employee of the GNCC, or close relatives of employees of GNCC, cannot have any direct or indirect economic interest or receive any income or other benefits from licence holders, or hold any position in the business of a licence holder.

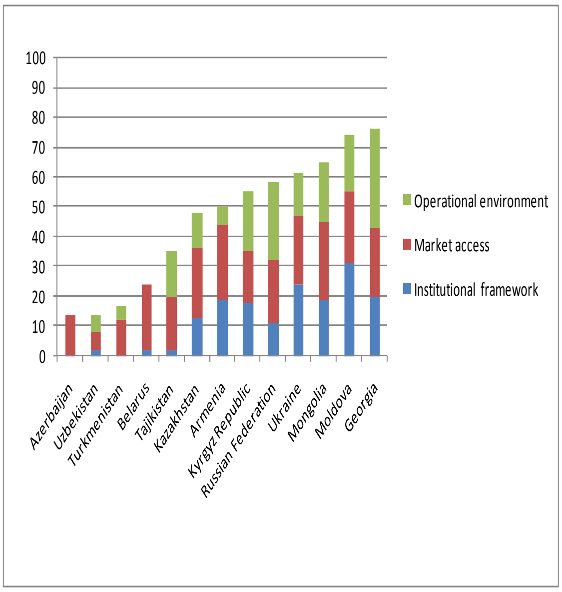
Outlook: Although continuously improving, the electronic communications infrastructure and equipment in Georgia remains outdated because of decades of insufficient investment, making traffic management overly complicated, allowing some traffic to be carried and/or terminated illegally (without the requisite payment) by some operators. Mobile communications, in particular, have become increasingly important because of the inadequacy of the fixed line facilities provided in many places (particularly in rural and remote areas). However, Georgia's telecommunications market has improved considerably in the last couple of years and should continue this trend, with rising revenues and increased investment in infrastructure.

[5] For more information see: http://www.ebrd.com/country/sector/law/capital/assess/index.htm
[6] For more information see: http://www.ebrd.com/country/sector/law/capital/survey/index.htm

Assessment: In a 2008 assessment of the communications sector of EBRD Countries of Operation the sector regulatory regime in Georgia was deemed to have "High Compliance" when measured against international best practice.

Key indicators for Georgia from the EBRD Assessment

This spider diagram includes six main group indicators. For each indicator, the diagram presents the scores as percentages of the maximum achievable score. The scores begin at zero at the centre of the chart and reach 1.00 at the outside, so that in the overall chart, the wider the web, the better the score in the assessment.



Regulatory spider diagram

Comparative regulatory assessment EBRD countries of operation in the Commonwealth of Independent States (CIS) + Mongolia

(see http://ebrd.com/country/sector/law/telecoms/assess/index.htm for more details).

ANNEX 4: ENVIRONMENTAL DEVELOPMENTS

1. Environmental and Social Legislation, Policies and International Commitments

The Ministry of Environmental Protection (MoEP), through its General Inspectorate, oversees the activities of an array of state organisations such as the Service of Biodiversity Protection, the Department of Environmental Policy and International Relations, the Service of Nuclear and Radiation Safety, and the Department of Integrated Environmental Management, with competence in areas such as biodiversity and climate change, waste management, ownership and use of land, air, water and soil protection. The MoEP is responsible for the implementation of the Law on Environmental Protection (1996), including monitoring and regulation of environmental pollution, sanitary supervision over the protection of the epidemiological rules, regulation of the use of land, protection of natural resources and the ecosystem, amongst others.

The MoEP has issued an action plan for 2009 where 4 priority areas are identified: (i) improvement of the legislative base, (ii) institutional optimisation, (iii) long-term strategy for environmental protection and management of natural resources, (iv) public awareness raise for environmental protection. These priorities will be reached through the elaboration of an Environmental Code regulating environmental inspection activities, forestry sustainable development, eco-tourism in protected areas, post-conflict action, disaster preparedness, and mechanisms for consultation with society.

During the preparation of Environmental Code, the need emerged to unify and simplify the legislation (currently over 25 laws and 4000 pages of Regulatory Acts, often in conflict with each other). The MoEP has set the task of issuing a common Environmental Legislative Base, with clear separation of responsibilities between Parliament and Government. The Environmental Code will be created on the basis of consensus between Ministries, NGOs, political parties, experts and civil society, the process starting in January 2009 with completion by 1st March 2010. The action plan includes the systematisation of Georgian laws, compilation of existing standards, preparation of a list of unregulated areas, an inventory of obligations assumed through International Agreements together with analysis on compliance, and finally the presentation of the Draft Code by 2010.

The Department for Environmental Policy and International Relations looks after policy and strategy elaboration on environmental issues, coordinating the activities of international environmental programs in cooperation with the Secretariat of Environmental Conventions as well as foreign partners. The Black Sea Convention Protection Department oversees the implementation of the United Nations Convention on the Law of the Sea (1982), the MarPol convention, and the Convention on the Protection of the Black Sea from Pollution (Bucharest, 1992).

The Department of Forestry is responsible for the management and protection of forests and the sustainable exploitation of forest resources and restoration. The Ministry of Agriculture and Food Industry encompasses the Department of Land Resources and Land Cadastre, responsible for land use regulations, land reform issues, land protection and supervision of effective exploitation of land resources; and the Department of Technical Engineering, Ecology and Natural Resources, with control over agricultural pollution, food industry, inspection of soil erosion and soil re-cultivation.

Other related state offices include the State Ecological Examination Department, the Centre of Scientific Ecological Information, the Hydrometeorology Department, the Departments for Water Resources Protection, Air Protection, Biodiversity Protection, Land Resources Protection and Waste Management, Fish Resources Protection and Reproduction, the Central Laboratory for Pollution Control, and the Scientific Research Institute for Marine Ecology and Fishery.

The EU-Georgia Action Plan for 2004-2009 states as objectives to encourage economic development and enhance poverty reduction efforts and social cohesion; to promote sustainable development including the protection of the environment and further convergence of economic legislation and administrative practices. The implementation of the Action Plan is contributing to the approximation of Georgian legislation and standards to those of the EU. Progress is reported in the adoption/implementation of economic and trade regulations and the devise and implementation of mechanisms and policies to protect the environment.

The United Nations Development Assistance Framework (UNDAF) for 2006-2010 seeks to mainstream Millennium Development Goals (MDG) targets within Georgia's development priorities. The programme comprises five areas: (i) poverty and economic growth, (ii) governance, (iii) basic social services, (iv) volatility and instability, (v) environment. The United Nations Development Program (UNDP) has targeted assistance within the areas of governance capacity building through training programs; poverty reduction through policy advice and promotion of employment opportunities; crisis prevention and recovery; environmental and natural resource management; with human rights, gender equality and environment responsibility all mainstreamed into its projects. The Food and Agriculture Organisation of the United Nations (FAO) provides technical assistance promoting food security and sustainable development and creating and enforcing an institutional, legal and regulatory frame in agriculture, forestry, fisheries and water management sectors.

Regarding international environment-related agreements, Georgia is party to:

Air Pollution: Protocol to the 1979 Convention on Long-Range Transboundary Air Pollution Concerning the Control of Emissions of Nitrogen Oxides or Their Transboundary Fluxes.

Stockholm Convention on Persistent Organic Pollutants.

Biodiversity: Cartagena Protocol on Biosafety to the Convention on Biological Diversity.

EIA: Convention on Environmental Impact Assessment in a Transboundary Context (Espoo, 1991)

Climate Change: UN Framework Convention on Climate Change

Climate Change-Kyoto Protocol: Kyoto Protocol to UN Framework Convention on Climate Change

Desertification: UN Convention to Combat Desertification in Those Countries Experiencing Serious Drought and/or Desertification

Endangered Species: Convention on International Trade in Endangered Species of Wild Flora and Fauna (CITES).

Agreement on the Conservation of Population of European Bats – EUROBATS.

Convention on the Conservation of Migratory Species of Wild Animals.

Agreement on the Conservation of Cetaceans of the Black Sea, Mediterranean Sea and Contiguous Atlantic Area – ACCOBAMS.

Hazardous Wastes: Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal.

Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade.

Law of the Sea: United Nations Convention on the Law of the Sea (LOS).

International Convention for the Prevention of Pollution from Ships (MARPOL).

The Black Sea Biodiversity and Landscape Conservation Protocol to the Convention on the Protection of the Black Sea against Pollution.

Nuclear Safety: Treaty on the Non-proliferation of Nuclear Weapons, and others.

Ozone Layer Protection: Montreal Protocol on Substances That Deplete the Ozone Layer

Public consultation: Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters (Aarhus)

Wetlands: Convention on Wetlands of International Importance as Waterfowl Habitat (Ramsar)

Current environmental NGOs' activities focus on the following areas: air, soil and water pollution; alternative energy and energy efficiency; biodiversity and species conservation; ecological tourism; environmental education; environmental legislation; environmental media; health and the environment; nature reserves; sustainable agriculture; sustainable development. Some of these groups have well-developed organizational structures and effectively operating mechanisms. Amongst other initiatives, the BTC project has provided opportunities for NGOs inputs through involvement in the EIA process and in further environmental and social monitoring. Despite a current lack of international funding, of adequate domestic legislation, of regular media coverage, and of general public understanding, the Georgian environmental NGO community is generally active and influential.

2. General Environmental Setting

2.1 Physical

Georgia is located in the Caucasus region; its northern border with Russia runs along the crest of the Greater Caucasus mountain range, bounded to the west by the Black Sea, to the south by Turkey and Armenia, and to the east by Azerbaijan. Georgia covers a territory of 69,700 km² and its population is approximately of 4.7 million. Located on the "Silk Route" between Europe and Asia it has always been an important North-South and East-West link.

Georgia's landscape is varied and paired with its rich cultural history it offers tourism potential. Although the dominant feature is undoubtedly the mountains, its horizons range from coast to low-land marsh-forests and swamps, from moderate rain forests to eternal snows and glaciers, including semi-arid plains (more characteristic of Central Asia) in the eastern part. Dense forests account for over one third of the territory while alpine and subalpine zones cover roughly about 10 per cent. Georgia's highest peak is Mount Shkhara at 5,201m above sea level (masl). The Likhi Range divides the country into eastern and western halves and the Greater Caucasus Mountain Range separates Georgia from the Russian Republics of the North Caucasus, while the Lesser Caucasus Mountains form the southern borders. The main roads through the mountain range into Russian territory lead through the Roki Tunnel between South and North Ossetia and the Darial Gorge (Khevi). The region between Kazbegi (the only mountain in the country to be of volcanic origin) and Shkhara (200km along the Main Caucasus Range) is dominated by numerous glaciers: out of 2,100 Caucasian glaciers, 40% are in Georgia. Prominent features include the Javakheti Volcanic Plateau, lakes (Tabatskuri and Paravani) as well as mineral water and hot springs. The Southern Georgia Volcanic Highland is a young and unstable geologic region with high seismic activity and some of the most significant earthquakes recorded. There are 2 RAMSAR sites in Georgia, equating to 34,480 hectares: central Kolkheti and the wetlands of Ispani II marshes.

According to the WDPA, Georgia has a total of 33 nationally designated terrestrial and marine protected areas across 2720Km (roughly 4% if its territory). The Georgian Centre for the Conservation of Wild Life (member of IUCN) identifies 8 key regions: Akhaltsikhe, Bakuriani, Batumi, Kazvegi, Kbareli, Lagodekhi, Poti and Telavi.

The Georgian Agency of Protected Areas, a department of the MoEP, reports a total of 495,892 hectares of protected areas (roughly 7% of its territory), with 14 Strict Nature Reserves, eight National Parks, 12 Managed Nature Reserves, 14 Natural Monuments and two Protected Landscapes. It is worth noting that approximately 75% of Protected Areas in Georgia are covered by forests.

The Borjomi-Kharagauli National Park, located in the Lesser Caucasus, is considered one of the largest national parks in Europe, the diversity of its geographical and ecological zones contributing to a rich flora and fauna and unique historical monuments and cultural heritage. Other protected areas and national parks completing the list are: the Algeti National Park, the Ajatemi Protected Area, the Batsara-Babaneuri Protected Area, the Bichvinta-Miusera Protected Area, the Chachuna Protected Area, the Imereti Caves Protected Area, the Katsoburi Protected Area, the Kazbegi National Park, the Ritsa Protected Area, the Kobuleti Protected Area, the Tbilisi National Park, the Mariamjvari Protected Area, the Vashlovani Protected Area, the Liakhvi Protected Area, the Tusheti Protected Area, Kolkheti National Park, the Mitrala National Park, the Kintrishi Protected Area, the Pskhu Gumista and Gardabani Protected Area, and finally the the Lagodekhi Protected Area, one of the first nature conservation zones in Georgia, established as early as 1912.

The Government of Georgia Action Plan for 2009 includes, in its environmental strategy, the development of the Mtirala National Park and the building of a Visitors Center, infrastructure work for the Ktsia-Tabatskuri Managed Reserve, the establishment of the Javakheti National Park and the biosphere reserve in Kazbegi, continuation of the Borjomi-Kharagauli National Park development project, and general promotion of financial sustainability of the protected areas.

2.2 Biological

Georgia has a natural resource base that offers strong economic growth potential. Fertile land and a favourable climate enable diverse agricultural production that includes fruits and vegetables, livestock, dairy products, nuts and tea. The country has a history of viticulture with around 500 varieties of grapes, with significant potential for export if quality standards are improved. Fast–flowing rivers offer good hydropower potential capabilities, the two major being the Rioni and the Mtkvari. Latest oil exploration activities have indicated oil and gas potential; other resources include manganese, iron, coal, copper, gold, granite, limestone, marble and mineral waters.

As far as biodiversity is concerned, Georgia houses a large number of animal species due to its landscape and elevation diversity, comprising for example, according to the WWF, circa 1000 species of vertebrates. In 2003, Georgia approved the Red Book Law (Legislative Bulletin 19, 01.07.03), a safeguard system for biodiversity and genetic resources within Georgian territory, under which any species incorporated to the “red list” is considered endangered and guaranteed immediate legal protection. RAMSAR reports state 19 species of threatened birds, amongst which the white breasted duck, the pygmy re-breasted pelican, the marble-fronted goose, and the cormorant goose.

Much of the natural habitat in the lowlands of Western Georgia has disappeared over the last 100 years due to urbanisation and agricultural development. Forests in the Colchis plain are today virtually non-existent apart from those in national parks and reserves (i.e. Paleostomi Lake area). The forest area consists of deciduous trees such as oak, hornbeam, beech, elm, ash and chestnut up to 600 masl. Between 600 and 1,500 masl, the forest (beech, spruce and fir, mainly) becomes mixed with both broad-leaf and coniferous species; the tree line ends at around 1,800 masl, at which point the alpine zone takes over (in most areas, up to 3,000 masl). The eternal snow and glacier zone lies above the 3,000m line. The general landscape features numerous valleys and gorges separated by mountains. Coniferous forests dominate in the Borjomi Gorge and in the extreme western areas.

2.3 Human

Ethnic Georgians form a majority (83.8%) of Georgia's current population of about 4,400,000 (2007 estimate). Other ethnic groups include Azeris (6.5%), Armenians (5.7%), Russians (1.5%), Abkhazians and Ossetians. Numerous smaller groups also live in the country, including Assyrians, Chechens, Chinese, Georgian Jews, Greeks, Kabardins, Kurds, Tatars, Turks and Ukrainians. Notably, Georgia's Jewish community is one of the oldest Jewish communities in the world. The official languages are Georgian and Abkhaz within the autonomous region of Abkhazia. Georgian, being the country's official language, is spoken by 71% of the population, with 9% speaking Russian, 7% Armenian, 6% Azeri, and 7% other languages. Georgia also has considerable linguistic diversity, with Georgian, Laz, Mingrelian and Svan spoken in the South Caucasus in addition to Georgian.

The following table presents some key demographic indicators (source: World Bank):

Population, total (millions)	4.4
Population growth (annual %)	-1
Life expectancy at birth, female (years)	75
Life expectancy at birth, male (years)	67
Unemployment, total (% of total labor force)	13

Georgia's literacy rate is close to 100%. The 1989 census recorded 341,000 ethnic Russians (6.3%), 52,000 Ukrainians and 100,000 Greeks in Georgia. Since 1990, it is estimated that 1.5 million Georgian nationals left, with about one million immigrants from Georgia legally or illegally residing in Russia and almost 100% of the ethnic

Greeks having left to Greece. In the early 1990s after the dissolution of the Soviet Union, violent separatist conflicts broke out in the autonomous regions of Abkhazia and South Ossetia; a large number of ethnic Ossetians left Georgia mainly to Russia's North Ossetia. Also, more than 150,000 ethnic Georgians left Abkhazia and are now IDPs all over Georgia.

Most of the population practices Orthodox Christianity of the Georgian Orthodox Church (81.9%).

Poverty is high in Georgia: the 2003 Poverty Reduction Paper estimates that 52% of the population live in poverty and 15% in extreme poverty. Unemployment is the main cause of poverty, but low education and lack of working capacity (old age, disabilities) also play an important role.

While gender inequality is generally low, emigration, labour market requirements and the poor social infrastructure have raised the extent of female labour and social discrimination. Traditional gender roles also create inequality. Opportunities for career and professional growth for women are restricted. Maintaining the family bears a heavy burden on women, while social compensation mechanisms such as free kindergartens and antenatal assistance fail to meet demand.

2.4 Climate change

Considering its relatively small territory, the climate in Georgia is extremely diverse, although two main climatic zones can be identified, roughly splitting it in east and west. Much of western Georgia lies within the northern periphery of the humid subtropical zone with annual precipitation ranging from 1000–4000 mm. Precipitation tends to be uniformly distributed, with a peak in autumn. The climate varies significantly with elevation; much of the lowlands in the west keep relatively warm throughout while the foothills and mountainous areas (including both the Greater and Lesser Caucasus Mountains) experience cool, wet summers and snowy winters. Ajaria is the wettest region of the Caucasus (up to 4500 mm of precipitation per year in some parts). Eastern Georgia features a transitional climate from humid subtropical to continental. Annual precipitation rates range from 400–1600 mm, with the wettest periods occurring during spring and autumn. Much of eastern Georgia experiences hot summers (especially in the low-lying areas) and relatively cold winters. Elevation is an important feature in the east, climatic conditions above 1500 masl are considerably colder than in the low-lying areas.

Climate change scenarios for Georgia comprise rising average temperatures, increased risk of heat waves, random heavy downpours as well as decreased rates of annual average precipitation and reduction of water resources. The sectors most exposed are water resources, tourism, agriculture and energy. Georgia is already experiencing serious challenges in its energy sector such as recurrent power cuts, outdated and inefficient existing energy assets, decreasing river flow/rain water sources and declining energy supplies. Georgia will therefore focus on ways to mitigate and adapt to climate change.

Georgia joined the United Nations Framework Convention on Climate Change (UNFCCC) in the category of non-Annex I country, also being signatory to other conventions on Climate Change such as the Kyoto Protocol. On those lines, the Climate Change Program (CCP) focus its projects on three main areas: GHG inventory, vulnerability and adaptation, and GHG mitigation and carbon financing. In 2008, Georgia organised a public Summit on Climate Change attended by over 300 delegates with the objective to open a state-wide dialogue on the challenges of climate change, its impacts on Georgia and the identification of opportunities for successfully tackling the issue. The Summit also highlighted mechanisms of reaction for state and local governments, business industries and other public and private sector leaders. However, legislation is yet scattered and at times contradictory, and despite recent attempts at mainstreaming climate change issues, the need to bring it into national planning and policy still stands strong. In addition to GHG reduction measures, it is imperative to address adaptation, mainly in the most vulnerable sectors such as water resources, agriculture, biodiversity conservation and tourism.

3. Areas of Environmental Concern and Priorities

Georgia's interest in harmonising its environmental legislation with the EU harmonisation is already accelerating improvements in the reform process. Priority areas include:

Institutional Capacity Building: strengthening of administrative capacity for environmental policy making and enforcement; also staff training and increased staff resources within government offices.

Biodiversity conservation and protection: unstructured urbanisation is affecting ecosystems, resulting in habitat loss. Further implementation of international agreements and stronger legislation are required to decrease the rate of loss of biodiversity and protect endangered species.

Waste Management: creation/rehabilitation of landfills and remediation of toxic hotspots.

Water Management and Conservation: despite good standards of access to drinking water and water supply systems, surface waters are affected by urban, domestic and industrial pollution. Water supplies and sanitation schemes remain outdated.

Urban Development and Tourism: restructuring and expansion of the tourism sector and general infrastructure –roads, water, power generation-.

4. Environmental Issues Associated with Bank's Priorities in Georgia

The Country Strategy identifies high-level operational priorities of Bank's activities in Georgia for the strategic period 2009-2011. The table below identifies in a non-exhaustive manner some potential environmental and social issues associated with each of these priorities:

Priority	Potential Environmental and Social Issues
Infrastructure, energy generation and environmental projects	o Water resource and watershed management o Potential biodiversity impacts, with particular focus on fragile areas (high mountains, arid zones of Eastern Georgia) o Lack of capacity to manage land acquisition o Increase in tariffs for basic municipal services and associated affordability issues for the poorest in the population o Undeveloped occupational safety culture o Political interferences in public consultation o Lack of participation of ethnic minorities in public consultation and decision making o Inadequate grievance processing mechanisms o

Priority	Potential Environmental and Social Issues
Financial sector consolidation/restructuring (TFPs).	o Labour issues such as child labour and minimum wages o Biodiversity loss o Occupational Health and Safety o Gender issues
Direct finance for foreign/local enterprises (SMEs - FDI)	o Lack of capacity in FIs and SMEs to manage environmental, social and labour issues o Land acquisition/displacement (small hydropower, municipal services) o Retrenchment in the public services sector
Policy dialogue (new Government to address regulatory, infrastructure shortcomings)	o Strengthening of National Action Plans (eg. Biodiversity, Natural Disaster, Spills Response etc.) o Consultation with civil society, practical implementation of the Aarhus convention. o Occupational Health and Safety, potentially in construction industry.

The Bank will continue to identify opportunities for environmental development in Georgia, such as the current Technical Assistance program for administration capacity building for environmental management within the Ministry of Environmental Protection and Natural Resources, in order to strengthen enforcement of environmental regulations and ensure clarity and effective compliance of the regulatory system.

All EBRD operations in Georgia are subject to the Bank's Environmental and Social Policy (2008) and incorporate, where appropriate, Environmental and Social Action Plans into the legal documentation in order to address issues raised during due diligence, in line with the Bank's mandate to actively support environmentally sound and sustainable development through its investment projects.

ANNEX 5: ASSESSMENT OF TRANSITION CHALLENGES

Assessment of Transition Challenges 2009: Summary of Results

		Market Structure	Market Institutions	Overall
Corporate	**Agribusiness.**	Medium	Medium	Medium
	General Industry	Medium	Large	Medium
	Property and Tourism	Large	Small	Medium
	Telecoms	Medium	Medium	Medium
Energy and Infrastructure	**MEI**	Large	Large	Large
	Natural Resources	Large	Large	Large
	Power	Small	Medium	Medium
	Sustainable Energy	Medium	Medium	Medium
	Transport	Medium	Medium	Medium
Financial Institutions	**Banking**	Medium	Large	Medium
	NBFI	Large	Large	Large
	MSME	Large	Medium	Medium
	Private Equity and Capital Markets	Large	Large	Large

ANNEX 6: BANK COMMITMENTS AND NET PORTFOLIO

(As at 30 September 2009, € million)

by Sector

Sector Name	COMMITMENTS				NET PORTFOLIO				
	No. of projects	EBRD Funding	% of total EBRD	Disbursed	No. of projects	Portfolio	% of Total Portfolio	Undrawn commitment	Operating assets
Financial Institutions	**65**	**314.6**	**47.5**	**278.3**	**47**	**257.1**	**55.4**	**34.9**	**222.2**
Infrastructure	**11**	**62.5**	**9.4**	**53.8**	**10**	**32.9**	**7.1**	**8.7**	**24.2**
Municip. & Environmental Infr.	*7*	*15.6*	*2.3*	*6.9*	*7*	*13.7*	*3.0*	*8.7*	*5.0*
Transport	*4*	*46.9*	*7.1*	*46.9*	*3*	*19.2*	*4.1*	*0.0*	*19.2*
Energy	**10**	**148.5**	**22.4**	**148.4**	**7**	**72.3**	**15.6**	**0.1**	**72.2**
Natural Resources	*5*	*82.1*	*12.4*	*82.1*	*3*	*55.7*	*12.0*	*0.0*	*55.7*
Power & Energy	*5*	*66.4*	*10.0*	*66.3*	*4*	*16.6*	*3.6*	*0.1*	*16.5*
Corporate	**36**	**136.7**	**20.7**	**106.3**	**29**	**101.8**	**21.9**	**38.7**	**63.1**
Agribusiness	*21*	*65.0*	*9.8*	*62.8*	*16*	*34.8*	*7.5*	*10.3*	*24.4*
General Industry	*7*	*21.1*	*3.2*	*20.5*	*6*	*18.0*	*3.8*	*0.7*	*17.3*
Property & Tourism	*7*	*29.7*	*4.5*	*23.0*	*6*	*28.1*	*6.1*	*6.8*	*21.4*
Telecoms Informatics & Media	*1*	*20.9*	*3.2*	*0.0*	*1*	*20.9*	*4.5*	*20.9*	*0.0*
Country Total	**122**	**662.3**	**100**	**586.8**	**93**	**464.1**	**100**	**82.4**	**381.7**

by Portfolio Class and Investment Type

	COMMITMENTS				NET PORTFOLIO				
	No. of projects	EBRD Funding	% of total EBRD	Disbursed	No. of projects	Portfolio	% of Portfolio	Undrawn commitment	Operating assets
Private	110	573.6	86.6	506.9	83	432.4	93.2	73.6	358.8
State	12	88.7	13.4	79.9	10	31.7	6.8	8.8	22.9
Country Total	**122**	**662.3**	**100**	**586.8**	**93**	**464.1**	**100**	**82.4**	**381.7**
Non-Sovereign	107	575.3	86.9	508.6	84	433.5	93.4	73.6	359.9
Sovereign	15	87.0	13.1	78.2	9	30.6	6.6	8.8	21.8
Country Total	**122**	**662.3**	**100**	**586.8**	**93**	**464.1**	**100**	**82.4**	**381.7**
Debt	85	531.1	80.1	488.5	69	369.9	79.7	50.9	319.1
Equity	17	66.0	10.0	59.2	12	58.9	12.7	6.8	52.1
Guarantee (TFP)	8	21.7	3.3	4.6	6	20.4	4.4	15.7	4.6
Debt and Equity	12	43.5	6.6	34.5	6	14.9	3.2	9.0	5.9
Country Total	**122**	**662.3**	**100**	**586.8**	**93**	**464.1**	**100**	**82.4**	**381.7**

PROJECT PIPELINE[7]

in EUR million

(as of 30 September 2009)

Sector	Million €	%	No. of Operations	%
Financial Institutions	**68.8**	**16.7**	**14**	**33.3**
Infrastructure	**138.0**	**33.6**	**5**	**11.9**
Municipal. & Environmental Infratructure.	*5.0*	*1.2*	*3*	*7.1*
Transport	*133.0*	*32.4*	*2*	*4.8*
Energy	**148.5**	**36.1**	**4**	**9.5**
Natural Resources	*33.5*	*8.1*	*1*	*2.4*
Power & Energy	*115.0*	*28.0*	*3*	*7.1*
Corporate	**59.0**	**14.4**	**19**	**45.2**
Agribusiness	*15.6*	*3.8*	*6*	*14.3*
General Industry	*17.8*	*4.3*	*8*	*19.0*
Property & Tourism	*20.2*	*4.9*	*2*	*4.8*
Telecoms Informatics & Media	*5.4*	*1.3*	*3*	*7.1*
Total	**414.2**	**100.8**	**42**	**100**

[7] Projects having passed Concept Review or equivalent approval stage plus the exploratory projects as of end-September 2009. 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 Period From 1/01/1994 to 30/09/2009

Commitment Name	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage	Sector	Linked to Inv.
Kutaisi Water II and Tskaltubo Water and Wastewater - PIU Support including Hydraulic Modelling, Detailed Design and Construction Supervision	850,000	0	11/05/09	Committed	Local Authority Services	Y
Georgia: Strategic Environmental Assessment of Aragvi River Basin	150,000	49,500	10/02/09	Committed	Energy	N
Rustavi Solid Waste - PIU Support	427,130	0	21/04/09	Committed	Local Authority Services	Y
Procredit Bank of Georgia: Regional Expansion	538,591	538,591	25/07/05	Closed	Finance, Business	Y
Borjomi-Bakuriani Water - Engineering Design & Field Supervision	171,123	147,208	02/08/07	Disbursing	Local Authority Services	Y
Implementation of Credit Scoring for MSE Lending - Constanta	66,613	66,613	14/11/07	Disbursing	Finance, Business	Y
Insolvency Law Reform in Georgia	224,637	224,637	29/10/04	Closed	Community/Social Services	N
Strengthening of the Georgian Insurance State Supervision Service (GISSS)	173,397	173,397	10/11/04	Closed	Finance, Business	N
Georgia: Trade Finance Advisory Services	87,100	87,100	17/11/04	Closed	Finance, Business	N
Policy Dialogue and Support in the Georgian Wine Sector	134,962	134,962	25/01/05	Closed	Manufacturing	Y
Secured Transactions Law Reform in Georgia - Phase 1	68,275	68,275	25/01/05	Closed	Community/Social Services	N
Georgia: Trade Finance Advisory Services (Extension)	22,500	22,500	20/09/05	Closed	Finance, Business	Y
Secured Transactions Law Reform - Phase 2	91,445	91,445	06/10/05	Closed	Community/Social Services	N
Tbilisi Water Restatement and Audit	48,950	48,950	27/11/06	Closed	Local Authority Services	N
Batumi Public Transport - Business Plans	28,375	28,375	10/01/07	Closed	Transport, Storage	Y
Batumi Public Transport - Credit Analysis of the City	36,836	36,836	17/01/07	Closed	Transport, Storage	Y
TAM - Caucasautomagistrali	28,872	28,872	16/02/06	Closed	Manufacturing	N
Kobuleti Waste Water Treatment Plant: Preparation of Detailed Engineering Design and Supervision	49,888	49,888	11/05/07	Closed	Local Authority Services	Y
GEEP - Georgia Energy Efficiency Programme	530,304	324,128	05/11/07	Disbursing	Energy	Y
Batumi Public Transport - Environmental Action Plan for the Batumi Bus Company, "Batumis Avtotransporti"	49,516	5,000	14/12/07	Disbursing	Transport, Storage	N
Kobuleti Water - Complementary Detailed Engineering Design	43,450	8,000	20/06/08	Disbursing	Local Authority Services	Y

Commitment Name	**Euro Committed**	**Euro Disbursed**	**Fund Approved Date**	**Commit. Stage Name**	**Sector**	**Linked to Inv.**
Continuation of the BAS Programme in Georgia	561,357	297,171	19/09/08	Disbursing	Manufacturing	N
Basis Bank - Assistance with Institution Building Plan	250,000	0	30/10/08	Committed	Finance, Business	Y
TAM - Interplast	75,000	23,093	31/10/08	Committed	Manufacturing	N
TAM - Populi	75,000	40,131	31/10/08	Committed	Manufacturing	N
TAM - Caucasus Online	100,000	31,158	05/11/08	Disbursing	Manufacturing	N
TAM - Begi	75,000	24,045	19/11/08	Disbursing	Manufacturing	N
Cartu Bank - Assistance with implementation of IBP	250,000	0	21/11/08	Committed	Finance, Business	N
Black Sea Regional Transmission Project: ESIA	300,000	15,000	21/11/08	Committed	Energy	Y
TAM - East Gate Group	75,000	30,703	03/12/08	Committed	Manufacturing	N
Adjara Solid Waste Management - Corporate Development and Regional Support Programmes for the Autonomous Republic of Adjara and the Solid Waste Company	304,605	0	03/12/08	Committed	Local Authority Services	Y
Black Sea Regional Transmission Project: Assessment of the regulatory environment	180,000	60,000	18/02/09	Committed	Energy	Y
Rustavi Solid Waste - Corporate Development and City Support	266,169	0	23/03/09	Committed	Local Authority Services	Y
Georgia: GEEP - Extension of Consultancy Services	484,563	0	26/05/09	Committed	Energy	Y
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	641,334	641,334	06/08/03	Closed	Finance, Business	Y
Georgia SME Line of Credit - Micro and Small Credit Advisers Extension	501,971	501,971	17/12/04	Closed	Finance, Business	Y

Commitment Name	Euro Committed	Euro Disbursed	Fund Approved ate	Commit. Stage Name	Sector	Linked to Inv.
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	530,879	530,879	06/08/03	Closed	Finance, Business	Y
Georgia SME Line of Credit - Micro and Small Credit Advisers Extension	732,498	732,498	17/12/04	Closed	Finance, Business	Y
Poti Water Detailed Design Consultancy	49,848	49,848	09/05/06	Closed	Local Authority Services	Y
Georgia: Factoring Advisory Services for Banks & Factoring Companies	175,080	175,080	15/06/06	Closed	Finance, Business	Y
Tbilisi Public Transport Project: Project Preparation Services	132,070	132,070	04/02/05	Closed	Local Authority Services	Y
Judicial Capacity Building	95,000	95,000	31/05/05	Closed	Community/Social Services	N
Technical Assistance to Ministry of Environment - Georgia	250,000	131,771	06/10/05	Committed	Community/Social Services	Y
Kutaisi Water Company, IFRS Restatement and Audit	49,190	49,190	23/11/05	Closed	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
Adjaria Solid Waste Management, IFRS Restatement and Audit	49,454	49,454	13/02/06	Closed	CEALs,CoFinancing Lines & RVF's	Y
Tbilisi Public Transport Project - Regulatory Framework	200,000	59,970	13/02/06	Disbursing	Transport, Storage	Y
Georgia: Tbilisi Public Transport Project - Corporate Development Programme	450,000	409,500	13/02/06	Disbursing	Transport, Storage	Y
TAM - Elit Electronics	85,053	85,053	23/05/06	Closed	Manufacturing	N
Georgian Gas Transmission Pipeline Rehabilitation TC	303,544	303,544	12/07/06	Closed	Energy	Y
Georgia: Micro and Small Enterprise (MSE) Partner Banks - MSE Credit Avisory Services	340,000	209,911	17/10/06	Disbursing	Finance, Business	Y
Georgia: City of Kutaisi Municipal Water Project/City of Poti Municipal Water Project.	957,000	612,909	17/10/06	Disbursing	Local Authority Services	Y
Georgia: TCB & Bank Republic - Assistance in Mortgage Lending	271,319	271,319	23/10/06	Closed	Finance, Business	Y
Training of Trainers in Agrilending in Georgia	41,163	41,163	20/02/07	Closed	Finance, Business	Y
IMEDI L Insurance Company: Institutional Development Programme - Assistance in underwriting, reinsurance and sales & marketing	175,000	106,382	22/02/07	Disbursing	Finance, Business	Y
Regulatory Framework for Batumi Public Transport.	100,000	19,790	08/06/07	Committed	Transport, Storage	Y
Borjomi Water Project	650,000	0	11/06/07	Committed	Local Authority Services	Y
Corporate Development (Twinning) Programme for Batumi Bus Company	200,000	0	11/06/07	Committed	Transport, Storage	Y
Georgia: Business Support Council - Senior Consultant	78,764	34,809	10/10/07	Disbursing	Community/Social Services	N
Georgia: Georgian Energy Efficiency Programme ("GEEP")	726,872	372,099	30/10/07	Disbursing	Energy	Y

Commitment Name	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Sector	Linked to Inv.
Georgia: Investment Council - Miscellaneous Expenses	39,125	3,395	20/11/07	Disbursing	Community/Social Services	N
Investment Council in Selected ETCs - Georgia - PA for Senior Consultant	13,478	2,070	05/12/07	Disbursing	Community/Social Services	N
Kobuleti Water Project	653,975	0	14/12/07	Committed	Local Authority Services	Y
Kobuleti Water - Additional Detailed Engineering Design for Rehabilitation of Kobuleti Water Supply and Sewage Systems	43,450	8,000	19/06/08	Committed	Local Authority Services	Y
Adjara SWM - Corporate Development and Regional Support Programmes for the Autonomous Republic of Adjara and the Solid Waste Company	304,605	0	14/10/08	Committed	Local Authority Services	Y
Basis Bank - Assistance with Institution Building Plan	250,000	0	30/10/08	Committed	Finance, Business	Y
Georgia - Training in Loan Workouts & Corporate Recovery	19,413	19,413	12/11/08	Closed	Finance, Business	Y
Cartu Bank - Assistance with implementation of IBP	250,000	0	21/11/08	Committed	Finance, Business	N
Rustavi Solid Waste - Corporate Development, Stakeholder Participation and City Support Programme	266,169	0	20/03/09	Committed	Local Authority Services	Y
Georgia: GEEP - Extension of Consultancy Services	484,563	0	26/05/09	Committed	Energy	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 Development	66,627	66,627	06/09/96	Closed	Finance, Business	N
SME line of credit - project implementation	157,216	157,216	19/12/96	Closed	Finance, Business	Y
Institutional Support to TBC Bank - Resident Adviser	11,228	11,228	07/12/04	Closed	Finance, Business	Y
Georgian Railway Co.: Technical Assistance for Environmental & Social Due Diligence	49,080	0	21/05/09	Committed	Transport, Storage	N
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

Commitment Name	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Sector	Linked to Inv.
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
Georgia: Training in Credit Analysis of Tourism-related Businesses	34,720	34,720	03/10/07	Closed	Finance, Business	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

Commitment Name	**Euro Committed**	**Euro Disbursed**	**Fund Approved Date**	**Commit. Stage Name**	**Sector**	**Linked to Inv.**
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
Adjara Solid Waste Management – Feasibility Study and Project Preparation	312,833	215,429	06/12/07	Disbursing	Local Authority Services	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
Poti and Kutaisi: Project management and implementation support services – Support to the PIU	559,595	307,296	11/06/07	Disbursing	Local Authority Services	Y
Kobuleti, Rustavi and Borjomi Detailed Design Review	49,262	48,971	19/12/07	Committed	Local Authority Services	Y
Project Management and Implementaion Support Services for Kobuleti and Borjomi Water Projects	400,000	0	21/12/07	Committed	Local Authority Services	Y
Kutaisi Water – Additional Detailed Engineering Design	70,014	14,000	03/07/08	Committed	Local Authority Services	Y
Borjomi Water – Technical Specification of a new Water Treatment Plant	49,900	15,000	29/10/08	Committed	Local Authority Services	N
Kutaisi Water Project Phase II – Due Diligence Services	49,840	49,266	22/12/08	Disbursing	Local Authority Services	N
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	9,152	18/03/03	Disbursing	Energy	Y
Enguri Hydro Power Plant Rehabilitation Project Panel of Experts	92,315	72,256	18/03/03	Disbursing	Energy	Y
Enguri hydropower plant (tied portion)	55,924	55,924	20/06/96	Closed	Energy	Y
Tbilisi Metro Restatement and Audit	49,200	49,200	27/11/06	Closed	Transport, Storage	N
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
TAM – Nikora Ltd	74,440	47,322	11/10/07	Disbursing	Manufacturing	N
Debt restructuring and management	54,917	54,917	17/10/96	Closed	Energy	Y

Commitment Name	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Sector	Linked to Inv.
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
GEEP - Georgia Energy Efficiency Programme	516,236	260,688	30/10/07	Disbursing	Energy	Y
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
Populi - Fresh Food Processing	49,932	0	22/12/08	Committed	Manufacturing	Y
	31,071,697	**21,124,484**				
	31,071,697	**21,124,484**				
No of Commitments:	**162**					

TC utilisation stands at 68% reflecting a high level of absorption in such areas where TC is used either at preparation stage or for training purposes immediately after signing while disbursements related to project implementation, monitoring and institutional strengthening are spread over a longer period of time. The latter typically makes up the majority of TC commitments across most sectors. Hence a much lower rate of absorption in the more recent periods than in the earlier ones as shown in the tables below.

TC Contribution by Sector Team

Team Name	Sum of Euro Committed	Sum of Euro Disbursed
Agribusiness	49,932	-
Energy Efficiency and Climate Change	2,845,002	1,231,689
Financial Institutions	2,046,749	848,042
Group for Small Business	75,883	75,883
Municipal & Environmental Infrastructure	7,964,848	2,628,100
Natural Resources	303,544	303,544
Power and Energy	630,000	349,500
Investment Council	130,441	42,382
TAM/BAS Programme	1,149,723	723,733
Environment	49,080	-
Grand Total	**15,245,203**	**6,202,873**

TC Contribution by year

Fund Approved Year	Sum of Euro Committed	Sum of Euro Disbursed
2006	3,234,587	2,649,121
2007	5,666,798	2,528,087
2008	3,195,992	856,165
2009	3,147,825	169,500
Grand Total	**15,245,203**	**6,202,873**

Sector team/Year

Sum of Euro Committed	Fund Approved Year				
	2006	**2007**	**2008**	**2009**	**Grand Total**
Agribusiness			49,932		**49,932**
Energy Efficiency and Climate Change		1,885,725		959,277	**2,845,002**
Environment				49,080	**49,080**
Financial Institutions	786,400	240,936	1,019,413		**2,046,749**
Group for Small Business		75,883			**75,883**
Investment Council		130,441			**130,441**
Municipal & Environmental Infrastructure	2,030,717	3,259,373	865,290	1,809,468	**7,964,848**
Natural Resources	303,544				**303,544**
Power and Energy			300,000	330,000	**630,000**
TAM/BAS Programme	113,926	74,440	961,357		**1,149,723**
Grand Total	3,234,587	5,666,798	3,195,992	3,147,825	**15,245,203**

ANNEX 8: TAM/BAS ACTIVITIES IN GEORGIA

Previous TAM/BAS experience in Georgia

The TAM/BAS Programme supports economic transition by achieving enterprise change in potentially viable micro, small and medium enterprises in the EBRD countries of operation.

TAM

TAM supports the introduction of international best practice in small and medium sized enterprises with the potential of becoming future leaders in their market through the introduction of international advisors from developed countries with 15-20 years of professional experience in the relevant sector. TAM projects typically last around 18 months. The Programme also carries out seminars and training activities promoting international best practices by disseminating successful case-studies to entrepreneurs.

TAM has undertaken a total of 27 projects in Georgia, 20 of which have been completed and 7 of which are still in progress. TAM projects have a wide coverage across industry sectors, however, food manufacturing is the most common sector. TAM has worked with enterprises of varying size, although most have a turnover of below €10 million. There has been a geographic concentration of projects in the capital, Tbilisi. Of projects fully completed, 16 have been rated satisfactory or better. The high degree of willingness and eagerness of the staff of assisted enterprises to learn from the TAM team has been identified as a key factor for TAM project success.

BAS

BAS acts as a facilitator for the use of local, private-sector consultants by MSMEs to obtain a diverse array of services. BAS works on the demand and the supply side. By assisting individual enterprises to engage with local consultants on narrowly-based, specific projects with a rapid payback, it stimulates demand and the understanding of the potential benefits of using external consultants. It also directly increases the supply and quality of local advisory services, through targeted market development activities. BAS supported projects typically last around four months.

Since inception in June 2003, BAS has undertaken a total of 465 projects with MSMEs, engaging 176 consultants (of which 159 are local). A total of 336 projects have been internally evaluated in Georgia, with more than 96% rated as "successful".

The BAS Programme in Georgia has also undertaken a number of Market Development Activities aimed at development of sustainable infrastructure of local business advisory services. There has not been a significant shift in the industry spread of projects over time; Food/Beverages and Construction/ Engineering remain the most common sectors. In terms of types of projects supported, advice targeted at Computerised Financial and Management Information Systems as well as Market Analysis and Planning has been most popular throughout the period. The concentration of projects in Tbilisi has changed substantially over time, away from Tbilisi and towards other major cities. Moreover, the BAS office has increasingly been focusing on cross-cutting issues. After the success of the pilot, the BAS Programme launched a full scale WIB Programme in June 2008. Through this initiative, BAS has carried out 27 projects, tailored to women entrepreneurs in need of specialised advisory services. Moreover, BAS has initiated a series of workshops on computer usage and basic PC skills; training on business start up and development.

Linkages with banking

To date, 14 TAM/BAS assisted companies in Georgia have attracted 19 investments from the EBRD or EBRD related financial intermediaries mobilising a total project value of over € 69 million.

A growing MSME sector with economic potential

The Georgian government does not track the contribution of small and medium-sized enterprises to the country's economic growth or the total number of enterprises. A 2005 USAID survey states that the MSME sector contributes to 25% of total enterprises and 10% of GDP. The sector has been growing since 2005, as small and medium sized businesses make up the majority of new registered businesses. However, regional economic development is highly disproportionate with more than half of the businesses concentrated in the capital Tbilisi. Finally, the large difference between MSMEs contribution to turnover (17%) and employment (40%) shows that there is scope to improve the businesses' productivity and competitiveness on the local and international market.

Strong need for TAM/BAS

A change in attitudes and business orientation is required for Georgian businesses to become more competitive. Training is particularly important in the areas of basic business skills (such as business plan preparation and loan application), market analysis, accounting and financial reporting, development planning, marketing and human resources.

Although there are various professional organisations, which are working to improve training outcomes in these areas, there is a need to increase their outreach and the participation of senior managers of Georgian businesses in their activities. There is also a widespread view among stakeholder that the crisis has exposed the managerial weaknesses of many companies in Georgia.

A present yet heterogeneous infrastructure of business support

The private consultancy market is growing from a weak base. Improvements are needed with respect to provision of information, quality assurance, pricing and availability of an appropriate range of services. Business support infrastructure is fragmented and relies heavily on donor support.

On the demand-side, many private consultancies ascribe the state of the consultancy market to the weak financial resources of local companies. From a supply-side perspective, consultancies highlight difficulties in finding and retaining qualified workers.

USAID's Business Climate Reform Programme helps the Georgian government in pursuing a broad reform agenda across multiple fronts to create the conditions for economic growth and job creation. The Programme intends to enhance the breadth, depth, and pace of the Government of Georgia's reform efforts and is working in the areas of regulatory streamlining, fiscal reform, and commercial law to strengthen the business environment in Georgia. Agricultural policy in Georgia is burdensome for the economy and competition in the local market is limited.

Numerous international donor programmes

Various international donors provide support for pilot projects aimed at MSME sector development and improvement of the country's competitiveness and employment rate. Numerous programmes provide specific credit lines for enterprise development or specifically target unemployed persons by helping them setting up a start-up. Other donors act on the policy side and assist the government in its effort to foster a more business friendly environment.

The overwhelming majority of stakeholders see a strong need for international donors to facilitate the development of the MSME sector and the management and technical skills of companies. Accordingly, the local MSME market is far from being perceived as sufficiently mature to make a case for donor withdrawal. Local organisations and institutions are simply not prepared to fill the gaps in the MSME sector to the same extent as the international donor community.

Recommendations for future TAM interventions

This Brief finds strong support among interviewed stakeholders for TAM to continue operating in Georgia in 2009-2011. The main impediments faced by Georgian MSMEs, which could be addressed by TAM Programme assistance, relate to poor organisational and management skills, business planning, accounting and financial reporting, marketing skills and a lack of exposure to international best practices.

TAM should particularly target the tourism, manufacturing, food processing, transport and logistics as well as the ICT sectors that were identified as key industries with high growth potential on the basis of export performance and contribution to GDP.

Recommendations for future BAS interventions

The main impediments faced by Georgian MSMEs, which could be addressed by BAS Programme assistance, relate to poor basic business skills (business planning, accounting and financial reporting, loan applications), management culture (need for HR management, consulting in reorganization and restructuring, introduction of general corporate governance and integrated management systems), partner search, foreign investment consulting, marketing, and strategic planning.

The BAS grant should remain a key component of BAS assistance, thus helping financially constrained enterprises to assess consultancy services. However, targeted market development activities should be a big component of BAS assistance in Georgia.

A Grant Guideline Matrix is proposed in order to prioritise intervention to avoid duplication of efforts from international donors. Higher grants should be given to:

- Enterprises outside the capital city.

- Projects aiming to improve environmental management and energy efficiency.
- Projects aimed at promoting women in business: under the WIB Programme, smaller companies owned/managed by female(s) can benefit from higher subsidy rates.

in addition to targeted market development activities

It is recommended to complement TAM/BAS assistance at the enterprise level with the following market development activities in order to maximise the Programme's transition impact in Georgia:

-*Visibility and dissemination:* The TAM/BAS Programme will take steps to promote the use of business advisory services disseminating information on business advisory services and best practices via booklets and other publications; Participate in trade fairs and exhibitions. TAM should organise more seminars and trainings related to international best practices.

-*MSME and consultancy training:* The TAM/BAS Programme will continue to support the development of a high quality, diverse and competitive business advisory services market. BAS will develop specific training courses and workshops that will reinforce the provision of existing services, while also encouraging the delivery of new advisory service products, promoting best service delivery practice, and building sustainable provider capacity. Capacity reinforcement will include strengthening both soft advisory skills and thematic advisory skills.

-*Support to and development of existing relevant local institutions* – particularly in relation to the market for local business advisory services. TAM/BAS will increase efforts to transfer its project development skills to relevant local institutions that have the ability, or the potential, to support the development of the MSME sector and of the local consultancy market. These institutions in Georgia include the Georgian Employers Association and the Chamber of Commerce and Industry. BAS will explore facilitating the grassroots establishment of the professional association of consulting companies.

with a strengthened focus on addressing cross-cutting issues

In order to address cross-cutting issues that are pertinent to Georgia's MSME sector's development, the TAM/BAS Programme should promote measures to increase energy efficiency in production and reduce environmental pollution. However, such measures will only be successful if entrepreneurs start understanding the potential future payback for their enterprise and do not only act under donor pressure. TAM/BAS should also devote efforts to supporting women entrepreneurs and encouraging women's access to middle management and executive positions primarily by the continuation of targeted initiatives, such as the ongoing BAS Women in Business Programme. Reaching areas outside of the capital should remain a high priority for TAM/BAS.

This Brief as contribution to EBRD's policy dialogue

By thoroughly analysing the business environment and clearly identifying the challenges faced by the MSME sector, this Brief further strengthens the EBRD's policy dialogue toolkit. Future challenges for the government (among others) are identified as improving judicial efficiency, enforcement of property rights, ICT penetration, local availability of research and training services, MSMEs' access to finance and the corporate governance standards of firms. There is also a need to facilitate the introduction of a business culture in which senior managers are able and willing to use consultancy services to address organisational weaknesses.

An input for enhancing linkages with banking

In line with TAM/BAS Strategic Plan 2008-2010, TAM/BAS should continue to assist the Bank to meet its objective of generating a commercially viable project pipeline for the Bank's direct investments by:

- Identifying potential pipeline (pre-investment).
- Providing "consulting and business" services for the preparation and support of Bank private enterprise financing projects and for the enterprises themselves.
- Providing candidates for non-executive board member positions.

In addition, the Programme should link MSMEs in need of finance with local financial institutions supported by EBRD, such as the Regional Direct Lending Facility (DLF), the Direct Investment Facility (DIF) and the Medium-Sized Loan Co-Financing Facility (MCFF). This will strengthen the Bank's impact in the enterprise sector and in the financial sector, as outlined in the EBRD Country Strategy for Georgia.

ANNEX 9: MULTILATERAL AND BILATERAL ASSISTANCE

World Bank

Georgia joined the WB in 1992 and IDA (International Development Association) in 1993. To date World Bank commitments to Georgia total $1,217,500,000. Current Portfolio comprises 11 projects with total commitments of $295.3 million.

World Bank Country Partnership Strategy (CPS) for FY06–09 built on the government's Economic Development and Poverty Reduction Program (EDPRP), as well as emerging government strategic thinking on the country's development framework and provided assistance of USD 336.7 million in credits and loans. The CPS program had three pillars: (i) Enabling Income and Employment Generating Growth; (ii) Improving Human Development and Social Protection; and (iii) Improving Efficiency in Public Service. Addressing corruption and governance issues was seen as an overarching theme that was to be addressed in each of the three pillars. According to the CPS Completion Report, the results for each of the three pillars were satisfactory.

The new Country Partnership Strategy (CPS) for Georgia for FY10-13 has been prepared against the backdrop of twin crises – the August armed conflict with Russia followed by the global economic downturn. As a result, the joint World Bank/IFC strategy focuses on post-conflict and vulnerability issues in the near term, and strengthening the foundations for medium term competitiveness and growth. The first pillar will address key identified vulnerabilities including macro-stability, jobs, social services and the financial sector. The second pillar will continue to support Georgia's structural reform program to best position itself in the medium term by continuing to improve the private sector environment, build its role as a transit corridor, and improve efficiency, transparency and accountability in public resource use. The amount of new IDA and IBRD lending is estimated to be at least $396 million, comprising $130 million from IDA and $266 million in indicative IBRD funding. IFC financing is expected to be about $210-360 million over the period, depending in part on how the crisis unfolds.

IFC

Georgia became a shareholder and a member of IFC in 1995. Since then IFC has invested over $449 million for 30 projects in the financial, power, oil and gas, real estate and manufacturing sectors. Following the August 2008 crisis, IFC focused its investment activities on stabilizing the financial sector through the provision of capital and liquidity to systemically important banks in partnership with EBRD and other IFIs. IFC has also contributed to Georgia's development through technical assistance in the areas of corporate governance, tax, regulatory and licensing reform and crisis management in the financial sector. IFC will focus its efforts in the future on investments in renewable energy, infrastructure, manufacturing and agribusiness.

SIDA

In accordance with the Swedish strategy for cooperation with Georgia 2006-2009, Sweden has mainly supported initiatives in two principle sectors of concentration: a) strengthened democracy and increased respect for human rights, and b) economic development in the area of agriculture. Support has also been provided towards municipal environmental projects coordinated by EBRD. Swedish development cooperation is guided by the EU-Georgia ENP Action Plan. As envisaged in the strategy, there has been a sharp increase in assistance over the strategy period with annual disbursements reaching 10 MEUR in 2008.

EIB

"In 2006, EBRD signed a Memorandum of Understanding (MoU) with the European Investment Bank (EIB) and the EC regarding the cooperation of EBRD and EIB in Eastern Europe, the Southern Caucasus, Russia and Central Asia. Based on the MoU, EBRD and EIB closely cooperate in the countries concerned with regard to the financing of operations in transport, energy, telecoms and environmental infrastructure. In Georgia, this cooperation took off after the entry into force of the EIB's Framework Agreement with Georgia on 18 October 2007 and is now bearing fruits with a first operation, the 500 kV Transmission Lines Project, nearing the end of the joint due diligence process. Further projects, notably in the energy sector but also in transport, are at various stages of preparation, and -going forward - efforts should be spent to identify joint operations in the telecoms and environmental sectors. It is also worth noting that in September 2008 EIB participated together with EBRD in the Joint Needs Assessment".

International Monetary Fund (IMF)

Since 2006, the Fund has supported the Government of Georgia's economic reform programme with resources provided under the Poverty Reduction and Growth Facility (PRGF) and the General Resources Account (GRA). A new PRGF arrangement, approved by the IMF's Executive Board on June 4, 2004 in the amount of SDR98 million, expired on September 30, 2007. All resorces were drawn. In the summer of 2008, following the conflict with Russia, Georgia faced a sudden decline of foreign capital inflows, which led the the authorities to ask for a stand-by arrangement (SBA). On September 15, 2008, a SBA in the amount of SDR477.1 million (about US$748.3 million) was approved by the IMF's Executive Board to support the Georgian authorities' macroeconomic policies, rebuild gross international reserves, and bolster investor confidence. SDR287.9 million had been drawn. On August 6, 2009, the IMF's Executive Board approved the completion of the review, which allows for the immediate disbursement of an additional amount equivalent to SDR 94.6 million (about US$148.4 million). The Board also approved an augmentation under the SBA in the amount of SDR 270 million (about US$423.5 million), and the SBA's extension to June 14, 2011. In view of the weaker economic and external financing prospects, the augmentation and extension of the SBA aims at facilitating an orderly exit from high public and external deficits, and the associated dependence on official financial support. Since 2006, the Fund has also provided technical assistance in the areas of tax administration, budget classification and accounting, monetary policy and monetary and exchange rate operations, banking supervision and regulation, and statistics.

ADB in Georgia

Georgia joined ADB in 2007. The Resident Mission was established on December 15, 2008. The Interim Operational Strategy for 2008–2009 has identified three priority areas for ADB's country operations including (i) improvement of municipal infrastructure (ii) reduction of road transportation constraints on economic activity, and (iii) energy infrastructure upgrading and development.

During the donor conference in Brussels in October, 2008, ADB pledged 300 million USD over the coming three years for development assistance to Georgia. Already by the end of 2009, second year of the pledge, ADB will have significantly surpassed this pledge.

In September, 2008, ADB approved USD 40 million concessional loan for the Municipal Services Development Project (MSDP), which is being implemented by the Municipal Development Fund and includes 66 subprojects across the country. MSDP encompasses improvement of municipal services particularly through rehabilitating and developing water and sanitation systems, local roads and other related infrastructure. In July, 2009 ADB approved a 30 million concessional loan for the second phase of Municipal Services Development Project (MSDP2).

USD 500 million Multitranche Finance Facility (MFF) encompassing 6 year program for subregional roads development in the country is expected to be approved in 2009. The first two tranches of MFF will develop Kobuleti and Batumi bypass roads, which will serve as principal domestic corridors linking the major cities, ports and tourist centers.

ADB has implemented two budget support programs in 2008 and 2009 (Total of USD 150 million on concessional terms) aiming to assist Georgia in meeting the emergency needs arising from adverse economic and social impact caused by the conflict with Russia in August 2008 and the global financial crisis.

ADB's only private sector transaction in the country was carried out in 2007. The USD 25 million loan was extended to the Bank of Georgia for SME onlending. ADB is planning to further widen its private sector operations in the country in consistence with its strategy 2020.

European Community

Bi-lateral relations between the European Commission (EC) and Georgia were established in 1992 with an objective to facilitate the development of relations between the Government of Georgia and the European Union (EU) and facilitate the implementation and coordination of the EU cooperation programmes in Georgia.

In 2004 Georgia was included in the European Neighbourhood Policy (ENP), which was developed with the objective of avoiding the emergence of new dividing lines between the enlarged EU and its neighbours and instead strengthening the prosperity, stability and security of all concerned.

The ENP Action Plan represents the formalisation of the closer ties in political, geographic and trade and economic terms, between EU and Georgia. The political, trade, and economic interdependence between the two partners brought them to enhance their relations and to promote stability, security and welfare.

By agreeing an ENP Action Plan, Georgia and the EU have committed themselves to developing deeper trade and economic integration and to strengthening bilateral political cooperation, including on: 1) Foreign policy; 2) Justice; 3) Energy; 4) Transport; 5) Poverty Reduction; 6) Freedom and Security, notably in the field of border management and migration; 7) Environment.

In May 2009, a new Eastern Partnership (EaP) aiming at enhancing the EU's overall relations with its Eastern Neighbours, including Georgia was launched. The EaP in particular foresees enhanced bilateral framework agreements - Association Agreements - which will include inter alia the establishment or the objective to establish Deep and Comprehensive Free Trade Areas with countries that are willing and able to enter into such engagement. The future Association Agreements will deepen political association of the partner countries with the EU and lead to their gradual integration in the EU economy through initiatives such as promoting further convergence towards EU legislation and standards. The Eastern Partnership also foresees easier travel to the EU for the partners' citizens and promotes democracy, good governance, energy security, economic reform and environmental protection.

Being included in the ENP, Georgia became eligible for the European Neighbourhood and Partnership Instrument (ENPI). The aim of ENPI is to improve the EC capacity to support cross-border cooperation along the EU-s external borders and thus give substance to the EU's aim to avoid dividing lines and promote harmonious development across the EU external border.

It will grant a strong impact on specific sectors, in particular:

Transport. As shown by TRACECA, the Transport Corridor Europe – Caucasus – Asia or the "New Silk Road". Its main goal is to develop economic relations, trade and transport communications along this Corridor.

Energy. Regional synergies are being developed in this sector, in particular in relation to harmonising energy markets, the transit of oil and gas, electricity, energy efficiency, energy saving and renewable and facilitating investment in energy projects of common interest.

Environment. Regional cooperation in this sector is targeting *inter alia* the regional dimension of the EU Water Initiative and regional aspects of protection and sustainable management of forests, regional cooperation concerning regional seas, and compliance with multilateral agreements.

Furthermore, the EU provides Georgia with important technical assistance in various areas, including regulatory approximation with the international and EU's trade and investment related laws and standards.

In addition, Georgia presently benefits from EC's Macro-Financial Assistance MFA grants which contribute to the improving of the country's external debt sustainability. In 2006, two grant instalments of a total amount of EUR 22 million were released to the state budget, backed by Georgia's good progress in structural reforms, notably in the area of public financial management. In January 2006, the Council adopted a decision to make available a new package of macro-financial assistance in the form of a grant facility of € 33.5 million. A third (final) grant instalment of EUR 11.5 million is pending, linked to further progress by Georgia in public finance management reforms.

At end 2007, Georgia's outstanding debt to the EC amounted to EUR 57.5 million.

The EC announced at the Donors' Conference on Georgia (Brussels, 22 October 2008) that it will assist Georgia with EU funding up to 500 Million Euros with a comprehensive post-conflict assistance package. Via this new assistance package, which covers the period **2008 - 2010**, the EC aims to provide assistance to the resettlement of IDPs, the economic reconstruction and recovery activities as well as macro-financial stabilisation and support to Georgia's infrastructure.