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

STRATEGY FOR GEORGIA

As approved by the Board of Directors at its meeting on 4 September 2013

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EXECUTIVE SUMMARY

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

Since the Rose Revolution of 2003 the Georgian authorities have been pursuing a reform agenda aimed at transforming the country into a European democratic state. There have been notable achievements on this path, including the recent peaceful transfer of power through a free and fair election, which is rare in the region. However, many challenges remain. It is important to ensure an inclusive dialogue with all political parties, including those in opposition, and civil society in order to foster their full participation in the political process. Indirect government control of the media had been an ongoing concern. However, since the October parliamentary elections the media landscape has started to improve. Strengthening further the implementation of the commitments in the areas of rule of law and independence of the judiciary would be important for the continued development of Georgia's democratic institutions.

The combined effects of the 2008 Russia-Georgia war and the global economic crisis hit Georgia hard, but the economy has since recovered strongly. Output expanded by 7.2 per cent in 2011 and 6.1 per cent in 2012, but signs of a slowdown emerged recently. Growth has been broad-based with manufacturing, financial services and tourism among the main contributors. Although the current account deficit increased, rising private inflows triggered appreciation pressures and enabled the central bank to replenish external reserves. The share of non-performing loans in the banking sector has declined steadily. The general government deficit declined to 2.9 per cent of GDP in 2012. The authorities have been able to reduce reliance on official external financing, while maintaining a precautionary arrangement with the IMF. As a result several international rating agencies upgraded their ratings of Georgia's sovereign debt.

The short-term macroeconomic outlook is generally positive as growth is expected to be driven by higher social expenditures and remittances and recovery of private sector credit, provided post-election political risks are mitigated quickly. However, the current account deficit remains large, at around 11.5 per cent of GDP in 2012, and the financial sector is heavily dollarised. The stock of external liabilities is high for an emerging market economy, although it is largely financed by FDI and remittances. A precautionary stand-by arrangement with the IMF provides an additional safety buffer against potential external shocks, and exchange rate movements can be smoothed to avoid destabilising the financial sector.

The structural reform context for economic growth is promising. Georgia remains the region's top reformer. Large- and small-scale privatisation is very advanced, prices are set by the markets, and trade and foreign exchange systems are virtually unconstrained. The authorities have worked to modernise the country's infrastructure, including construction of the Black Sea Energy Transmission System, which should integrate Georgia into the regional energy market, improve the regulatory framework and set standards for corporate governance and business conduct. The government has continued to further simplify and streamline the tax system, including for small and micro enterprises. These reforms should help reduce the size of the shadow economy, in particular when supported by an independent and impartial judiciary.

The Georgian economy benefited from comprehensive reforms implemented in recent years. However, some shortcomings of the liberal economic model have become apparent more recently. The new government, with the support of the international community, has a window of opportunity to address the shortcomings of Georgia's recent developmental model while maintaining the country on the path of strong and sustainable growth. The key remaining transition challenges that can be addressed with the support of EBRD financing and policy advice include:

- **Low levels of private investment in the economy.** During the crisis, private investment declined to around 8 per cent of GDP. The government's efforts to encourage foreign direct investment should be broadened to target a more diversified range of investors and sectors. Stimulating domestic savings, possibly through the development of a privately funded pension system, would also support private investment as well as the development of local capital markets.
- **Underutilised renewable energy sector potential.** The country's energy sector virtually collapsed during the transition period but has undergone a significant transformation in recent years as hydropower capacity was rebuilt and transmission networks established. However, Georgia's integration in regional energy markets remains incomplete and the sector suffers from significant distribution losses and seasonal supply volatility.
- **Limited integration in regional and global production markets and value chains.** Growth would benefit from regional expansion, including greater access to European, Russian and other neighbouring markets that would attract large scale investments. Georgia's location and favourable investment climate should support the transition from a strategic transit corridor to a logistics platform for the wider region. This requires further improvements to transport infrastructure, investing in logistics facilities and industries adding value to goods transiting through the country.

Strategic directions

The Bank's priorities in Georgia over the next three years will focus on strengthening private sector investment, modernising the energy sector and promoting Georgia's regional and global economic integration. The Bank will also support the new Georgian government's priority of making growth more socially inclusive by, for example, improving the quality of municipal services in less-developed regions of Georgia. To a significant extent, the Bank's ability to deliver on its objectives will depend on further progress with reforms. Specifically, the Bank's activities in Georgia will focus on the following areas:

- **Fostering private investment.** The Bank will continue to pursue operations with private sector clients directly and, indirectly, via private banks operating in Georgia. As the business environment in Georgia is generally very good, policy dialogue activities in this area will focus on the unfinished reform agenda in the area of governance, rule of law and competition policies, in line with the authorities' priorities.

- **Completing the modernisation of the energy sector.** The Bank will complete the energy sector projects started during the past strategy, which aim to increase energy production and access export markets. Future projects will foster private sector participation and will be supported by policy dialogue in the areas of domestic markets reform and introduction of modern regulatory frameworks.
- **Supporting Georgia's regional and global economic integration.** The Bank will focus on projects in various areas including infrastructure, logistics, telecommunications and the financial sector that would support cross-border economic activities. The Bank will support opportunities for skills transfer to enable Georgian companies to take advantage of trade opportunities and to become more competitive in a wider regional and international context.

The Bank will cooperate closely with other international financial institutions and multilateral and bilateral partners, including the European Union, in its operations as well as through policy dialogue to maximum transition impact in Georgia.

1. THE BANK'S PORTFOLIO

1.1. Overview over Bank activities to date

As at end-November 2012 the Bank has signed a total of 155 projects with cumulative investment value of EUR 1,802 million since initiating its operations in Georgia in 1991. The total value of these projects was EUR 5 billion. 66 per cent of the Bank's cumulative investments were made in the financial institutions sector, 19 per cent in the energy sector, and 11 per cent each into the corporate sector and 4 per cent in the infrastructure sector.

During the previous Strategy period, from end 2010 through end 2012, EBRD's operating assets in Georgia grew by EUR 149 million and the portfolio by EUR 191 million (this was affected by the cancellation of a EUR 110 million transport project in 2011). The Bank's current portfolio is well diversified with 50 per cent in the financial institutions sectors, 33 per cent in the energy sector, 13 per cent in the corporate sector and 4 per cent in the infrastructure sector. Currently 82 per cent of portfolio in Georgia is in the private sector.

Over the previous Strategy period the Bank signed 56 projects for a total value of EUR 639 million. Year-to-date the Bank has signed one project to the value of EUR 7 million.

Table 1: Portfolio Development in Georgia as of 31 March 2013

SECTOR	**NET CUMULATIVE BUSINESS VOLUME**				**CURRENT PORTFOLIO STOCK**				
Amount in EUR million	Number of projects	EBRD signed	Total Project Cost	*EBRD % of Total*	Number of projects	Portfolio	*% of Portfolio*	Operating Assets	*% of Operating Assets*
Energy	**17**	**346**	**3,145**	**19%**	**10**	**208**	**33%**	**156**	**32%**
Natural Resources	6	104	2,310	6%	3	38	6%	38	8%
Power and Energy	11	242	836	14%	7	170	27%	118	24%
Financial Institutions	**65**	**1,182**	**1,290**	**65%**	**31**	**314**	**50%**	**230**	**47%**
Bank Equity	14	108	190	6%	7	97	15%	97	20%
Bank Lending	35	1027	1,011	57%	20	215	34%	130	27%
Insurance, Fin Services	3	4	4	0%	1	0	0%	0	0%
Small Business	13	43	86	2%	3	3	0%	3	1%
ICA	**65**	**193**	**413**	**11%**	**24**	**85**	**13%**	**82**	**17%**
Agribusiness	29	114	170	6%	8	41	6%	41	8%
Equity Funds	5	7	25	0%	3	4	1%	2	0%
Information & Communication Technologies	0	0	0	0%	0	0	0%	0	0%
Manufacturing & Services	19	46	70	3%	10	22	4%	22	4%
Property & Tourism	7	26	148	1%	3	18	3%	18	4%
Infrastructure	**13**	**80**	**231**	**4%**	**9**	**26**	**4%**	**21**	**4%**
MEI	8	19	66	1%	7	13	2%	8	2%
Transport	5	61	165	3%	2	13	2%	13	3%
TOTAL	**156**	**1,802**	**5,079**	**100%**	**74**	**634**	**100%**	**489**	**100%**

Table 2: Portfolio Development in Georgia, 2009 – March 2013

Amount in EUR million	2009	2010	2011	2012	End Mar 2013	Development over the previous strategy period (end 2009- end 2012)
Net Cumulative Business Volume	681	1,453	1,612	1,719	1,802	+€1,038m
Current Portfolio Stock	462	731	680	653	634	+€191m
Number of Portfolio Operations	87	89	84	82	74	-5 projects
Operating Assets	360	419	513	509	489	+€149m
% Undrawn	19%	39%	18%	13%	12%	
						Cumulative 2010 – 2012
Annual Business Volume	81	349	187	103	7	+€639m
Number of Operations	15	21	20	15	1	+56 projects
Gross Disbursements	144	92	132	75	11	+€299m
Annual Cancellations	0.3	24	143	4	1	-€171m *(Georgian Rail in 2011)*
Active Pipeline Stock	390	149	72	221	191	
Private Sector Share (% Portfolio)	94%	67%	82%	82%	82%	
Non Sovereign (% Portfolio)	94%	83%	82%	82%	82%	

1.2. Implementation of the previous Country Strategy

The Bank completed its ambitious commitment to invest USD 950 million over a three year period under the USD 4.55 billion October 2008 donors' pledge.

As envisaged in the previous Strategy, the Bank's massive support to the banking system in Georgia contributed to a largely successful restructuring of the systemic banks which presently are and/or will be able to tap the international capital markets. Further liquidity was also provided to the banking industry at large in order to foster SME lending. However, loan demand, at the end of the Strategy period, remained flat and the improved liquidity of the banking sector is yet to translate into a significant increase of banks' lending. Dollarisation of the banking system has not receded measurably during the Strategy period while renewed efforts to tackle this weakness have been undertaken jointly with the IMF and the World Bank and are expected to yield results in the longer run.

In the energy sector, the Bank achieved significant landmarks with the completed rehabilitation of Enguri hydro power plant which provides approximately 40 per cent of the country electricity consumption. The financing of the 500 KV Black Sea Transmission line will enable linking Azerbaijan and Turkey via Georgia and is setting the pace for the development of new HPPs in Georgia, to partly satisfy Turkey's energy requirements. In the MEI and Transport sectors, the Bank's performance was below expectations as sovereign transactions in the water and waste management areas have been offered to donors providing concessionary terms of financing while Poti port development was downscaled and taken over by a new foreign sponsor not requiring financing.

In the enterprise sector, the Bank struggled to make significant inroads. Nevertheless, the use of the ETCI products, particularly MCFF, has proven very effective, clearly putting EBRD at an advantage to develop its outreach of SMEs. Lower FDI since the

2008 crisis and dearth of large domestic corporates explain the absence of larger transactions in this area. A sub-sovereign loan in the amount of EUR 110 million to a transport company was signed in 2010. This facility was subsequently cancelled on a mutually agreed basis as the borrower successfully tapped international capital markets with a fixed rate Eurobond issue.

1.3. Transition impact of the Bank's portfolio

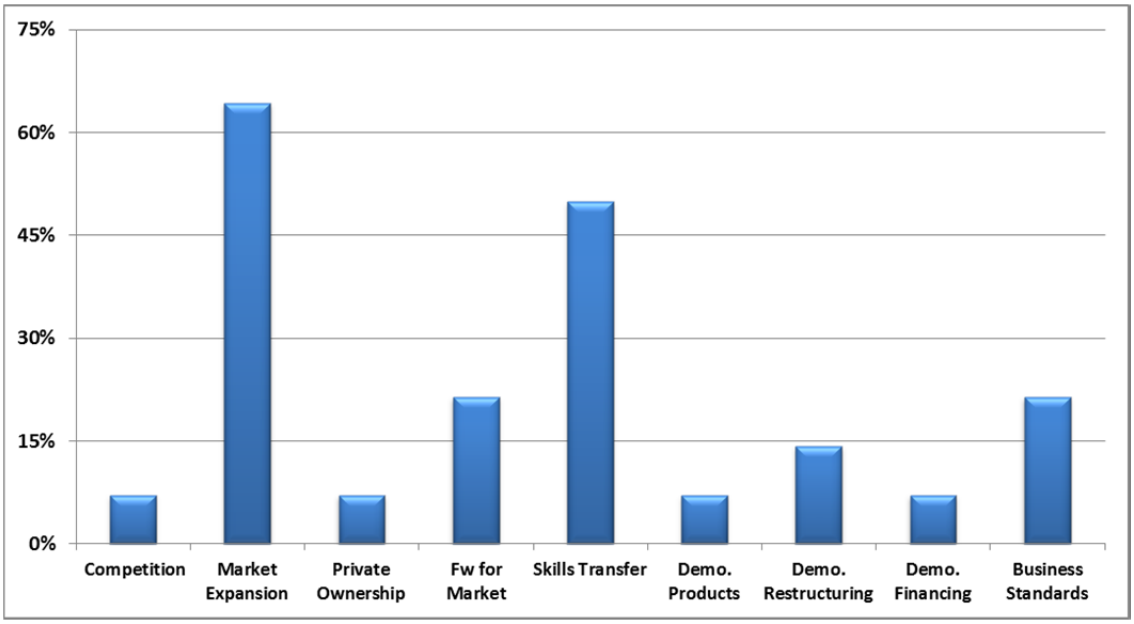
Between February 2010, when the previous Strategy was adopted, and end-2012, 17 transition-rated[1] operations were signed in Georgia. Six projects out of these were rated with Excellent transition impact potential, including three loans signed with commercial banks under the Georgian Agricultural Finance Facility (GAFF). GAFF’s main transition objective lies in supporting increased access to bank finance for the country’s primary agriculture and MSME agribusinesses, and promoting sustainable best practices and sustainable farming methods in primary agriculture through associated technical assistance. Another two projects in the Georgian financial sector were rated as having Excellent transition potential due to its strong demonstration effects of successful restructuring through energy efficiency investments without subsidies to banks. Finally, the first greenfield hydro power plant construction project in Georgia has Excellent transition impact potential thanks to its positive demonstration effects of new products and expansion of renewable energy markets, as well as promoting private ownership in the sector.

Two operations were rated as Satisfactory. The transition impact for the port modernisation project is constrained by the remaining institutional deficiencies, including the absence of a port regulator and a weak competition authority. An MSME project has limited transition impact potential because of the small increase in SME lending envisioned and the state ownership of the foreign bank. Thus, 88 per cent of project signed in Georgia from February 2010 to end-2012 were ex ante rated as having “Good” or “Excellent” transition impact potential, which exceeds the institution-wide target of 80 per cent of projects to be assessed “Good” or better.

The transition objectives of projects signed during the Strategy period reflected the remaining challenges that need addressing in the country, as well as sector specificity of the Bank’s activities in Georgia in 2010-2012. About 60 per cent of transition-rated projects were extended to the country’s financial institutions, including those that will introduce underdeveloped types of finance (agricultural and energy efficiency lending) and increase general MSME lending by financial institutions that were significantly affected by the crisis. Infrastructure and energy projects accounted for the remaining share of new projects which traditionally target regulatory and institutional improvements for markets. As a result, key transition objectives for the new projects in Georgia were on supporting market expansion and transfer of skills. Almost three quarters of all operations signed in Georgia since February 2010 targeted at least one of these objectives, respectively. Over 20 per cent of projects addressed improvements in frameworks for markets and setting higher standards for corporate governance and business conduct (Figure 1).

[1] There were 13 additional operations (under MCFF, DLF and DIF frameworks) which were not individually assessed for their transition; these are assessed and monitored on facility level.

Figure 1. Targeted transition objectives in Georgia (share of projects), 2010-2012



The projects in the country's portfolio are performing well in terms of achieving their envisaged transition impact: 31 out of 33 projects in the Bank's active portfolio are on track to achieving their transition potential as of end-2012.[2] Out of these projects, seven active operations in Georgia have a rank in the range from 1 to 3 – in other words, they have mostly achieved their desired transition impact.[3] 24 operations are mostly on their way to achieving their transition objectives, or partially achieved their transition impact. Finally, two operations have failed to achieve their transition potential. One client in the Property and Tourism sector has been unable to meet the key expected outcomes, including increased competition in the market by developing international quality properties, due to difficult conditions resulting from the financial crisis and political developments. Another operation, an MSME support project with a commercial bank, has failed to achieve portfolio growth and quality targets, again due to the negative impact of the financial crisis.

The rank of Georgia's active portfolio, at 4.52 as of end-2012, is lower than the average of the Bank's operations (4.05). This is mostly due to two factors. First, there is a higher than usual number of operations that are currently rated Satisfactory (14 out of 33): most of them are in the financial sector and have been downgraded to reflect the negative impact of the financial crisis in the banking sector, which has resulted in the only partial achievement of the envisaged transition impact. Second, the portfolio has a large share of new projects (12 operations were signed after 2009) and as such are yet to undergo decreased risks to transition. Therefore, despite the relatively high average rank recorded for the Georgia's stock, the overall performance of the country's portfolio can be deemed to be on track.

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[2] This includes all active operations more than 6 months since signing and which were monitored for their transition impact at least once

[3] Rank is a combination of the relevant rating for transition impact potential and risks to transition impact. Expected transition of operations is usually monitored once a year and is ranked numerically from 1 to 8, with 1 to 3 indicating the mostly realised impact, 3 to 6 – generally on track to achieve transition objectives, and 7 to 8 – minimum transition impact or excessive risks.

2. OPERATIONAL ENVIRONMENT

2.1. Political context

The free and fair parliamentary election of 1 October 2012 resulted in a peaceful transfer of power through the ballot box. The election resulted in President Mikheil Saakashvili conceding the defeat of the United National Movement (UNM) to the opposition coalition Georgian Dream, headed by Bidzina Ivanishvili. Both President Saakashvili and Ivanishvili, the new Prime Minister, have declared their intention to work together.

The initial stage of the power transfer has been timely and smooth. Going forward, a constructive cohabitation between these two major players can help ensure that the existing development challenges are addressed in an efficient manner. The UNM, which has been in power since late 2003, has to act as a parliamentary minority; while Georgian Dream which, with its 85 seats in the 150-seat parliament, falls short of the constitutional majority and therefore must work constructively with the UNM to continue on the path of building strong democratic institutions and the rule of law.

The new government formed by Georgian Dream after the October elections has high expectations and a challenging agenda to manage. The government has announced a broad reform programme, including ambitious plans on employment, healthcare, social protection, and agriculture.

In external relations, the government confirmed that Georgia’s pro-EU, pro-NATO orientation remains intact, which anchors its domestic reform agenda. Relations with Russia have improved in terms of re-establishing economic links but remain short of diplomatic ties.

See Annex 1 for a detailed assessment of the political context.

2.2. Macroeconomic context

Macroeconomic performance has been strong, although signs of a slowdown recently emerged. Output expanded by 7.2 per cent in 2011 and 6.1 per cent in 2012. Growth has been broad-based with manufacturing, financial services and tourism among the main contributors. As inflation has remained subdued, the central bank was able to loosen monetary policy by decreasing the refinancing rate from the peak of 8 per cent in June 2011 to 4.5 per cent in March 2013. Although the current account deficit remained high, at 11.5 per cent of GDP in 2012, rising private inflows caused appreciation pressures and enabled the central bank to replenish external reserves. Although the share of non-performing loans (NPLs) deteriorated recently, it remains significantly below the 2008-9 crisis levels. The general government deficit declined to 2.9 per cent of GDP in 2012. The authorities have been able to reduce reliance on official external financing, while maintaining a precautionary arrangement with the IMF.

The country’s successful stabilisation and recent performance have been recognised by the markets. Several international rating agencies upgraded their ratings of

Georgia's sovereign debt. As the risk premium paid by the country narrowed, the national railways company, Georgian Oil and Gas Corporation (GOGC) and Bank of Georgia have been able to tap international markets. However, an international placement of the national railways' shares had to be postponed in light of the difficult financial markets environment.

However, the uncertain global environment warrants continued engagement with IFIs. The short-term macroeconomic outlook is positive as broad-based growth is expected to continue at a fast pace, benefitting from credit expansion, public and private investment and remittances. At the same time, the current account deficit remains large and the financial sector is heavily dollarised. The stock of external debt is relatively high for an emerging market economy. The precautionary stand-by arrangement with the IMF provides an additional buffer to ensure the country's high current account deficit can be financed, should private sector inflows decline, and exchange rate movements can be smoothed to avoid destabilising the financial sector.

See Annex 7 for a table with Selected Economic Indicators.

2.3. Structural reform context

Georgia remains the region's top reformer. Large- and small-scale privatisation is very advanced, prices are set by the markets, and trade and foreign exchange systems are virtually unconstrained. Among the first generation reforms, application of effective competition policies, strengthening enterprise governance and restructuring remain among the key challenges.

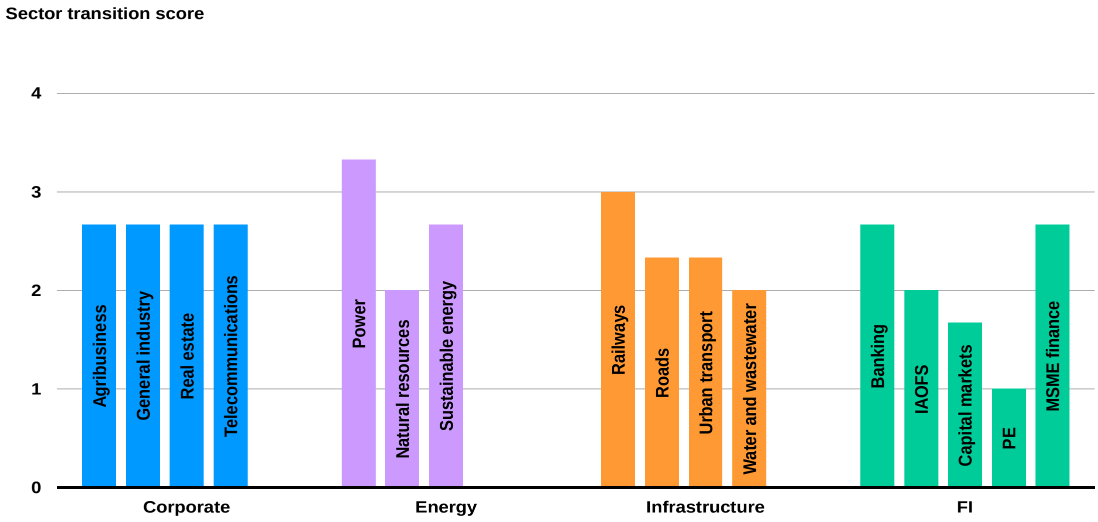
The authorities worked on further improvement of the country's infrastructure and identifying mechanisms for addressing market failures. The ongoing construction of the Black Sea Energy Transmission System should integrate Georgia in the regional energy market, if supported by an improved regulatory framework and better standards for corporate governance and business conduct. The construction of a new hydropower plant will lead to greater cross-border energy flows via a transmission line from Georgia to Turkey. The purchase of the Poti Port by the subsidiary of the Danish Maersk company from RAKIA should further integrate Georgia into the global shipping networks over time. The authorities' efforts to encourage recovery in the agricultural sector and their targeted support to the infrastructure should boost growth.

Over the past three years, the government has continued to further simplify and streamline the tax system. These included elimination of tax on dividends from publicly traded enterprises, on interest income on bank deposits and on capital gains. The tax regime for small and micro enterprises was also simplified. These reforms should help reduce the size of the shadow economy, in particular when supported by an independent and impartial judiciary.

The central bank has worked to modernise the country's monetary policy and financial stability frameworks. The reforms included activation of central bank standing facilities and active use of refinancing instruments, reduced frequency of foreign exchange interventions and greater exchange rate flexibility. The central bank has continued to strengthen its capacity to forecast and model inflation. To limit financial sector vulnerability, the NBG tightened prudential regulations by strengthening capital requirements on foreign currency loans, initiating the transition to risk-based supervision and introducing policies for consumer financial protection.

For a detailed assessment of the remaining sector transition challenges see Annex 2.

Figure 1. EBRD transition indicators for Georgia



Source: 2012 Transition Report.

2.4. Business environment

Georgia made significant progress in strengthening its investment environment. Ranking ninth of 183 countries, Georgia is the best-rated country in the transition region in the World Bank's 2013 Doing Business index. Georgia is the top improver since 2005 both in Eastern Europe and Central Asia and globally. With 35 institutional and regulatory reforms since 2005, Georgia has improved in all areas measured by Doing Business. To improve efficiency of and confidence in the tax system, the authorities have implemented electronic tax filing, improved customs clearance procedures, introduced an advanced tax ruling option binding on the tax authority and created a tax ombudsman office. However, recent experience has shown that in spite of the reforms tax administration may be subject to political influence.

Transparency International's Corruption Perceptions Index indicates that Georgia is among countries with a relatively low level of corruption. Georgia ranked 51st out of 176 countries in 2012. In this regard, Georgia scores well relative to other post-Soviet countries. Georgia ranks 21st in the 2013 Economic Freedom Index, up from 34th place in 2012 following improvements in six of the ten economic freedoms including management of public finances, investment freedom, and property rights.

2.5. Social context

Georgia is a country characterised by strong economic growth and high levels of social exclusion and income disparities. The impressive institutional and business environment reforms of the past years failed to fully translate into economic opportunities for much of the country's population. Jobs creation in labour-intensive sectors or in the geographic regions outside of the urban centres was slow, which left 57 per cent of the total population living on (mostly subsistence) agriculture. There is more unemployment in urban areas than in rural areas, at 26.5 per cent and 6.5 per cent, respectively. Tbilisi has the highest rate of unemployment among the main regions, at 29.3 per cent, followed by Adjara region (18 per cent), and Samegrelo and Zemo Svaneti region (16.5 per cent). Male unemployment is higher than for the female population, at 16.7 and 13.1 per cent, respectively. Youth unemployment is high at 34 per cent, with total unemployment at 15 per cent also high compared to other CIS countries. Average agricultural GDP per self-employed worker is only USD160 per month, compared to overall GDP per employee of around USD1,000 per month.

The GINI coefficient by cash income is high and, at 0.52, comparable to that of Brazil. The GINI coefficient by gross consumption is slightly lower at 0.42. The share of the population under the poverty threshold increased from 6.4 per cent to 9.2 per cent between 2008 and 2011, although it has declines slightly from its 2009 crisis-related peak of 9.9 per cent. During the same period, the share of population under 60 per cent of the median consumption also increased from 21.3 to 23 per cent. Georgia has a Gender Inequality Index value of 0.418, ranking it 73 out of 146 countries in 2011, indicating a relatively high level of gender inequality. Before the election in 2012, 6.5 per cent of parliamentary seats were held by women, and 63.8 per cent of adult women have reached a secondary or higher level of education compared to 58.9 per cent of their male counterparts. Female participation in the labour market is 55.1 per cent compared to 73.8 for men.

EBRD's Life in Transition Survey (LiTS), conducted in late-2010, found that only about one-quarter of respondents are satisfied with life which, despite a two percentage points rise since 2006, puts the country near the bottom in the transition region in this respect. Life satisfaction has increased slightly among the lower and upper socio-economic sections of the population, but has dropped by about five percentage points among middle-income respondents.

There are a number of reasons that explain this increase in social exclusion despite the substantial growth of economic output: market reforms did not translate into innovations and investment in high-technology industries, which would increase employment and equity in income distributions; the business climate reforms have had little effect on agriculture, which remains the largest employer; the Russian trade and transit embargo for Georgian goods introduced in 2006 contributed towards a sharp one-off slowdown in export growth, compensated over time by growth in exports to other markets; and trade liberalisation efforts have not been supported by investment in training and human capital development, resulting in many companies not being able to capitalise on potential export opportunities.

The need to provide better economic opportunities to wider sections of society was the central theme in the 2012 parliamentary elections, with both the previous government and the new government focusing on questions of employment, education and rural development.

2.6. Legal context

Georgia has continued to implement reforms to its legal system in the last years. Notably, improvements have been made in simplifying regulations applicable to export-import operations, banking, tax and other areas. However, further reform efforts are needed in various sectors.

Specifically, corporate governance practices are still considered weak, in both companies and banks and introduction of a Corporate Governance Code for companies would be a welcome move. For secured transactions, modernising the present registration regime by promoting on-line access to the registered data and a change towards a notification-based system would also be seen as an improvement.

The 2012 law on insolvency has improved the legal framework in this area. It contains the mechanisms for both liquidation and reorganisation of an insolvent debtor; however it continues to be weak in certain areas as regards creditors' rights and protection of the insolvency estate. Improvements to the judicial system have been observed in recent years and more reforms seem to be on the way.

See Annex 3 for a more detailed assessment of the legal environment.

2.7. Energy efficiency and climate change context

Energy intensity of Georgia’s remains high by European standards. As the country does not have significant oil and gas reserves, until recently it imported almost two-thirds of its primary energy from external sources. Georgia has overcome the chronic energy shortages of the past by renovating hydropower plants and diversifying sources of energy imports.

There is a substantial potential for energy efficiency (EE) improvements and Renewable Energy (RE) development in Georgia. Nevertheless, there is still a lack of awareness of EE and PFIs are still often unfamiliar with EE projects, and Georgia has been slow in the development of EE and RE. Despite the government’s success in improving the energy supply and security situation in the country, there is still much to be done to improve and develop energy legislation and regulation as well as technical standards and operational procedures in the electricity sector.

Georgia's electricity sector has been liberalised and partly privatised, but remains weakly regulated. Distribution is fully privatised to foreign strategic investors. Generation assets are privately owned, with the exception of the largest HPP Enguri plant that supplies around 40 per cent of the country’s electricity needs. In September 2006 a broadly liberalised market structure was introduced under the authority of the Electricity System Commercial Operator. However, regulated prices and significant cross-subsidisation still persist. Tariff setting processes lack transparency, although the new government announced that it is determined to ensure that tariffs are decided in a transparent manner and under close public scrutiny.

The majority of electricity production comes from hydroelectric plants, which ranks Georgia high in terms of renewable energy and low in terms of emissions. Feed-in tariffs for new renewable projects are not harmonised and weak. 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. The frequently changing regulatory framework does not offer predictable returns to investors. Remaining challenges include further reforms in the energy sector (tariffs, collection), strengthening the legal and institutional setup for energy efficiency, improvements in the framework for renewables and developing expertise for the implementation of energy efficiency projects.

Georgia currently has no special legislative acts to regulate the use of renewable energy sources. The Tax Code enacted in 2005 does not provide any tax benefits for the production and use, import and putting equipment into operation for the production of renewable energy or power saving equipment. At this stage the existing law on electricity and gas does not include renewable energy sources explicitly. Basic goals for renewables have however been developed.

Water resources in Georgia are vulnerable to existing climatic conditions and to future climate change. According to the Second National Communication (SNC) to the UNFCCC, Georgia already experiences significant temporal and spatial variability in precipitation and surface runoff, and this is expected to become more severe with reduced surface runoff overall under most climate change projections.

In addition there are concerns about long-term climate change impacts on Georgia’s glaciers, which have significant implications for water resource management and for hydropower. In order to manage the consequences of climate change on water resources and adapt to changing climatic conditions, institutional and technical measures leading to the efficient use of water resources will be required. Climate change resilience and adaptation issues will need to be taken into account, particularly in the agribusiness, mining, and hydropower projects. In addition, coastal regions of Georgia may be vulnerable to sea level rise and the associated risks of storms and floods. These impacts will need to be considered in investments in coastal infrastructure such as ports.

3. STRATEGIC ORIENTATIONS

Although the Georgian economy has recovered from the dual crises of 2008-9 and has grown at a fast pace since then, it is facing a number of long-term challenges. While the previous Country Strategy for 2009-12 focused in part on supporting the country’s short-term crisis response, this new Country Strategy for 2012-15 will refocus the Bank’s activities on addressing the longer-term core challenges of the Georgian economy. The Bank’s strategic priorities in Georgia are guided by its assessment of the key transition challenges and are consistent with the authorities’ reform priorities.

The Bank has identified three main challenges to be addressed during the next Strategy period: (1) fostering private sector investment, which declined after the crisis; (2) completing the modernisation of the energy sector; and (3) supporting Georgia’s regional and global economic integration to benefit from economies of scale. To a significant extent, the Bank’s ability to deliver on its objectives will depend on progress with reforms.

Alongside these strategic priorities, the Bank recognises that the sustainability of Georgia's transition achievements and long-term growth prospects depend on the authorities' ability to ensure that growth is more inclusive. The authorities have acknowledged the importance of deepening transition while expanding its benefits. The unemployment rate and income inequality are high. With the majority of the population not benefitting from the economic reforms and related growth, there is a risk of the transition process stalling or even reversing. Sustainable market transition can only be achieved if it creates incentives for large enough sections of the population to support the transition process. EBRD will therefore target improving productivity levels in sectors employing large shares of workers, especially agriculture, manufacturing and construction, and will increase its focus on SME development through access to finance and integration into a viable value chain. The Bank will support the new government's objectives of improving the quality of life for the Georgian people by re-engaging in municipal projects where it can bring value-added through design, implementation and grant and TC support from donors.

3.1. Fostering private investment

Key challenges

During the crisis, private investment declined to around 8 per cent of GDP. The previous government responded by embarking on a proactive investment promotion campaign, scaling up the public investment programme and setting up a state-backed Partnership Fund to leverage equity in public companies to attract significant infrastructure and other investments. The authorities' efforts to encourage foreign direct investment (FDI) should be broadened to target a more diversified range of investors and sectors. Large-scale privatisation, the main source of FDI before the crisis, is virtually complete. Therefore, policies should focus on greenfield domestic and foreign investments. Stimulation of domestic savings, possibly through the development of a privately funded pension system, would also support private investment. Financial sector policies should focus on completing the transition to inflation targeting and further strengthening prudential supervision.

Specific sectoral transition challenges critical for enhancing private investment include:

- Strengthening enforcement of competition legislation and enhancing corporate governance and business standards in the areas of product quality, environment and health and safety management.
- Facilitating adequate access to capital and financial services by micro-, small and medium-sized enterprises (MSMEs) and start-up agricultural enterprises, especially in the regions of Georgia outside the capital city.
- Building on the achievements of agricultural sector liberalisation by improving sector efficiency and upgrading hygiene and quality standards through pro-active policies. Increase both competition and standards of service in the retail sector.
- Strengthen the banking sector and non-bank financial institutions and support financial intermediation, in particular to the MSME sector and in the regions, with a view to helping the banking sector to prepare for further strategic investment from Western financial institutions.

- Lengthen the maturity of banks' (local currency) funding base in order to enable local currency lending focusing on unhedged SME and retail borrowers, and improve foreign exchange risk and portfolio management.
- Strengthen long term local currency savings by reducing level and volatility of inflation and developing non-bank financial activities, such as leasing, insurance and pension funds.

Bank's operational response

To foster private investment, the Bank will continue to pursue operations with private sector clients directly and, indirectly, via private banks operating in Georgia. The Bank will focus on projects in the industrial and agribusiness sectors as well as the financial sector, and will increase its focus on SME development through promoting access to finance and integration into a viable value chain. In particular, EBRD will support the manufacturing sector, focusing on improving production technologies of processing companies to modern standards, as well as introducing strict environmental and health and safety standards.

The Bank will provide enhanced financial support to medium and small enterprises by adapting the Bank's use of instruments to reflect changes in investment opportunities in Georgia based on increased use of the Medium-sized Co-Financing Facility (MCFF) in order to enhance the Bank's outreach to medium-sized enterprises. Where appropriate, the Bank will also use its Direct Lending Facility (DLF) while the Direct Investment Facility (DIF) will focus on the provision of subordinated debt to strengthen SME clients' balance sheets. The Bank will also focus on a smaller number of larger projects, in order to bring back commercial banks as B lenders.

The Bank will support the agricultural sector by developing the local supply chains to increase efficient production and establish high standards, while encouraging the introduction of modern technologies, the transfer of know-how and improved input quality. The recently introduced Georgia Agribusiness Financing Facility (GAFF) will be a vital tool to tackle the chronic lack of capital in the sector. Particular attention will be paid to supporting agricultural start-ups (those moving from subsistence to market production).

To deepen financial intermediation the Bank will support the modernisation of the banking sector by providing targeted debt as well as equity or subordinated debt on a selective basis if and when appropriate. The Bank will prioritise the development of local currency funding and lending on a sustainable basis. Continued support to the central bank improving its control of inflation will contribute to lowering inflation and building trust in local currency saving. Local currency products offered under the 'subsidised' framework will support agriculture (under GAFF) and microfinance lending, segments that are most vulnerable to currency risk and currently underserved by the banks. The Bank will prioritise actions making local currency lending sustainable. This will include supporting local currency bond issuance by Georgian banks to strengthen their funding base and EBRD bond issuance in Georgian lari to enhance pricing benchmarks.

The Bank's activities in the non-bank financial sector will depend on the regulatory and policy frameworks. The insurance sector has been affected by the requirement to invest reserves in building hospitals, which has increased risks in the sector. The bank will support selectively leasing and non-bank microfinance institutions. Strengthening and establishing institutional savings instruments for old age pensions should be a priority helping capital market development by establishing a steady demand for long term local currency instruments. EBRD can help these reforms by assisting the design of appropriate investment policies tailored to accelerate local capital market development.

The Bank has been involved in dialogue with the Georgian authorities about joining the Eastern Europe Energy Efficiency and Environmental Partnership (E5P) programme, which Georgia has now applied to join.

Policy dialogue and TC

The business environment in Georgia is generally very good, but the new government's economic priorities need further refining. Policy dialogue activities in this area will therefore focus on the unfinished reform agenda in the area of governance, rule of law, competition policies and sectoral policies where the new government may redefine its priorities. The Bank will consider possible co-investment with the Sovereign Wealth Fund, as successor to the Partnership Fund, provided that its new status delivers strong corporate governance and in projects compatible with the Bank's strategic priorities fostering private sector participation. The Bank will seek to support the establishment of a sound legal and regulatory framework for the development of local currency financing, working with donors and other IFIs.

3.2. Complete modernisation of the energy sector

Key challenges

The country's energy sector, which virtually collapsed during the transition period, has undergone a significant transformation in recent years as hydropower capacity was rebuilt and transmission networks established. However, the country's integration in regional energy markets remains incomplete and the sector still suffers from significant distribution losses and seasonal supply patterns inherent to Georgia's hydrology.

Remaining transition challenges in the energy sector include:

- Attracting FDI in large hydropower generation projects requiring sophisticated equipment and management as well as high environmental standards.
- Pursuing further integration of domestic and regional energy markets through completion of an adequately calibrated transmission system effectively linking countries of the region via Georgia.
- Improve efficiency of the energy system by reducing losses in transmission and distribution and by extending geographic reach.
- Improve energy efficiency and cross-country energy trading by strengthening tariff setting methodology and eliminating cross-subsidies to reflect more closely the regional market price of energy.

Bank's operational response

To support modernisation of the energy sector, the Bank will complete the energy sector projects started during the past Strategy period, including those designed to increase energy production and access export markets. It will also continue to support the further enhancement of the transmission capacity developed with the Black Sea Transmission line, through additional hydropower plant investments, consistent with EU regulations on cross-border exchange of electricity. Future projects will privilege private sector participation.

To help attract FDI to large hydropower generation projects, the Bank will support the involvement of international private players in the further development of the country's underutilised hydropower potential. To improve energy efficiency the Bank will support residential energy efficiency lending and further modernisation of energy inefficient traditional industries (e.g., cement) through continuing support for energy efficiency credit lines.

Policy dialogue and TC

The Bank's financing in support of further modernisation of the energy sector will be supported by policy dialogue aimed at promoting further domestic markets reform and the introduction of modern regulatory frameworks. In particular, the Bank will work with the Georgian authorities, other IFIs and donors to assist in the design of an appropriate sovereign support to off-take agreements for large HPP projects in order to stimulate strategic investment from major international developers and operators while minimising the impact of such support on the country's contingent liabilities. Policy dialogue will also be aimed at limiting government interference in energy tariff setting that would be a potential deterrent to new investments in both small and large renewable energy projects.

3.3. Supporting Georgia's regional and global economic integration

Key challenges

In light of the country's relatively small size, growth would benefit from regional projects that can attract large-scale investments. The country's location and generally favourable investment climate should support the transition from a strategic transit corridor to a regional logistics platform. This requires further improvements to transport infrastructure, investing in logistics facilities and in industries adding value to goods transiting through the country. Success will be predicated upon supporting policies aimed at the opening of the regional and broader international markets, including in the context of the on-going negotiations on a Deep and Comprehensive Free Trade Area with the EU.

Specific sectoral transition challenges related to Georgia's regional and global economic integration include:

- Leveraging Georgia's strategic location on the transit corridor between Central Asia and Europe to enhance value-added in the economy. The logistics sector remains underdeveloped, with few western-standard warehouse facilities.

- Enhancing private sector participation in transport infrastructure to improve efficiency, the quality of service, access to remote areas and communities, and their long-term financial sustainability, along with regulatory reforms.
- Further develop the country's vast potential for tourism in a sustainable pattern through venues, both in Tbilisi and the regions, that are suitable to and affordable by tourists from more diversified locations and income levels.

Bank's operational response

To promote Georgia's regional and global economic integration, the Bank will focus on projects in various areas including infrastructure, logistics, telecommunications and the financial sector that would support cross-border economic activities. These projects will aim at creating opportunities for skills transfer to enable Georgian companies to take advantage of trade opportunities and to become more competitive in a wider regional and international context.

To support the strengthening of Georgia's role as a regional transport platform, the Bank will prioritise private sector opportunities in areas such as the expansion of the ports infrastructure and the modernisation of the country's airport infrastructure. In the related field of transport logistics, the Bank will support logistics and warehousing companies which serve broader regional markets enabling the country to take advantage of its geographic position as an important transit link between the South Caucasus, Central Asia and Europe.

Building on the country's favourable investment climate, the Bank will support private equity funds targeting the broader region. This will facilitate and encourage private equity investors from the broader region to invest in Georgia, leveraging synergies across investment segments in support of Georgia's regional economic integration.

Modern communications networks are essential for Georgia to enhance its role as a regional transport and logistics platform. The Bank will therefore support the development of Georgia's communications and internet infrastructure in a competitive environment to ensure that all regions of Georgia, especially those remote from urban centres, are connected.

To help Georgia become a regional and indeed global tourist destination, the Bank will promote the broadening of the range and regional coverage of the hospitality and tourism sectors and support modern retail best practice through selective investments, including with potential multinational players, while encouraging competition.

Policy dialogue and TC

Where a degree of sovereign participation is contemplated, the Bank will engage with the new government in determining the most appropriate venue for joint efforts in fostering private investment in support of regional economic integration. Should the Partnership Fund be maintained as a Sovereign Wealth Fund, policy dialogue will aim at strengthening its corporate governance, including financial audit. The Bank will also consider new governmental projects of raising *ad hoc* funds to the extent that such investments originate from and are used in support of the private sector.

3.4. Environmental and social implications of the Bank's proposed activities

EBRD projects in Georgia are subject to the 2008 Environmental and Social Policy and associated Performance Requirements. For direct investments, the Policy requires projects to be structured to meet European Union and Georgian national environmental requirements. EBRD will work with clients so that projects that do not initially meet EU environmental criteria will move toward fully meeting EU standards in the future.

For projects that are Category A under Appendix 1 of the Policy, the Bank-mandated disclosure and public consultation period for Environmental and Social Impact Assessments (60 and 120 days for private and public projects, respectively) exceeds the 30-day disclosure period required under Georgian law. To ensure that that public comments made during the longer EBRD disclosure period are considered in the Georgian permitting process and thus are meaningful, disclosure and planning have to be carefully coordinated so the authorities have the opportunity to consider all comments before making decisions.

To protect Georgia's rich cultural heritage, which can be affected by infrastructure projects and construction works, the Bank requires that clients consult with the Ministry of Culture and Monument Protection in order to devise approaches needed to avoid or mitigate potential adverse effects.

In line with Georgia's commitment to hydropower development, many new projects are being proposed on rivers that are as yet unaffected by previous development. For such projects in particular, careful attention has to be paid to biodiversity, as well as impacts on local populations, which may include vulnerable groups. In river basins where new projects are to be added to existing developments, the Bank will require that cumulative impacts be considered. Previously, the Bank has commissioned strategic environmental assessments of multiple hydropower developments on the Mktvari (Kura) River and on the Paravani River, which will be valuable for developers and regulatory authorities for future projects in these river basins.

For investments in Financial Intermediaries (FIs) aimed at increasing private investment, the Bank will continue to monitor client FIs to ensure they implement their agreed environmental and social due diligence and monitoring procedures so as to adequately manage environmental and social risks. As needed, the Bank will follow up a 2012 FI training session with additional sessions to familiarise FI staff with the Bank's requirements and with environmental and social due diligence.

Populations in some areas of Georgia speak languages other than Georgian. For projects in those areas, the Bank will ensure that clients maintain a high level of community engagement in local languages, during the due diligence phase as well as during operations, to ensure that stakeholder concerns and priorities are understood and taken into account. Projects that may have transboundary impacts will need to follow the requirements for UNECE Espoo Convention. In some areas, however, gathering information and consulting with local stakeholders may be difficult due to disputed borders.

If needed for hydropower projects and other projects that may require land acquisition, in particular for linear projects such as transmission lines and roads, the Bank will work with clients to register land titles and ensure expropriation and compensation are undertaken in accordance with the Bank's Performance Requirements.

In past projects, the Bank has observed that construction practices in Georgia do not always meet international standards for environmental control and occupational health and safety (EHS). To help remedy that, the Bank is providing Technical Cooperation funds for a pilot project in Georgia to initiate development of practical guidelines for OHS management of construction sites.

Gender

In line with implementing the Bank's Gender Action Plan during the period which this Strategy covers, the Bank shall work with its clients in Georgia in a number of sectors and areas. In the Industry, Commerce and Agribusiness sector, clients will be encouraged to promote equal opportunities in the work place and provided with support where necessary. In line with the new MEI Policy, projects are to be designed and implemented so as to ensure that services are responsive to the needs of both men and women. With respect to energy and infrastructure, the Bank will continue to identify opportunities to work with its clients to promote equal opportunities in access to employment as well as in the actual work place. EBRD shall be working with its clients to identify where there are gender pay gaps and to minimise these by ensuring the principle of equal pay for equal work is implemented.

See Annex 8 for an assessment of gender equality.

4. ACCESS TO FINANCE

4.1. Private sources of capital

The Georgian banking sector remained sound through a severe crisis, and has returned to profitability. However, financial penetration indicators remain low. Despite strong growth in recent years, banking assets/GDP amount to only 53 per cent, and deposits/GDP remain at a low level of 29 per cent. Credit to the private sector as percentage of GDP amounted to 32 per cent at the end of 2011. Credit contracted by 13 per cent between 2008 and 2009, before resuming growth in 2010, initially focused on inventory re-stocking and then followed by growth in retail lending and fixed investments. Year-on-year private sector credit growth was 23.5 per cent as of December 2011 and had even reached 29 per cent in October 2011.

Only about 35.8 per cent of domestic credit to private sector goes to MSMEs as large banks that dominate the market focus on financing large enterprises. Access to finance became more constraint during the crisis and more than half of firms perceive it as a major obstacle in 2009 compared to about a third of them in 2008, according to the BEEPs survey. Despite a well-developed network and institutional structures, MFIs lack financial capital to meet the demand of micro lending.

Non-banking financial sector remains small. Its development is likely to be facilitated by the recently announced pension reforms. So far, Georgian companies seeking access to equity capital have pursued listing at the international stock exchanges as the local equity market remains very small.

Although the authorities have been pursuing the policy of flexible exchange rate and are gradually shifting to inflation targeting, local currency capital market remains limited and lari funding available only in short-term maturities.

4.2. MDB finance and collaboration with other IFIs

The Bank has been intensively coordinating its activities in Georgia with other IFIs and development partners, in particular during and after the country’s dual economic and security crisis of 2008-9. At that time, the international community put together a medium term financing package worth USD 4.6 billion, of which USD 950 million came from the EBRD. The package is now largely committed, with the remaining funding expected to be disbursed over the next several years.

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). In the summer of 2008, following the military conflict with Russia, Georgia faced a sudden decline of foreign capital inflows, which led 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. In August 2009, the IMF's Executive Board 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. The augmentation and extension of the SBA has helped facilitate an orderly exit from high public and external deficits. 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.

In April 2012, the IMF’s Board approved a new 24-month Stand-By Arrangement (SBA) and a 24-month arrangement under the (concessional) Stand-By Credit Facility (SCF). Under the programme, Georgia has access to IMF credits of up to SDR 250 million (250 per cent of quota, or about US$386 million), evenly divided between the two arrangements. So far the authorities have treated the programme as precautionary and have not drawn any of the resources available under the programme.

World Bank

Georgia joined the WB in 1992 and IDA (International Development Association) in 1993. To date World Bank commitments to Georgia total $1.22 billion. 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 programme 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 programme 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 USD 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 stabilising 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.

Asian Development Bank

Georgia joined ADB in 2007, and the resident office was established in December 2008. The Interim Operational Strategy for 2008–2009 identified three priority areas: improving municipal infrastructure; reducing road transportation constraints on economic activity; and 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. ADB has since significantly surpassed this amount, committing USD 500 million in a seven-year Road Corridor Programme, approved in 2009; USD 300 million in an eight-year Sustainable Urban Transport programme, approved in 2010; and USD 500 million in an eight-year Safe Water and Sanitation programme approved in 2011.

4.3. Cooperation with the European Union

Bilateral relations between the European Commission (EC) and Georgia were established in 1992 with the objective of facilitating 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 strengthen the prosperity, stability and security of all concerned.

The ENP Action Plan represents the formalisation of the closer ties in political, geographic and economic terms, between EU and Georgia. The political 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 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.

Georgia benefits from the European Neighbourhood and Partnership Instrument (ENPI), with an amount of €180.7 million for the period 2011-2013. Within this national envelope, the following sectors have been identified as four focal sectors: i) democratic development, rule of law, good governance; ii) trade and investment, regulatory alignment and reform; iii) regional development, sustainable economic and social development, poverty reduction; and iv) support for peaceful settlement of conflicts. This financial envelope includes several large sector budget support programmes which support reforms of Georgian authorities, for example, in the fields of criminal justice, public finance management, support to Internally Displaced People and communities affected by conflict and, most recently in agriculture and rural development. In recognition for its progress on democracy and human rights, Georgia received additional funding in the order of €22 million in 2012.

The national allocation for Georgia is complemented by other forms of cooperation, in particular regional programmes under the ENPI which are addressed to all countries of the Eastern Partnership and focused on cross-cutting sectors such as energy, transport, and the environment as well as integrated border management. Furthermore, Georgia can benefit from projects funded by the Neighbourhood Investment Facility (NIF) where EU grants are blended with funds from European financial institutions, such as EBRD, to support investments and infrastructure financing in fields such as water and sanitation, energy efficiency, and the environment.

In addition, Georgia continues to benefit from EU Macro-Financial Assistance (MFA), a policy-based instrument for balance-of-payments support to third countries. In the aftermath of the August 2008 military conflict with Russia, the EU pledged at a donors' conference two potential MFA programmes for the country, each amounting up to EUR 46 million. They were part of a bigger post-conflict EU assistance package of up to EUR 500 million. The first MFA programme was successfully completed in 2009-2010, when the EU provided EUR 46 million in the form of grants to Georgia.

For the second MFA programme, the Commission adopted a proposal in January 2011. The main objectives of this EUR 46 million MFA financial package (to be provided equally in loans and grants) are to cover Georgia's external financing needs and to alleviate its budgetary financing needs, while supporting the country's fiscal consolidation and external stabilisation efforts and encouraging structural reforms.

The priorities of EU cooperation with the new government of Georgia for the next medium-term budget (2014-2020) lie in justice, agriculture and rural development and public sector reform.

EIB

The EIB and EBRD cooperate closely in their common countries of operations, including Georgia, pursuant to a tripartite Memorandum of Understanding signed initially in 2006 and updated in 2011, and which focuses on complementarity, additionality and the efficient use of each institution’s resources. The EIB started its operations in Georgia in 2007, initially with a remit focused on economic infrastructure (transport, energy, telecoms and environmental infrastructure) which was gradually broadened to include support of SMEs and education and health sectors. The EIB and EBRD have maintained close contact to identify potential joint operations, have appraised three operations together and to date have co-financed two projects: the high voltage transmission lines project, and the Vardnili and Enguri Hydro rehabilitation project. The two institutions maintain close dialogue and aim to identify further operations amenable to co-financing in Georgia.

ANNEX 1 – POLITICAL ASSESSMENT

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

Since the Rose Revolution of 2003 the Georgian authorities have been pursuing a reform agenda aimed at transforming Georgia into a European democratic state. There have been notable achievements on this path, including the recent transfer of power through the ballot box, in an unprecedented manner in the regional context.

However, many challenges remain. It is important to ensure an inclusive dialogue with the opposition and civil society in order to fully integrate them into the political process. Indirect government control of the media has been an on-going concern. Strengthening implementation of the commitments in the area of the rule of law and respect for human rights is essential for the development of Georgia's democratic institutions.

Representative and Accountable Government

Free, fair and competitive elections

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

The key electoral legislation includes the Constitution, the Election Code, the Organic Law on Political Unions of Citizens (Law on Political Unions), the Law on the State Audit Office, and the Criminal Code. The electoral legal framework underwent significant amendments less than a year before the 2012 parliamentary elections and was criticised by the opposition as lacking impartiality.

The last presidential election took place 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 IEOM concluded that the election was consistent with most OSCE and Council of Europe commitments but also revealed significant shortcomings, including allegations of intimidation and pressure, blurring of the distinction between the state activities and the election campaign of the ruling United National Movement (UNM), and shortcomings in the vote count, tabulation and post-election complaints procedure.

The parliamentary elections of 1 October 2012 marked the country's first democratic transfer of power since independence. The election was monitored by the OSCE/ODIHR, the European Parliament, and the Parliamentary Assemblies of the OSCE, NATO, and of the Council of Europe. They concluded that the elections were an important step in the democratic development of the country. The elections were competitive with active citizen participation throughout the campaign, including peaceful mass rallies. Fourteen political parties, two electoral blocs, and four independent candidates were registered and took part in the elections in an inclusive and transparent manner, providing voters with a wide choice.

The election resulted in President Mikheil Saakashvili conceding the defeat of the UNM to the opposition coalition Georgian Dream, headed by Bidzina Ivanishvili. The new parliament will have considerably increased authority as the 2010 constitutional amendments, which will enter into force in 2013, have reduced the powers of the president in favour of the prime minister and the government, thus shifting the country's political system towards a parliamentary model.

In preparation for the October 2012 parliamentary elections, the new Election Code was adopted in December 2011. It incorporates many recommendations of the Council of Europe Venice Commission and the OSCE/ODIHR, including reducing residency requirements for candidates, providing financial incentives for parties to increase the number of women on their parliamentary lists, and prohibiting the use of administrative resources for political purposes. However, the Election Code did not address the Venice Commission's main recommendation to strengthen the principle of equality of suffrage by reconstructing single mandate constituencies to be comparable in size.

A major constitutional change was introduced at the end of March 2013 when the parliament approved amendments abolishing the president's right to appoint a new government without parliamentary approval. The inclusive manner in which the amendment was approved was welcomed as paving the way for the consolidation of democracy in Georgia.

Separation of powers and effective checks and balances

Under the current Constitution, the political system is dominated by the executive. The ability of the legislature and/or judiciary to act as an effective counterweight is restricted by the excessive powers concentrated in the hands of the president.

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 the ministers. The parliament of Georgia consists of 150 members and is elected for a four-year term on the basis of mixed electoral system, with seventy seven members of parliament elected under a list-based proportional system in one nationwide constituency and another seventy three in single-mandate constituencies. The new Election Code provides that apart from political parties and blocs, elections in majoritarian districts can also be contested by independent candidates.

The constitutional amendments adopted in October 2010 will diminish the powers of the president and considerably strengthen the position of the prime minister. In accordance with the Constitution, these amendments will come into force only when the current president leaves his post in 2013. The Venice Commission, which acts as the Council of Europe's advisory body on constitutional matters, characterised the changes as "a step in the right direction", but identified parliament's continued limited influence as a shortcoming.

Effective power to govern of elected officials

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

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

Civil Society, Media and Participation

Scale and independence of civil society

Domestic and international civil society organisations in most cases register and operate without government restriction, and are allowed to investigate and publish their findings freely.

Funding for civil society organisations is a challenge, especially for smaller or less experienced organisations. Despite many positive characteristics, the Georgian civil society sector is not membership-oriented and is perceived by part of the population as being detached from their everyday concerns.

Independent pluralistic media that operates without censorship

The media in Georgia operate without formal state censorship. The Constitution provides guarantees for press freedom, and the print media offer a range of political views. According to Transparency International Georgia's National Integrity System Assessment for 2011, the country has mostly progressive and liberal laws governing the establishment and operation of media entities.

Television is the most influential medium and the primary source of information for the large majority of citizens. The country's largest TV broadcasters, with coverage on a national level, are nominally independent but appear to have close ties with the government. Opposition-oriented print media has relatively limited circulation. The media is diverse but some TV channels have limited coverage within the country thus preventing full access to information to Georgian citizens.

In an attempt to address mounting criticism by the opposition and civil society, the 'Must Carry, Must Offer' provisions have been introduced in the Election Code in June 2012. These provisions obliged cable networks to include all national media outlets with a satellite broadcasting license and those that reach over 20 per cent of the population. This has helped TV stations to increase their penetration into cable networks.

As reported by the OSCE/ODIHR, prior to the parliamentary elections the media environment was polarised and aligned along political or owners' interests. There were concerns about the lack of balance in reporting of activities of opposition by the main broadcasters.

Many welcomed the adoption of the media transparency law as having resulted in greater transparency and accessibility of information.

Since the October election, the media landscape has started to change. There is significantly less direct influence from the government and the formerly pro-government stations have become more neutral.

Multiple channels of civic and political participation

Throughout the last year there were consultations between the authorities and opposition parties and civil society on the electoral reform to improve the legal framework for the 2012 parliamentary and 2013 presidential elections.

The process leading to the adoption of the law on transparency of media ownership, which entered into force in January 2012, was praised by civil society as a good example of collaborative consultation between the government and civil society organisations. Since the October election, civil society groups have gained a stronger voice in policymaking as the government is more open to take stakeholder comments into consideration while drafting new legislation.

Freedom to form political parties and existence of organised opposition

There are no restrictions on political party formation beyond registration requirements, and the Election Code adopted in December 2011 allows an individual to run for office without party affiliation.

The predictability of the country's political landscape, dominated by President Mikheil Saakashvili and his supporters, has been affected by the arrival on the domestic political scene of Bidzina Ivanishvili, whose party has challenged the dominance of the ruling United National Movement (UNM). The fragmented opposition had struggled to form a stable alliance that could successfully challenge the UNM. Ivanishvili has brought a new impetus to the opposition consolidation efforts, the process resulting in gaining a majority of the seats in the October parliamentary elections.

Rule of Law and Access to Justice

Supremacy of the law

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

The right to a fair trial is envisaged in the legislation, although the strong position of the prosecutor and the need to enhance the independence of the judiciary continue to undermine this right.

Independence of the judiciary

The independence of the judiciary needs further strengthening.

While the Constitution provides for the independence of the judiciary, outside influence is a problem. Transparency International Georgia's *National Integrity System Assessment* for 2011 noted that the judiciary "suffers from undue influence exerted by the Prosecutor's Office and the executive authority during the adjudication of criminal cases, as well as cases where the political leadership's interests are at stake" and that the judiciary's "inadequate level of independence" undermines the ability to exercise oversight of the executive branch.

Georgia needs to ensure further liberalisation of criminal justice policies and practices in line with Council of Europe standards, revise regulations on administrative detention, and reflect the recommendations of the Public Defender's Office in policy making.

In April 2013 parliament approved amendments to the law on common courts in which reforming the High Council of Justice (HCoJ) is the central issue. The HCoJ has the authority to appoint or dismiss judges and to initiate disciplinary proceedings against judges. The amendments intend to bring the law closer to European standards and, according to the Venice Commission, represent progress for the independence of the HCoJ. The president vetoed the law, arguing that the recommendations of the Venice Commission regarding the pre-term termination of the authority of sitting members of the HCoJ, had not been taken into consideration, but parliament overrode the presidential veto in May 2013.

Government and citizens equally subject to the law

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

Despite marked progress in a number of areas in the justice sector a number of challenges remain. The main problem relates to the strong position of the prosecutor and the need to enhance the independence of the judiciary. The amendments to the Criminal Procedure Code, which entered into force in November 2011, are aimed at enhancing judicial control over plea bargaining by explicitly requiring judges to assess not only the legality, but also the fairness of agreements between the prosecution and the defendant.

Effective policies to prevent corruption

Since the Rose Revolution Georgia took a "zero-tolerance" approach toward graft in the public sector and various indicators measuring corruption acknowledged the country's progress by placing it among more advanced European countries.

Transparency International's Corruption Perception Index (CPI) in 2012 ranked Georgia 51st out of 176 countries. Perceived corruption in Georgia's neighbours is much higher with Armenia ranking 105th, Russia 133rd and Azerbaijan 139th.

Georgia did well in the rankings related to anti-corruption reforms. The country has an Anti-Corruption Council created on the basis of the law on conflict of interests and corruption in public service. The functions of the Council include the coordination of anti-corruption activities, the implementation of the anti-corruption action plan and strategy, and the initiation of relevant legislation.

Notwithstanding these achievements, many problems remain, including the unfinished agenda of institutional reform. Most of the reform has come from a committed executive branch, but for it to be sustainable in the long term, checks and balances must be significantly strengthened, the judiciary must be reformed, the media has to be further empowered and civil participation and oversight needs to be increased.

Civil and Political Rights

Effective guarantees of fundamental rights and freedoms

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

The implementation of the commitments in this area, however, was uneven. The government's respect for the freedom of assembly was questioned when the authorities dispersed several protests. The Constitution protects the freedom of association but the implementation was selective. There were reports during last year that members of trade unions and opposition parties were selectively targeted for prosecution by law enforcement agencies. The country's labour code allows all workers to form and join independent trade unions, and protects their right to strike and bargain collectively.

The Constitution protects religious freedom and, in practice, the government generally respects it.

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

Political inclusiveness for women, ethnic and other minorities

The 2010 Gender Equality Law provides for the establishment of a Gender Equality Council, the enhancement of women's security, equality in the labour market, and the strengthening of women's political participation.

The Gender Action Plan was implemented consistently. Problems in domestic violence remain. Women are underrepresented in public office. There are nine women in the 150-seat parliament. According to the OSCE report on the May 2010 municipal elections, women were underrepresented in leadership positions in the election administration as well as among the candidates for, and members of, city councils. The OSCE mission found that many parties put forward candidates belonging to national minorities and that election materials were available in minority languages, but not in all areas inhabited by minorities.

Ethnic minorities are poorly represented in state administration. Georgia has not signed the European Charter for Regional or Minority Languages. There is limited representation of ethnic Armenians and ethnic Azeris in the parliament.

The Constitution and laws of Georgia prohibit discrimination based on sexual orientation. However, homosexuality is perceived as inconsistent with the traditional Orthodox Christian values prevalent in the country. Consequently, homosexuals are often targets of verbal and physical societal abuse. Protests in May 2013 in support of LGBT rights generated unprecedented public discussion of this previously neglected subject.

Freedom from harassment, intimidation and torture

The Constitution and the law prohibit torture and cruel, inhuman and degrading treatment or punishment. However, there were reports that government officials continue to employ them with limited accountability. According to human rights observers, the most important problems were the abuse of prisoners and detainees and sub-standard prison conditions. The Committee for the Prevention of Torture (CPT) and Public Defender Office (PDO) have criticised protracted investigations and insufficient disciplinary measures, and recommended that the authorities deliver a strong message of ‘zero tolerance against ill-treatment’.

In 2011 NGOs and the public defender documented a number of cases of police officers mistreating detainees. There were also reported cases of mistreatment in penitentiary facilities where pre-trial detainees and convicts are held. Victims often failed to report abuse due to fear of retribution. According to the Ministry of Justice, in 2011 authorities initiated 20 investigations into allegations of torture, nine into inhuman treatment and one into the use of duress to compel evidence.

ANNEX 2 – ASSESSMENT OF TRANSITION CHALLENGES

The table and the supporting text below provide an overall assessment of Transition Challenges by sector, based on Transition Report 2012. There are two separate scores for each sector, rating market structures and market-supporting institutions.

Georgia: Sector transition indicators

Sectors	Market structure	Market-supporting institutions
Corporate sectors		
Agribusiness	Medium	Medium
General industry	Medium	Medium
Real estate	Large	Small
Telecommunications	Medium	Small
Energy		
Natural resources	Large	Large
Sustainable energy	Medium	Large
Electric power	Small	Medium
Infrastructure		
Water and wastewater	Large	Large
Urban transport	Large	Large
Roads	Large	Medium
Railways	Medium	Medium
Financial sectors		
Banking	Medium	Medium
Insurance and financial services	Large	Medium
MSME finance	Medium	Medium
Private equity	Large	Large
Capital markets	Large	Large

Source: Transition Report 2012

Agribusiness
Market structure: Medium
Market institutions: Medium

Georgia has made notable improvements in its rating since 2005 as a result of price liberalisation and land reform. Government intervention in the sector is minimal and prices are liberalised with low tariffs across commodities and agricultural inputs. Productivity levels in primary agriculture, however, remain well below potential. The latest land reform has set the institutional framework for functioning private land markets. As a result, a large portion of agricultural land has been privatised (foreign ownership is possible). 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 sector also needs consolidation of some of the major and most advanced players to reach economies of scales for international promotion and sales efforts. A Russian trade embargo has limited Georgian export potential in agriculture, including in the wine industry. The banking system restricts its lending to the sector to mainly short term trade financing and thus lending to agriculture is extremely low even in comparison to other EEC countries.

Manufacturing and Services
Market structure: Medium
Market institutions: Medium

The sector is liberalised and open to international trade underpinned by Georgia's WTO membership. In recent years, significant progress was made in the privatisation of state-owned enterprises and in the improvement in the administrative procedures for starting a business. Consequently, the sector has attracted a large amount of FDI for example, in cement (from Germany's Heidelberg cement) and a green-field steel plant (Indian/UK investors) before the crisis in 2008. This has resulted in improved productivity and some improvements in business standards. FDI inflows in the sector that declined sharply post-crisis are recovering fast on the back of improving business environment. Corporate governance and business conduct of enterprises have also improved. Enterprises report revenues more transparently as a result of a combination of anti-corruption drive and further streamlining and simplification of the tax system. These reforms have also lowered the costs of doing business especially for small companies. According to the European Commission, independent audits are required for companies admitted to the stock exchange and companies licensed by the National Bank of Georgia since 2010. Competition policy reform has picked up, with a new Comprehensive Strategy in Competition Policy adopted in December 2010. As part of the reform, a new Agency for Free Trade and Competition was set up in February 2010. Even though its effectiveness is still uncertain at this stage, detaching the competition agency from the Ministry of Economy and Sustainable Development constitutes a move toward more independence.

Real estate
Market structure: Large
Market institutions: Small

The property market is at a relatively early stage 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. The mortgage market remains underdeveloped. Georgia's property-related business environment has been substantially improved recently, and the property registration process can now be regarded as exemplary (rank 1st out of 185 countries since 2012 in the World Bank Doing Business report). Substantial improvements have been made regarding the efficiency and fairness of court procedures, but further improvements are needed with regard to the judicial system's ability to protect private property and contracts remains. Gaps in terms of the development of modern secondary legislation supporting the sustainability of real estate (energy efficiency, impact on environment) are still large.

Telecommunication
Market structure: Medium
Market institutions: Small

The telecommunications sector is regulated by the Georgian National Communications Commission (GNCC), which is subject to comprehensive rules on independence and transparency. The regulatory framework is already relatively well developed, largely aligned with the EU requirements (the EU 2003 regulatory framework), although there are still remaining challenges (e.g. ensuring that the regulator has sufficient powers to enforce market access requirements or in the area of universal service regulation). Both fixed and mobile number portability was implemented in 2011. The process of digital switch-over has been launched and is expected to be completed by 2015. In the fixed line segment, the incumbent SilkNet (formerly United Telecom of Georgia, sold by the government to a Kazakh-Georgian consortium in 2006) still has a large market share. In the mobile segment, there is competition between three operators. There are no mobile virtual network operators (MVNOs). The state does not have any outstanding ownership stakes in the fixed and mobile operators. 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, especially in mountainous areas. Internet uptake is suffering from inadequate networks and investment into improvement of the network. Fixed broadband penetration is still very low.

Natural Resources
Market structure: Large
Market institutions: Large

Georgia is an increasingly important transit route for oil and gas, although the conflict with Russia in August 2008 has cast some uncertainty on the stability and security of energy supplies. The country's mining sector has potential to develop and exploration licences have been recently awarded. There is some private participation (Frontera, CanArgo, Jindal Petroleum and others) in the oil and gas exploration sector on the basis of PSAs agreements in partnerships with the state-owned Georgian Oil and Gas Corporation (GOGC) but production is negligible. GOGC was created in 2006 by bundling together all state assets in the oil and gas business with the aim of creating an energy national champion. It is fully state-owned, is responsible for upstream oil and gas exploration and production, and dominates the domestic gas import/export, transportation and distribution business. Georgia has privatised its gas distribution companies as well as some large licensed importers which consume gas for industrial purposes. Georgia's main gas distribution companies are today directly or indirectly controlled by Kazakh and Azeri national companies. While the gas sector is nominally being liberalised, competition in the sector remains limited as GOGC maintains control over the import of gas. The oil products distribution sub-sector is open to competition and a number of regional players participate in the market. Georgia is increasing its importance as a transit route with existing projects and new endeavours, which generates additional revenues for the national budget. Although transit fees in relation to the BTC/SC pipelines are published, as part of EBRD involvement in the financing of the projects, further measures are required to fully integrate revenue streams into the public budget and improve governance and transparency of GOGC. The Georgian National Energy and Water Regulatory Commission (GNERC) lacks full independence and payment discipline remains low.

Sustainable Energy
Market structure: Medium
Market institutions: Large

Electricity and gas prices still do not include environmental costs. Since 2006 losses in the power system were substantially reduced and collection rates increased. Energy standards in building codes are rarely followed in practice. The majority of electricity production comes from large hydro, which ranks Georgia high in terms of RE and low in terms of emissions. Feed-in tariffs for new renewable projects are not harmonised and weak. 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. There are concerns that a recent amendment to the Law of Georgia allows for the Electricity System Commercial Operator to buy hydro power produced by new HPPs at a long-term fixed tariff during the three months of winter would hinder investment. The frequently changing regulatory framework does not offer predictable returns to investors. Georgia ratified the UNFCC and Kyoto protocol where it holds the status of the Non-Annex 1 Party. No GHG emission targets or policies were adopted. The country hosts 1 CDM project. Remaining challenges include further reforms in the energy sector (tariffs, collection), strengthening the legal and institutional setup for EE, improvements in the framework for RE and further project, institutional development for CC, and developing expertise for the implementation of energy efficiency projects.

Power
Market structure: Small
Market institutions: Medium

Georgia's electricity sector has been 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 40 per cent of the country's electricity needs. In September 2006 a broadly liberalised market structure was introduced under the authority of the Electricity System Commercial Operator. However, regulated prices and significant cross-subsidisation still persist. Delineation between ministerial and regulatory authorities remains unclear and political interference in the regulatory process is frequent. Weak transparency in the tariff setting process persists. Since 2006 there has been a substantial reduction in network losses but they still remain at a relatively high level (12-14 per cent). Collection rates increased to nearly 100 per cent in 2009 and 2010. 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.

Water and wastewater
Market structure: Large
Market institutions: Large

The decentralisation of the water/wastewater sector was recently reversed, as the central government reorganised the water/wastewater services into regional structures. Most water companies have been unified into one national water company called the United Water Supply Company of Georgia (UWSCG) covering approximately 1.5 million people. In addition there is the privatised Tbilisi/Rustavi/Gardabani Water Company (covering 2 million people) and Adjaran water companies covering approximately 400,000 people. In UWSCG's service area the former local water companies have been transformed into service centres, responsible for billing, collection and ad hoc maintenance of the local water supply system. Most utilities remain in very poor financial state, tariffs are insufficient to cover costs, and operational performance is poor and network losses substantial. Metering level is low, but the implementation of meters nationwide started in 2011, and is currently on-going. The regulatory prerogatives (e.g. tariff setting) were transferred from municipalities to an independent regulator Georgian National Energy and Water Supply Regulatory Commission, and related legislation is in place, but regulatory capacity remains weak and consequently most water companies remain loss making. Nevertheless, thanks to grant support from the international community, the service level/quality has recently improved in some areas.

Urban Transport
Market structure: Large
Market institutions: Large

The private sector is active in urban transport, mostly in deregulated competition. However poor regulation translates into low quality services. The municipal public transport in Georgia is mainly represented by municipal bus and metro companies. The tram and trolleybus lines ceased to exist in 2006. In Tbilisi there is an incipient integrated electronic ticketing system. In July 2009 Tbilisi bus and metro companies joined into a single "Tbilisi Transport Company". The company is presently loss making.

Roads
Market structure: Large
Market institutions: Medium

The Roads Department of Georgia is established under the auspices of the Ministry of Regional Development of Georgia. Construction and maintenance works are outsourced, and the environment is competitive. 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.

Railways
Market structure: Medium
Market institutions: Medium

Since 2005, partly thanks to significant international cooperation, the Georgian government 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.

Banking
Market structure: Medium
Market institutions: Medium

The Georgian banking sector remained sound through a severe crisis, and has returned to profitability. However, financial penetration indicators remain low. Sustainable deepening of financial penetration will require lengthening loan maturities, and increased ability to serve regional and sectoral needs. In addition to focused products, distribution channels, and credit assessment skills, these goals will require tools to address currency and maturity mismatches including instruments for longer term funding, particularly in local currency, and FX hedging instruments. Credit risk embedded in foreign currency lending remains high, and further gains in de-dollarisation need to be accompanied by product design and underwriting approaches to mitigate this risk. Concentration in the banking system is relatively high, with top five banks controlling over 80 per cent of assets. Deposits and loans are highly dollarised. NBG is in the process of implementing Basel II, with a view to eventually adopting Basel III. To facilitate the transition towards risk-based supervision under Basel II, NBG began in 2010 to reorganise internally, and developed benchmarking procedures. The NBG Consumer Protection Division introduced a consumer protection framework in June 2011. Banks are required to disclose to borrowers the effective interest rate, currency induced credit risk, contract amendment rights, and other information. Bank customers are able to submit complaints to the NBG, which is analysing complaints data to strengthen supervision.

Insurance and other financial services
Market structure: Large
Market institutions: Medium

The insurance market remains relatively small (with premia-to-GDP ratio of 1.74 per cent, of which nearly all- 95 per cent- is in the non- life segment). Few complex products and very few life products are offered in the market and the insurance industry lacks adequate skills. Most risks are re-insured off-shore, leaving little local domestic capital accumulation for investment. The Georgian insurance market furthermore has become even more concentrated; of the 13 active companies, the top three players account for almost 70 per cent of the market. On the regulatory side, Georgia remains in its early stages in the non-bank financial sector and the government does not intend to increase legislation significantly at this stage. Nevertheless, with respect to the insurance sector, the former has expressed commitment to harmonise legislation and supervisory methods, in an attempt to move closer towards Solvency I/II. Although a member of IAIS, legislation and regulation fall short of the IAIS standards. Georgia is an associate member of the International Actuarial Association. The scale of private pension funds operations is very limited. A small 3rd Pillar is in operation, but the tax treatment of future withdrawals has not been clarified, which creates uncertainty for potential participants. Pillar II legislation is under consideration but there is unlikely to be political support for pension reform in the near term. Leasing operations are being gradually developed but from a very low base-. The regulatory framework in the leasing sector remains underdeveloped. There are no restrictions on foreign entry into the NBFI sector.

Micro, Small and Medium-sized enterprises
Market structure: Medium
Market institutions: Medium

The SME sector accounts for a small but rising share of the economy’s value-added. In 2011, the SME sector in Georgia accounted for 21.8 per cent of value-added and 19.9 per cent of total turnover, while in 2011, the share in turnover constituted 14.4

per cent according to GeoStat. Bank lending to the MSME sector has increased with the rapid growth of Procredit Bank contributing to a significant competitive pressure in this segment of the market and number of banks developing SME lending. Nevertheless, only some financial intermediaries have developed sustainable MSME lending, forcing MSMEs to rely on the capital of their owners and retained earnings. Domestic credit to GDP accounted for 32.8 per cent in 2011. Only about 35.8 per cent of domestic credit to private sector goes to MSMEs as large banks that dominate the market focus on financing large enterprises. Access to finance became more constraint during the crisis and more than half of firms perceive it as a major obstacle in 2009 compared to about a third of them in 2008, according to the BEEPs survey. Despite a well-developed network and institutional structures, MFIs lack financial capital to meet the demand of micro lending. Sixty-four microfinance organisations are currently operating in Georgia. According to Microfinance Information Exchange (MIX) microfinance lending reached 4 per cent of GDP at the end-2010. A few public programs have been developed to support SME sector but mainly with international support. The legal and regulatory framework is supportive of SME lending. A real estate cadastre is fully operational. A central collateral register and credit information systems are in place and available to the public. Legal framework and enforcement of creditor rights could be improved. A private credit information bureau "CreditInfo Georgia" is in place and information is accessible online. Individuals can access their credit history and be alerted to its changes at a fee. The system for registration of pledges on movable property created in 2009 enables authorised users to register such pledges online. This online registry is centralised and fully operational throughout the country. Recently, Georgia amended its civil code in order to broaden the range of assets that can be used as collaterals.

Private equity
Market structure: Large
Market institutions: Large

A challenging business environment, limited investment opportunities and poor exit prospects all conspire against this sector. A local commercial private equity sector is yet to develop and to date the country has not attracted significant interest of international private equity funds. One country-dedicated fund manager and less than five regional fund managers that include Georgia in their scope have been identified, although none of the regional fund managers has yet invested in Georgia. Active capital and capital available for commitment are estimated to amount to only 0.17 and 0.12 per cent of GDP in 2011, respectively. Net committed capital is mainly concentrated in the small capital segment, with very minor allocations in the growth funds and infrastructure investment strategies. Other private equity strategies, from mezzanine to venture capital are non- existent. There is little local investor participation. Georgia furthermore shows very low compliance with the OECD Principles of Corporate Governance and public equity markets provide no viable exit.

Capital markets
Market structure: Large
Market institutions: Large

Georgia showed low compliance with IOSCO principles, and significant problems in implementation of the laws exist, with both effectiveness and quality of legislation in the market assessed to be poor. Still, private enforcement of securities market cases through the local courts appears to be effective. Georgia's money market lacks both infrastructure and liquidity. The interest rate index is so far only used as reference for loans. Activity in the interbank market has potential to increase as a result of the narrowing of the interest rate band by the NBG for overnight loans and deposits (+/-1.5pps within the policy rate). This action makes the interbank market a more effective tool for liquidity management for commercial banks. There is some interbank activity, though it is limited. In 2010 the NBG introduced a master repo agreement to facilitate securitised interbank transactions but the electronic platform for trading has not yet been launched. Banks manage short term liquidity with 'depo swaps', placing short term dollar deposits with another bank in exchange for Lari deposits. Depo swaps increase banks' balance sheets with a liquid asset, thus improving the overall liquid asset ratio. The government bond market infrastructure is in place for both primary and OTC secondary markets, but liquidity is negligible. Since August of 2009 the Georgian government has been issuing 6-month and 1-year treasury bills. Treasury bonds with maturities of two, five and ten years were subsequently introduced. These are important steps in building a reference yield curve. The Georgian Stock Exchange ('GSE') has an electronic trading infrastructure allowing floor and remote trading by the eight registered brokerages; however, due to low volumes sessions are held only on Monday, Wednesday and Friday, from 13.00 to 14.15. At the end of 2010, 135 companies were listed on the Exchange, with total market capitalisation of 6.2 per cent of GDP and a turnover ratio of 0.0016.

ANNEX 3 – LEGAL TRANSITION

This annex reflects on the state of transition of Georgia in a number of selected legal areas directly relevant to the new EBRD Country Strategy. Such areas include legislation to support SME development (secured transactions, corporate governance, insolvency), infrastructure (public-private partnerships) and energy efficiency. The data, which originate from assessments conducted by the Bank's Legal Transition Programme, show that further reform efforts are needed in all these sectors.

For secured transactions, modernising the present registration regime by promoting on-line access to the registered data and a change towards a notification-based system would be a welcome move. Corporate governance practices are considered weak, in both companies and banks. In the insolvency sector, the 2012 amendments to the insolvency laws have made some improvements. The insolvency law contains the mechanisms for both liquidation and reorganisation of an insolvent debtor; however it continues to be weak in certain areas as regards creditors' rights and protection of the insolvency estate. The introduction of new electronic systems should nevertheless assist with making the insolvency process more efficient and transparent for creditors. In the PPP sector, despite the existence of numerous positive elements, the law does not constitute a sufficiently solid basis for the development of projects. Moreover, specific legislation dedicated to energy efficiency is still lacking in Georgia. A positive note is the improvement to the judicial system that has been observed in recent years.

SME-supporting legislation

Secured transactions

The Bank's objective to improve access to finance for small and medium-size enterprises requires a solid secured transactions regime. A modern secured transactions framework for taking pledges over movables was first introduced in 2005 by amending the Civil Code. The new provisions provided for flexible, efficient and modern legal means for the creation, perfection and enforcement of a pledge. Since then the Civil Code saw several amendments of the provisions regulating taking both mortgages over immovable and pledges over movable property and rights, with the last ones taking place in 2011.

The result is a well-developed and modern legal framework for taking security interests. However, limited on-line access to the registered information and somewhat outdated and lengthy procedures for registration (necessity to present documents to the registrar) can still cause delays of the transactions and increase costs. This can be burdensome for the parties, particularly SMEs, and therefore the modernisation of the system would be a welcome move.

Corporate governance

The main provisions can be found in the Law on Entrepreneurs adopted in 1994. The law regulates the formation, organisation and dissolution of joint stock companies, including banks. The law sets the basics for corporate governance, describing the governing bodies of companies and their responsibilities. Additional provisions relevant for banks can be found in the Law on Activity of Commercial Banks. There is also a Corporate Governance Code for Commercial Banks, issued in 2009 by the Association of Banks, which banks are required to follow under the so-called 'comply-or-explain' mechanism, although in practice such reporting does not appear to take place.

The 2007 EBRD assessment on corporate governance showed Georgia being in "very low compliance" with the OECD Principles of Corporate Governance, showing a number of shortcomings in all areas under consideration. Although Georgia has enacted a number of tools for regulating corporate governance, it has missed detailing some of key issues in the governance of companies and banks. The enactment of the corporate governance code for of commercial banks has been a step in the right direction, provided however that the code's recommendations do not merely remain on paper.

Insolvency

The principal legislation governing the law on insolvency in Georgia is the Law on Insolvency Proceedings (the "Law on Insolvency") dated 28 March 2007 and amended 29 June 2012, which applies to corporate entities and sole traders. It can be initiated by debtors that are cash-flow insolvent or that are under the threat of imminent insolvency. Certain new amendments made to the Law on Insolvency, which relate to the application of new electronic insolvency case management systems, will only come into force from 1 January 2014.

The EBRD's 2009 insolvency sector assessment (the "Assessment") highlighted a number of weaknesses in Georgian insolvency laws in existence at the time of the Assessment. Despite some improvements introduced by the 2012 amendments, a number of the issues remain unaddressed. For example a moratorium on legal proceedings against the debtor arises only following a decision by the court to open insolvency proceedings, rather than from the date of the petition for insolvency and is restricted to enforcement proceedings. Provisions regarding reorganisation in insolvency remain weak: the reorganisation plan requires the approval of all secured creditors. Consenting creditors can offer to purchase the claim of the dissenting creditor or allow it to enforce its security outside of the reorganisation plan, but there is no ability for 'cram down', i.e., for a qualified majority of creditors to impose a reorganisation plan on a minority of dissenting creditors. This reduces the likelihood of reorganisation of the debtor's business. Furthermore, the avoidance provisions in the Law on Insolvency relating to acts detrimental to creditors entered into by the debtor prior to insolvency remain limited in scope and rather unclear.

Public-private partnership (PPP) legislation

The EBRD objective to support PPPs in transport and municipal infrastructure call for an appropriate legal regime. In this context, the 2012 EBRD Concession/PPP Laws Assessment (the "2012 Assessment") found Georgian legislation to be in low compliance with international standards. The main document is the Law "On the Procedure for Granting Concessions to Foreign Countries and Companies") adopted in 1994. The Assessment revealed that the law has much room for improvement as far as its scope of application is concerned. In particular, concessions are defined as "long-term leasing agreements" and seem to be limited to natural resources and activities related thereto. In fact, strictly speaking the law has rather limited applicability to PPP in its common sense. Furthermore, the law does not clearly define the contracting authority and as one can see from its title domestic investors are discriminated against. The law provides for the adoption of a list of objects that can or cannot be subject to concessions but no such list could be identified.

Moreover, the law contains very few provisions regarding the selection of the concessionaire and refers to regulations in this respect. However, no such regulations could be identified. In addition, the law refers to the establishment of a special register of concession agreements, but such register could not be identified either. Thus, the selection procedure is insufficiently regulated. The law contains very few elements regarding the project agreement, government support and financial securities. Furthermore, the possibility of international arbitration is not clearly provided for.

Energy efficiency

There is no dedicated law on energy efficiency in Georgia. The country has received technical assistance with the drafting of a general energy efficiency law in 2007 but no draft has been publicly released or submitted for consultation.

At present, Georgia has no primary legislation dedicated to renewable energy either, though aspects relevant to renewables exist in the energy legislation, as hydro power has long been the most important electricity source in the country. In fact, Georgia has one of the largest undeveloped hydro power potentials in the world at about 32 TWh per year. Georgia's potential hydro power production is roughly 7.27 MWh per capita, which is considerably higher than that of the world's biggest hydro power producers, Norway and Canada.

A more dedicated policy approach is needed with regard to promoting energy efficiency, including developing general energy efficiency legislation and institutional setting, introducing procedures for ensuring adequate environmental standards and regulation of waste management. Georgia has to harmonise the energy legal and regulatory framework by improving the environment for private sector and introducing modern and dedicated renewable energy law.

Judicial Capacity

The *EBRD Judicial Decisions Assessment 2011* found the quality of court judgments in commercial law matters in Georgia to be among the best in the group of countries formed by the Commonwealth of Independent States, Georgia and Mongolia. Factors still adversely affecting the quality of court decisions include certain gaps in commercial areas such as competition law, as well as judges' high caseload. In addition, it was considered that judges would benefit from further judicial training in commercial law and market practice. Implementation of commercial law decisions was considered to be the most effective in the countries group. Even so, there remained a backlog of unenforced decisions and certain inefficiencies in the functioning of enforcement agencies. The recent introduction of a dual system of private and government bailiffs is aimed at raising enforcement standards.

The most notable recent improvements in the Georgian judiciary lie in the area of judicial independence and impartiality. This is partly reflected in the EBRD Judicial Decisions Assessment, which found Georgia to score well on the indicator of perceived impartiality of written decisions. However, there appears to be a broad consensus that real progress has been made in raising the actual level of judicial conduct and impartiality in judicial decision-making. This is attributed to a concerted and multi-layered anti-corruption campaign initiated by the Georgian government in 2003. In respect of the judiciary, this encompassed thorough retraining of judges, with those passing the requalification tests being appointed for longer terms and receiving higher salary. Furthermore, a reform was introduced prohibiting communications between judicial officers and any party (private or public) having an interest in litigation before the courts. Substantial penalties apply in relation to any violation of these provisions.

The anti-corruption campaign has achieved positive results, evidenced by an increase in public confidence in the courts. Many local lawyers believe that bribery of judges has been all but eliminated in Georgia, at least at the first instance level. This is reflected in Georgia's improved standing in corruption-related metrics, such as the EBRD/World Bank *Life in Transition Survey*, which found that the level of perceived corruption in Georgia is now as low as that in western European countries. A further important factor is that the government has clearly been active in disseminating its work under the anti-corruption campaign.

However, ensuring full judicial independence requires further efforts. Courts are still believed to show deference towards the state in cases involving state interests or parties. In criminal matters, young judges are often overshadowed by a well-resourced and powerful prosecutor's office; the introduction of a jury system is intended to address this imbalance. Further, the lack of full judicial tenure and the potential of relocation to remote jurisdictions remain threats to judicial independently. The government is continuing its efforts to strengthen the judiciary and address remaining concerns. Most notably, from 2013, judges will be appointed to the bench for life, rather than renewable terms.

ANNEX 4 – SMALL BUSINESS SUPPORT

The Small Business Support Team promotes economic transition by facilitating enterprise change in potentially viable micro, small and medium enterprises (MSMEs) and contributing to the development of a sustainable infrastructure of local business advisory services. This is achieved through two complementary programmes, the Enterprise Growth Programme (EGP), formerly the Turn Around Management Programme, and Business Advisory Services (BAS).

Previous SBS experience in Georgia

To date EUR 2.86 million of donor funding have been committed by **EGP in Georgia** since its inception in 1997. The largest donors of EGP projects have been the EU, the EBRD Shareholders Special Fund (SSF), the Netherlands, Japan, and other bilateral donors. EGP has carried out 38 projects, 7 of which are still in progress. These projects were implemented across various industry sectors, with top three being food and beverages manufacturing and chemical manufacturing. Thus far, 21 projects have been evaluated after completion with 48 per cent rated as “highly successful”, and 48 per cent as “successful”. 77 per cent of assisted enterprises reported increases in turnover, 44 per cent reported increases in pre-tax profit, 60 per cent reported increases in employment, 69 per cent of assisted enterprises reported productivity growth after the EGP project, and 38 per cent reported improvement in profit margin.

Since its inception in 2003, **BAS Georgia** has received a total of €6 million in donor funding. This has been supplemented by EUR 2.6 million in enterprise client contributions. As of the end of Q3 2012 the Programme has undertaken a total of 682 projects with MSMEs, engaging 225 consultants. Projects aimed at improvement of market performance and management effectiveness have been the most common type among all the projects carried out in Georgia The industry spread of enterprises assisted has been wide, with agribusiness, construction and wholesale and retail distribution being among the most common sectors. To date, 580 projects in Georgia have been evaluated, of which 47 per cent were rated successful or highly successful.

BAS assists small enterprises and more than 76 per cent of the projects are with enterprises with less than 50 employees. In terms of cross-cutting issues, BAS Georgia has focused on facilitating rural development. More than 50 per cent of the projects were located outside of Tbilisi. In 2011, BAS also started implementing the recently introduced ETC Accounting Improvement Programme (AIP) with the objective of raising enterprise financial management practices and standards in view of potential EBRD investments in the ETC countries and up till now 2 projects have been implemented. .BAS Georgia has also implemented a specific Women in Business Programme targeted at helping female entrepreneurs boosting their businesses through training and advisory services. In addition to projects, BAS Georgia has also undertaken a number of market development activities (MDAs) geared towards the development of management skills of local MSMEs and consultants.

MSME and Consulting sector in Georgia

The MSME sector and business environment

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 in a systematic manner. However, it is generally considered that the SME sector still underperforms in terms of value added. In 2010, the SME sector in Georgia accounted for only 19.3 per cent of value added and 16.1 per cent of total turnover, while in 2011, the share in turnover constituted 14.4 per cent according to national statistical agency. 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 and employment shows that there is scope to improve the businesses' productivity and competitiveness on the local and international market.

There is a positive trend with the country's macroeconomic performance, while the uncertain global environment warrants continued engagement with IFIs. At a ranking of ninth of 183 countries, Georgia is the best-rated country in the transition region in the World Bank's 2013 Doing Business index, which measures each country's performance in the area of regulatory and institutionary reforms. According to the 2008/09 Business Environment and Enterprise Performance Survey (BEEPS), a larger percentage of companies identified transport and access to finance as obstacles to doing business than in the previous 2005 survey. However, almost 80 per cent of Georgian firms in the latest BEEPS survey reporting political instability as an obstacle to their day-to-day operations, perhaps reflecting the destabilising impact of the Russia-Georgia war of 2008.

Bank lending to the MSME sector has increased with the rapid growth of Procredit Bank contributing to a significant competitive pressure in this segment of the market and number of banks developing SME lending. Nevertheless, only a limited number of financial intermediaries have developed sustainable MSME lending, forcing MSMEs to rely on the capital of their owners and retained earnings. Domestic credit to GDP accounted for 32.8 per cent in 2011. Only about 35.8 per cent of domestic credit to private sector goes to MSMEs as large banks that dominate the market focus on financing large enterprises. Access to finance became more constraint during the crisis and more than half of firms perceive it as a major obstacle in 2009 compared to about a third of them in 2008, according to the BEEPs survey. Despite a well-developed network and institutional structures, microfinance institutions (MFIs) lack financial capital to meet the demand of micro lending, especially for the growing needs of SMEs. Fifty-seven microfinance organisations are currently operating in Georgia. According to Microfinance Information Exchange (MIX) microfinance lending reached 4 per cent of GDP at the end-2010.

The consultancy market

The Georgian consultancy sector faces large transition challenges with regard to MSMEs. With the exception of basic business advisory services, demand for consultancy services is relatively weak and the variety and quality of services offered could be further improved. A large majority of consultants is qualified in the area of financial management and computerised financial systems, market analysis and planning and development planning. Conversely, there is a lack of consultants with an expertise in reorganisation and restructuring and engineering studies. Market penetration is inadequate, highlighting the need for further promotion, and the industry remains fragmented. Some international second-tier consultant firms are present in Georgia, but usually do not cater the MSME sector. There is no professional association of management consultants active to support and enhance the local consultant industry and the market continues to rely on donor support.

Infrastructure of SME support

The Ministry of Economic Development is responsible for the elaboration of MSME development policy. MSME development and support is defined by the law on “Small and Medium Enterprise support” introduced in 1999.

The Chamber of Commerce and Industry of Georgia unites all regional chambers and aims at assisting the Georgian business community. The principal objective of the Chamber is the representation and protection of the interests of business entities and individuals in Georgia. The Georgian Employers Association and Georgian Small and Medium Enterprise Association also play their role in supporting MSMEs. More than 30 private business service provider companies are operating in the country. Most provide fee-based services for businesses, including MSMEs and start-ups. However, there is a need to further develop the institutional support infrastructure structure to support the development of the sector.

Continuation of SBS programmes in Georgia

The Bank’s SBS programmes in the country will continue to support SMEs through direct enterprise assistance in order to contribute to the development of a competitive and sustainable private sector in Georgia. The programmes will focus on activities in priority sectors such as agribusiness, tourism, manufacturing, transport and logistics as well as ICT.

The programmes will facilitate client access to finance through the EBRD and its partner financial institutions. Cross-cutting issues such as rural development, gender equality and environmental improvement will also be addressed.

EGP plans to further support the transfer of management skills. EGP will work with enterprises which have a high growth potential in terms of export and contribution to GDP. In addition, it will focus on export-oriented companies helping them to internationalise their products and enhance their exposure to international best practices. EGP will focus on specific types of advice such as organisation and management skills, strategic planning, sales and marketing as well as business planning.

BAS plans to further enable MSMEs to access advisory services by facilitating projects with local consultants. A flexible grant scheme will be applied through annual updates of the Grant Guideline Matrix to prioritise intervention, ensure additionality and avoid duplication of efforts with international donors and governmental organisations. Typically, higher grants will be allocated for smaller enterprises, for enterprises located outside of major cities, for more complex consultancy services (e.g. energy efficiency) and for projects involving services where market demand is less mature, particularly environmental management.

At the market level, SBS will promote international best practices in priority sectors through dissemination of successful showcases and trainings. In doing so, it will also create a platform for dialogue amongst SMEs, consulting firms and private business development organisations. SBS will promote the use of business advisory services to stimulate demand and enhance the professionalism of the local consultancy sector in the regions. SBS will seek to develop a sustainable MSME support infrastructure through the support and development of local consultants.

In addition, BAS Georgia will continue to implement the ETC Accounting Improvement Programme (AIP) with the objective of improving enterprise financial management practices and raising their standards in support of potential EBRD investments. BAS will also seek to facilitate client access to finance through the EBRD's partner banks and other financial institutions.

ANNEX 5 – TECHNICAL COOPERATION

TC commitments by donor through EBRD, 2010-2012

Donor	TC Commitments (€)
Early Transition Countries Fund	235,683
EBRD Shareholder Special Fund	3,368,038
EU	6,277,502
Finland	494,075
Germany	17,140
Ireland	57,000
Netherlands	91,631
Slovak Republic	254,000
Sweden	1,226,886
Taipei China	55,886
Grand Total	**12,077,841**

TC commitments by sector through EBRD, 2009-2011

Sector/Team		TC Commitments (€)
SME Development*	SBS	2,272,099
	Agribusiness	32,944
	Enterprise Support	31,449
E2C2	E2C2	291,516
Environment	Environment	149,159
Financial Institutions	Financial Institutions	3,226,439
LTT	LTT	748,075
Infrastructure	MEI	5,326,160
Grand Total		**12,077,841**

Note: Commitment values based on year end or period end data for each year.

* This sector category encompasses direct assistance to SMEs and indirect assistance through policy dialogue between the EBRD, the authorities and commercial/business associations (e.g. Investment Councils)

ANNEX 6 – SELECTED ECONOMIC INDICATORS

	2007	2008	2009	2010	2011	2012 *Estimate*	2013 *Projection*
Output and expenditure			*(Percentage change in real terms)*				
GDP	12.3	2.4	-3.8	6.3	7.2	6.1	5.0
Industrial gross output	15.0	1.2	8.5	12.5	11.2	na	na
Labour Market[1]			*(Percentage change)*				
Gross average monthly earnings in economy (annual average)	32.5	45.3	4.1	7.3	12.0	5.5	na
Real LCU wage growth	21.3	32.1	2.3	0.2	3.2	6.5	na
			(In per cent of labour force)				
Unemployment rate (end-year)	13.3	16.5	16.9	16.3	15.1	na	na
Prices			*(Percentage change)*				
Consumer prices (annual average)	9.2	10.0	1.7	7.1	8.5	-0.9	3.0
Consumer prices (end-year)	11.0	5.5	3.0	11.2	2.0	-1.4	na
Fiscal Indicators			*(In per cent of GDP)*				
General government balance	-4.7	-6.3	-9.2	-6.6	-3.6	-2.9	-2.8
General government revenues	29.3	30.7	29.3	28.3	28.2	28.7	na
General government expenditure	28.4	32.7	35.8	33.1	29.1	29.4	na
General government debt	19.1	23.5	30.9	33.5	29.7	32.7	na
Monetary and financial sectors			*(Percentage change)*				
Broad money (M2, end-year)	54.0	7.9	7.8	23.9	20.3	20.4	na
Credit to the private sector (end-year)	75.9	25.4	-14.7	15.4	29.6	12.9	na
			(in per cent of total loans)				
Non-performing loans ratio	2.6	12.8	17.9	12.5	8.6	9.4	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Local currency deposit rate	12.0	11.2	10.7	10.2	12.1	9.4	na
Foreign currency deposit rate	8.3	9.2	9.2	7.6	9.1	8.3	na
Local currency lending rate	19.6	24.1	23.4	22.6	23.5	21.7	na
Foreign currency lending rate	18.7	21.9	19.3	14.9	15.6	14.6	na
Money market rate / Discount rate/ Policy rate	*10.0*	*8.0*	*5.0*	*7.5*	6.8	5.3	na
			(Laris per US dollar)				
Exchange rate (end-year)	1.6	1.7	1.7	1.8	1.7	1.7	na
Exchange rate (annual average)	1.7	1.5	1.7	1.8	1.7	1.7	na
External sector							
			(in per cent of GDP)				
Current account	-19.7	-21.9	-10.6	-10.3	-11.8	-11.5	na
Trade balance	-26.7	-29.8	-19.2	-17.8	-18.5	-19.6	na
Merchandise exports	20.5	19.0	17.6	21.2	22.5	21.7	na
Merchandise imports	-49.0	-49.0	-39.9	-43.4	-46.2	-45.9	na
Foreign direct investment	17.1	12.2	6.1	7.0	6.8	7.0	na
Gross reserves, excluding gold (end-year)	13.4	11.5	19.6	19.9	20.3	18.0	na
External debt stock	38.5	44.0	58.0	62.0	53.3	55.0	na
Public external debt	17.5	20.9	31.4	33.7	33.0	na	na
Private external debt	21.0	23.1	26.6	28.3	20.3	na	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	2.2	3.4	4.2	3.7	4.4	4.1	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	4.4	4.4	4.4	4.5	4.5	4.5	na
GDP (in billions of Laris)	16.994	19.075	17.986	20.743	24.344	26.139	na
GDP per capita (in US dollars)	2,321.5	2,917.7	2,426.9	2,604.1	3,209.4	3,519.6	na
Share of industry in GDP (in per cent)	9.1	8.6	7.7	16.9	15.5	na	na
Share of agriculture in GDP (in per cent)	9.2	8.1	8.1	7.3	7.6	na	na
FDI (In million of US dollars)	1,674	1,494	677	679	829	970	na
External debt - reserves (in US$ million)	4,429	5,819	6,937	7,505	8,966	8,665.3	na
External debt/exports of goods and services (in per cent)	123.7	154.4	197.4	179.4	160.5	143.1	na
Broad money (M2, end-year in per cent of GDP)	24.1	23.2	26.5	28.5	29.3	32.5	na

ANNEX 7 – GENDER EQUALITY

Gender Inequality and Human Development

According to the UNDP 2011 Human Development Index (HDI), Georgia is among the countries with a high human development index. It is ranked 75th out of 187 countries. The HDI is comprised of three dimensions: health, education and decent standard of living. The country ranks at 73st globally in terms of the UNDP Gender Inequality Index (GII). The GII is a composite measure, which captures the loss of achievement, within a country, due to gender inequality, and uses three dimensions to do so: reproductive health, empowerment, and labour market participation.

Labour force participation and gender pay gap

Women's labour force participation rates are lower as compared to men's in Georgia. According to the World Bank, in 2010 the proportion of women aged 15 and older in the labour force was 56 per cent as compared to 74 per cent for men. According to the United Nations Economic Commission for Europe, women earned on average 42.6 per cent less than men, when median monthly earnings were taken into account. Georgia has the third largest gender pay gap in the EBRD region, after Azerbaijan and Tajikistan.

Indicator	Female	Male	Year
Labour force participation rates	56%	74%	2010
Gender Pay Gap	42.6%		2010

Source: World Bank; United Nations Economic Commission for Europe

According to UNESCO, in 2008 the proportion of women graduates in Georgia in all tertiary programmes was higher as compared to that of men (57 per cent for women and 43 per cent for men). Of note, however, is that in 2010, 73 per cent of all graduates in the field of education were female whereas only 30 per cent of graduates specialising in subjects such as engineering, manufacturing and construction were female. This trend in gender differences in the fields of study has been observed for the last decade for which data are available. This gender segregation in education results in occupational segregation in the labour market, as the table below shows.

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

Source: Laborsta, International Labour Organisation, 2008

According to the 2012 Women's Economic Opportunity (WEO) Index of the Economist Intelligence Unit that ranks 128 countries on their ability to support economic advancement of women, Georgia is ranked 59th globally. The country ranks 15th out of 33 countries in the EBRD region with respect to the labour policy and practice indicator (sub-indicator of the WEO Index), which covers various questions including maternity and paternity leave provisions, regulations on equal pay for equal work, and the availability, affordability and quality of childcare services.

The mandatory minimum length of fully paid maternity leave is 126 days, and unpaid maternity leave is 351 days. The law does not provide for paternity leave. According to the 2012 World Bank/IFC Women, Business and the Law Report, there are no laws or constitutional provisions mandating equal pay for equal work in Georgia. Neither exist laws mandating non-discrimination in hiring practices on the basis of gender. It is noteworthy that Georgia is one of the three countries, Tunisia and Uzbekistan being the others, in the EBRD region that does not have equal-pay-for equal-work legislation. The lack of these labour rights in the workplace may partially explain the unexpectedly high gender pay gap.

Entrepreneurship and access to finance

There is no significant gender difference reported in access to formal financial services in Georgia. According to the World Bank's Global Financial Inclusion database (surveying approximately 1, 000 people using randomly selected, nationally representative samples), in 2011 about 31 per cent of male adults and 35 per cent of females owned an account at a formal financial institution. However, the ownership of accounts at formal financial institutions is low in absolute terms for both males and females.

According to the 2008 Business Environment and Enterprise Performance Survey (BEEPS), 40.8 per cent of 373 firms surveyed in Georgia had women among its owners and 19.8 per cent had a female in top management. Of the firms surveyed, women comprised 42.8 per cent of full time workers. However, only 11.3 per cent of women were permanent full-time non-production workers. Of the 14.5 per cent of firms within the BEEPS survey sample that applied for a loan in Georgia and had a woman among its top management, 12.5 per cent of these firms were rejected for loans. In comparison, 14.1 per cent of the 85.5 per cent of firms with no female top manager that applied for loans were rejected.