Ex-post Evaluation of Macro-Financial Assistance to Georgia

ECFIN 2018 013/D

Final Report

Client: Directorate-General for Economic and Financial Affairs (DG ECFIN)

Rotterdam, 5 April 2019

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Authors:
David Vavra, Team leader (OGResearch)
Judit Antal (OGResearch)
Peter Havlik (WIIW)
Tobias Broich (Ecorys)
Mikheil Kukava (Local expert)

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Abstract

This report presents the Ex-post Evaluation of the Macro-Financial Assistance (MFA) provided to Georgia in 2015-2017. In May 2010, faced with a challenging external environment, the Government of Georgia requested the activation of the second MFA pledged by the European Union (EU) at the International Donors' Conference in 2008. The financial assistance of EUR 46 million was disbursed over 2015-2017. Based on an extensive stakeholder consultation and various quantitative and qualitative methods, the evaluation concluded that (i) the operation was most prominent in reinforcing the structural reforms, restoring market confidence in the country and the replenishment of the foreign exchange reserves; (ii) the MFA, combined with IMF programmes contributed to the stabilization of Georgia's external and public debt trajectories; and (iii) the favourable terms of the MFA compared to market-based alternatives implied substantial fiscal savings. We assess the MFA operation as relevant in terms of its objectives, conditionality and coherent with other EU instruments and international supports. While the conditions has contributed to a significant progress in the area of Public Financial Management and banking regulation, progress has been uneven in the areas of the health care, as well as the trade and competition policy.

მოკლე მიმოხილვა

ეს ანგარიში წარმოადგენს საქართველოსათვის 2015-2017 წლებში გაწეული მაკროფინანსური დახმარების პროგრამის რეტროსპექტიულ შეფასებას. 2010 წლის მაისში, ქვეყნის წინაშე არსებული გარე გამოწვევების გათვალისწინებით, საქართველოს მთავრობამ დააფიქსირა თხოვნა ევროკავშირის მიერ 2008 წლის საერთაშორისო დონორთა კონფერენციაზე დათქმული მეორე მაკროფინანსური დახმარების ამოქმედების შესახებ. 2015-2017 წლების მანძილზე გადარიცხული ფინანსური დახმარების ოდენობა 46 მილიონ ევროს აღემატებოდა. დაინტერესებულ მხარეებთან აქტიური კონსულტაციებისა და სხვადასხვა რაოდენობრივი და თვისებრივი მეთოდების გამოყენების საფუძველზე, შეფასებამ დაასკვნა რომ (i) მაკროფინანსური დახმარება ყველაზე ეფექტური იყო სტრუქტურული რეფორმების გაძლიერების კუთხით, ქვეყანაში ბაზრისადმი ნდობის აღდგენისა და უცხოური ვალუტის რეზერვების შევსების მხრივ; (ii) მაკროფინანსური დახმარების პროგრამამ, საერთაშორისო სავალუტო ფონდის (სსფ) პროგრამებთან ერთად, ხელი შეუწყო საქართველოს საგარეო და საშინაო ვალის მდგომარეობის დასტაბილურებას; და (iii) მაკროფინანსური დახმარების ხელსაყრელი პირობები, ბაზარზე დაფუძნებულ ალტერნატიულ ვარიანტებთან შედარებით, გულისხმობდა მნიშვნელოვან ფისკალურ დანაზოგებს. ჩვენი შეფასებით, მაკროფინანსური დახმარება იყო რელევანტური, მისი მიზნების და პირობითი ვალდებულებების თვალსაზრისით და ასევე -- ევროკავშირის ინსტრუმენტებისა და სხვა საერთაშორისო მხარდაჭერის პროგრამების შესაბამისი. მართალია, პირობითმა ვალდებულებებმა ხელი შეუწყო მნიშვნელოვან პროგრესს საჯარო ფინანსების მართვის და საბანკო რეგულაციის სფეროში, პროგრესი არ იყო თანაბარი ჯანდაცვის, ასევე ვაჭრობისა და კონკურენციის პოლიტიკის სფეროებში.

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Abbreviations

AA	Association Agreement
AFD	Agence Française de Développement/ French Development Agency
BMZ	German Federal Ministry for Economic Cooperation and Development
BOP	Balance of Payments
CAREC	Central Asia Regional Economic Cooperation
CEN	European Committee for Standardization
CENELEC	European Committee for Electrotechnical Standardization
CIS	Commonwealth of Independent States
CRMD	Centralized Risk Management Department
DCFTA	Deep and Comprehensive Free Trade Area
DG ECFIN	Directorate-General for Economic and Financial Affairs
DG NEAR	Directorate-General for Neighbourhood and Enlargement Negotiations
DPL	Development Policy Loan
DSA	Debt Sustainability Analysis
EBRD	European Bank for Reconstruction and Development
EaP	Eastern Partnership
EaPIC	Eastern Partnership Integration and Cooperation
EEAS	European External Action Service
EC	European Commission
EFF	Extended Fund Facility
EIB	European Investment Bank
ELA	Economic Liberty Act
EMBI	JPMorgan Emerging Market Bond Index
ENI	European Neighbourhood Instrument
ENP	European Neighbourhood Policy
ENPI	European Neighbourhood and Partnership Instrument
EQ	Evaluation question
EU	European Union
EUD	EU Delegation to Georgia
EUR	Euro
EUR1	Certificate of Origin
ETSI	European Telecommunications Standards Institute
FDI	Foreign Direct Investment
FX	Foreign exchange
GD	Georgian Dream
GDP	Gross Domestic Product
GEL	international code for Georgian currency
GEOSTAT	National Statistics Office of Georgia
GIZ	German Development Agency
GRS	Georgia's Revenue Service
IBRD	International Bank for Reconstruction and Development
ICAAP	Internal Capital Adequacy Assessment Process
IDA	International Development Association
IFI	International Financial Institution
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
ISG	Inter-Service Steering Group

KfW	Kreditanstalt für Wiederaufbau/' Reconstruction Credit Institute'
Lari	National currency of Georgia
LCR	Liquidity Coverage Ratio
LFA	Loan Facility Agreement
LHS	Left hand scale
LMIS	Labour Market Information System
MFA	Macro-financial assistance
MoF	Ministry of Finance
MoLHSA	Ministry of Labour, Health and Social Affairs
MoU	Memorandum of Understanding
MSME	Micro, Small & Medium Enterprise
NBG	National Bank of Georgia
NEER	Nominal effective exchange rate
NGO	Non-governmental organisation
NTM	Non-tariff Measures
NTB	Non-tariff Barriers
OECD	Organisation for Economic Co-operation and Development
OOP	Out-of-pocket
PCA	Partnership and Cooperation Agreement
PISA	OECD Program for International Student Assessment
PEFA	Public Expenditure and Financial Accountability
PFM	Public Finance Management
PFPR	Public Finance Policy Reform
PPA	Power Purchase Agreements
PPP	Public Private Partnership
RHS	Right Hand Scale
SAO	State Audit Office
SBA	Stand-By Agreement
SCF	Stand-By Credit Facility
SME	Small and Medium Sized Enterprise
SPS	Sanitary and Phytosanitary
STEP	Skills Toward Employment and Productivity
SREP	Supervisory Review and Evaluation Process
SSA	Social Services Agency
SWD	Staff Working Document
TBT	Technical Barriers to Trade
TOR	Terms of Reference
UHC	Universal Health Care
UNICEF	United Nations International Children's Emergency Fund
UNM	United National Movement
US	United States
USA	United States of America
USAID	U.S. Agency for International Development
USD	US Dollar
VAT	Value-added tax
VET	Vocational Education and Training
WB	World Bank
WHO	World Health Organization
WMS	Welfare Monitoring Survey

Executive summary

This report presents the results of the Ex-post Evaluation of the Macro-Financial Assistance (MFA) provided to Georgia in 2015-2017. The evaluation was commissioned by the Directorate-General for Economic and Financial Affairs (DG ECFIN). The work was undertaken by a consortium of Ecorys, OGResearch, WiiW and NIESR with inputs from a local expert based in Georgia.

Objective and scope of the evaluation

The objective of this ex-post evaluation was i) to analyse the impact of the MFA on the economy of Georgia, and in particular on the sustainability of its external position; and ii) to assess the added value of the European Union's (EU) intervention. The evaluation aims to draw conclusions whether the ex-ante considerations determining the design and terms of the MFA operation were appropriate, taking into account the economic, political and institutional context and whether the outcome of the programme met the objectives. The evaluation mandate for this assignment was set out in the Terms of Reference (TOR), ECFIN 2018 013/D.

The evaluation covers three main areas of analysis: i) the economic impact of the MFA operation on the economy of Georgia with and without the involvement of the International Monetary Fund (IMF); ii) the value added of the EU intervention; and iii) the sustainability of the country's external position as a result of the assistance. These three areas have been assessed along the following criteria: relevance, effectiveness, efficiency, EU added-value, and coherence with other EU policies. The TOR specified two additional topics assessing the impact of the MFA on the social sector and the public debt sustainability.

The method of the evaluation

The methodological approach for evaluating the MFA operation is guided by the Commission's Better Regulation Guidelines[1] and the Guidelines for the Ex-Post Evaluation of Macro-Financial Assistance Operations (2015)[2] provided a specific methodological framework.

The evaluation is based on a variety of approaches. After the review of relevant literature and official documentation, the evaluation team has carried out an extensive stakeholder consultation through (i) semi-structured interviews with key informants during missions to Georgia and Brussels, including consultations with Government officials of Georgia, officials of the European Commission (EC), representatives of International Financial Institutions (IFIs), multilateral development banks and key development partners; through (ii) focus group discussions with parliamentarians, academics, non-governmental organisations and financial sector experts; and (iii) by applying a version of the Delphi method with the involvement of a wide range experts knowledgeable of MFA. Besides these qualitative approaches, the team has applied various quantitative methods: (i) a descriptive quantitative analyses of macroeconomic outcomes and impacts of structural reforms; (ii) a simulation based assessment using the IMF's debt sustainability analysis framework and (iii) an estimation of the potential fiscal savings associated with the favourable terms of the MFA compared to market based alternatives. The findings based on the different approaches helped to provide a basis for triangulation of the results and to build the evidence base for the evaluation.

Despite the multiple approaches, data limitation in certain areas (e.g. social and specifically health sector related indicators), as well as the short time span since the full implementation of the MFA provided challenges in terms of impact measurement. Furthermore, the rapidly changing external environment and

1 See http://ec.europa.eu/smart-regulation/guidelines/docs/swd_br_guidelines_en.pdf.
2 See http://ec.europa.eu/dgs/economy_finance/procurement_grants/calls_for_tender/2015/015d/annex4-methodological_orientations_en.pdf.

the fact that the MFA was provided in parallel with the IMF Stand-by Agreement (SBA) and Extended Fund Facility (EEF) programmes, other international financing instruments and technical assistances as well as the implementation of the Association Agreement encumbered the disentangling of the different factors behind the developments. Despite these difficulties, we believe that the conclusions are well founded.

Background to the MFA operation

In 2008, Georgia was heavily hit by the armed conflict with Russia and the global financial crisis. The fall in foreign direct investment (FDI) inflows, drop in market financing and shrinking remittances put the country's external financing under pressure and forced a severe macroeconomic adjustment. The net external borrowing fell from a level above 20 percent to below 9 percent of GDP in barely one year. GDP growth slowed considerably, resulting in a recession in 2009. The budget deficit deteriorated on account of a drop in revenues and the countercyclical policy, but the government agreed with the IMF and started the fiscal consolidation already in late 2008. Thanks to the consolidation efforts and the rapid correction in growth, the deficit decreased significantly after 2009.

Although the Georgian economy had been recovering following the double shock in 2008, and GDP growth accelerated, the country's external and budgetary position remained vulnerable in 2010. The current account deficit stayed high partly on account of the lingering effects of the conflict with Russia, including the trade blockade. The slow recovery of the FDI inflow left the balance of payments fragile. However, as of late 2010, the financing pressures perceived by the government moderated. So the Georgian authorities decided to treat the IMF arrangements as precautionary and did not draw the instalments that became available.

In 2014, the weakening external environment put further pressure on the Georgian economy. The region was hit hard by the spill-overs from the recession in Russia in the wake of the commodity price decline and economic sanctions, which sent the regional currencies tumbling. The depreciation of the regional currencies weighed heavily on Georgia's exports and remittances. As a consequence, the central bank allowed the lari to adjust, leading to a sharp depreciation of the exchange rate. Due to the high proportion of foreign exchange (FX) denominated financing, the depreciation led to rapidly escalating public and external debt-to-GDP ratios. At the same time, the FX reserves fall below the adequate level. In this context the Georgian authorities requested a new IMF loan, and the IMF approved a SBA on July 30th 2014 (of about USD 154 million). After 5 months and the disbursement of 80 percent of the available funds, the programme went off track - among others due to the fact that the government lost its commitment to fiscal consolidation preceding the general elections in 2016.

The new government elected in 2016 resumed consolidation efforts and requested a new IMF programme in 2017. In April 2017, the IMF approved a three-year EFF programme (of about USD 285 million) aimed at supporting the government reform agenda, reducing economic vulnerabilities, promoting higher and more inclusive growth while maintaining macroeconomic stability.

The MFA operation

At the International Donors' Conference in October 2008, the EU pledged two MFAs for Georgia of EUR 46 million each. The first MFA was implemented in 2009-2010 in the form of grants. In view of the continuing residual external financing need, the Georgian Minister of Finance requested the activation of the second part of the Commission pledge in May 2010. The EC responded in January 2011 with proposing a MFA of EUR 46 million half in the form of grants and half in medium-term loans, complementing the IMF SBA of USD 1.17 billion, having been in place since October 2008. The European Parliament and the Council adopted the proposal only on 12 August 2013 (Decision 778/2013/EU). The delay in the adoption was related to the blockage between the European Parliament and the Council on procedural issues regarding the Commission proposal for a MFA Framework Regulation. However, the launch of the MFA was also delayed by the fact that Georgia did not have a disbursing IMF agreement. As of end 2010, Georgia handled its IMF programmes as precautionary facilities and did not draw down the available tranches. As the MFA operation is complementary to a disbursing IMF programme, the precautionary treatment of the IMF programmes prevented the activation of MFA. The approval of a new, disbursing IMF SBA in July 2014 allowed the EC to reactivate the MFA and to restart the negotiations. Finally, the Memorandum of Understanding (MoU), the Grant and the Loan Facility Agreement were signed in December 2014.

The overall and specific objectives of the MFA are stated in the legislative Decision of the European Parliament and the Council of 12 August 2013. The general objective of the MFA was to “support economic stabilisation in conjunction with the current IMF programme”, while the specific objectives of the MFA were the “strengthening the efficiency, transparency and accountability, including public finance management systems in Georgia.” Furthermore, the Joint Declaration adopted together with the MFA Decision defined the following principles of the MFA operations: MFA “should aim to restore a sustainable external finance situation for eligible countries and territories facing external financing difficulties. It should underpin the implementation of a policy programme that contains strong adjustment and structural reform measures designed to improve the balance of payment position, in particular over the programme period, and reinforce the implementation of relevant agreements and programmes with the Union”.

The first instalment of EUR 23 million was conditional on the IMF SBA being on track as well as on the fulfilment of the general political pre-conditions and was disbursed in 2015. Besides the conditionality on the disbursing IMF programme, the second instalment was subject to the fulfilment of the following eight structural reform actions specified in the MoU:

Reform areas	Structural reform condition
Public Financial Management (PFM)	1. Improve awareness about public procurement
	2. Ensure independence of State Audit Office (SAO)
Social Safety Net	3. Carry out a Health care survey
	4. Establish a Unit for Health Care Quality Improvement
Financial Sector	5. Strengthen the process of ensuring banks’ capital adequacy
	6. Improve the risk management processes at the National Bank of Georgia (NBG)
Trade and Competition Policy	7. Centralize the management of EUR1 certificates
	8. Adoption secondary legislation related to the Law on Competition

While the Georgian authorities implemented the structural conditions by the first half of 2015, the disbursement of the second instalment was delayed because of the lack of Georgia’s progress in the implementation of the IMF SBA programme. Only after the approval of the IMF EEF to Georgia in April 2017, the EC proceeded with the disbursement of the second MFA 2 instalment.

Findings and conclusions of the evaluation

RELEVANCE

Relevance of the objectives: The objectives of the MFA set in 2011-2013 were still very relevant for the economic and the social challenges facing Georgia in 2014. The regional economic crisis caused a sudden deterioration in external balances, and FX reserves dropped below the adequate level. Furthermore, high and mostly FX denominated private and public debt levels signalled significant balance sheet vulnerabilities.

Relevance of the financing envelope and the form of the assistance: The amount of EUR 46 million was disbursed half in grants and half in the form of a medium-term concessional loan. The grant and loan blend and the financing terms of the MFA were very favourable and have contributed to significant fiscal savings (amounting to 0.3 percent of GDP) when compared to market-based alternatives. We found that both the form and the terms of the financing were relevant and appropriate. The MFA was part of a significantly broader package of EC support to the country. Although the size of the envelope was relatively low compared to the amount of assistance provided by international donors to Georgia, it reached 30 percent of the IMF SBA program from 2014 and therefore it was not negligible.

Relevance of the structural conditions: The structural reform conditions were designed to allow rapid disbursements by targeting very specific areas, which were mostly based on the government's own reform agenda and which required actions achievable in a short period of time. The actions – covering the most important reform priority areas – are assessed to be relevant in terms of the structural reform objectives. However, only half of them are seen as relevant in terms of the economic objectives of the operation. While difficult to prioritize, one of the most relevant conditions was the one strengthening the independence of SAO (Action 2). At the same time, compared to the other conditions, the scope of the action on the establishment of the risk management department at the NBG (Action 6) was limited. Furthermore, there was a broad agreement among financial sector experts that an action supporting responsible lending practices, particularly in the non-banking financial sector would have been highly beneficial at the time.

EFFECTIVENESS

Effectiveness in improving the external financial conditions: The assistance from the IMF and the EU contributed substantially to the stabilization of Georgia's external financial position. In the absence of these supports, the external debt-to-GDP ratio is estimated to have been about 8 percentage points higher in the medium-term. A significant part of the positive impact came through the confidence channel: the agreement with the IMF and EU had a substantial positive impact on market sentiments, reducing the financing costs. Georgia's external financing situation is expected to remain on a sustainable path: the current account deficit is expected to decrease, while the FDI is assumed to be a stable source of financing in the long run, supporting the decline of the debt-to-GDP ratio. Consistently with the relative amount of the assistances, most of the beneficial effects came from the SBA programme by the IMF.

Effectiveness in fiscal consolidation: The MFA assistance helped to alleviate fiscal pressure and supported the fiscal consolidation efforts of the government. The IMF SBA programme set a reasonable fiscal consolidation path. The fact that the targets were missed in 2015 and 2016 is attributed to the lack of the government's commitment to follow prudent fiscal policy. The lack of progress in the IMF program and the related temporary suspension of the MFA's second instalment put significant pressure on restoring the fiscal discipline. The new government elected in 2016 started a fiscal consolidation and plans to decrease the budget deficit to close to 3 percent by 2020.

Effectiveness in structural reforms: In line with the design of the operation, the actions had been implemented in a short timeframe (by the first half of 2015 the latest) and the direct effect of the conditions materialized through speeding up the reform processes. Besides its direct impact, the conditionality has contributed to the implementation of the structural reforms indirectly, by reinforcing the reform efforts of the IFIs and other donors. Strictly speaking, there were only few cross conditionalities with other operations, as the IFIs aimed not to replicate conditions, but the different programmes and technical assistances built on the achievements of each other's. Overall, the conditions had a complementary role and were well aligned with other support programmes and technical assistances, which was appreciated by the stakeholders. Regarding their medium-term impact, the actions promote a substantial progress in the area of PFM and bank regulation. Progress is uneven in the areas of the health care, and trade and competition policy, where stakeholders see the lack of sufficient human and infrastructural capacity as important bottlenecks.

EFFICIENCY

Efficiency of the design of the MFA operation: The MFA operation was closely coordinated with the IMF and other IFIs, making the EC able to draw on the expertise of these institutions. In addition, the EC achieved synergies with other EU policies and instruments, especially with its budget support operations and the Association Agreement. The leverage and synergies with other support programmes and IFIs helped contain the cost of the MFA.

Efficiency of the implementation of the MFA operation: Georgia requested the second MFA operation in May 2010; the EC submitted its proposal in January 2011, which was finally adopted in August 2013. Delay in the adoption was caused by procedural disagreements between the co-legislators. In the specific case of Georgia this exceptionally long timeline of the approval did not result in efficiency losses, because from the second half of 2010 until July 2014, i.e. the approval of a new IMF SBA, Georgia did not have a disbursing IMF programme, which had prevented the activation of the MFA. The delay in the disbursement of the second instalment was caused by the lack of progress with the implementation of the IMF programme. Overall, we found that taking into account the fact that the MFA operation is designed to support crisis management, the inception phase of the MFA operation (six months from the official request to the submission of the EC proposal) was relatively slow. The other delays in the process did not result in any efficiency losses.

EU ADDED-VALUE

Stimulate structural reform process. The operation had a distinguished role in stimulating the structural reform process and the continuation of the policy dialogue with the EU in a difficult economic period with the inherent risk of a loss of commitment and stagnation of reforms. The MFA helped the authorities to prioritize reforms, set up credible milestones and facilitated the communication of unpopular measures to the public. The operation also helped to anchor the demanding convergence to the EU regulation. By supporting the structural reform efforts, the EU also signalled that Georgia was on the right track, which had helped restore market confidence, and bring down financing costs.

Financial value added. The size of the MFA operation (EUR 46 million) corresponded to 0.4 percent of Georgia's GDP in 2015. Due to its un-earmarked nature, its favourable composition and terms, the operation efficiently contributed to alleviating the external and budgetary financing pressure in Georgia. Furthermore, the MFA support contributed to the replenishment of FX reserves, which was especially important in respect of the country's significant balance sheet vulnerabilities (high and mostly FX-denominated external and public indebtedness).

COHERENCE

Coherence of the operation: Georgia received substantial financial support from the EU after its military conflict with Russia in August 2008 and the MFA was part of a comprehensive package of the EU. The conditions of the MFA operation were closely aligned with other EU operations in the country and Georgia's commitments under the Association Agreement and DCFTA. Overall, the conditionality had a very important role in supporting the implementation of the reform agenda agreed under these arrangements.

SOCIAL IMPACT

Social impact of the operation: The MFA was designed to help the Georgian authorities in their efforts to address some of the social challenges via three channels. Firstly, by supporting the financing of the social reform agenda, which was particularly acute at the time, as Georgia was well behind its peers in terms of social spending. Secondly, the conditionality helped in prioritizing reforms in the area of health care services. Finally, the MFA together with other assistances supported GDP growth and via this channel had a positive impact on employment, disposable income and social developments in general.

Short-term social impact: Regarding the short-term objectives related to the health care sector, the assistance contributed to the improvement of the quality and the coverage of the system. However, we could not find evidence of progress in the cost-effectiveness of the health care services. The lack of advancement in this field was mainly due to the inefficient incentive structures and the human and infrastructural capacity limitations hampering the necessary adjustment of the system. We found that the operation supported the sustaining of social expenditures, which have increased over the implementation period of the operation.

Medium-term social impact: The assistance together with the IMF programme has had a positive, yet marginal impact on the most relevant medium-term social indicators. Unemployment ratio remained high and virtually unchanged, but poverty ratio and the GINI index measuring inequality showed a moderate decline in the implementation period. These minor positive developments materialized mostly through the operation's impact on sustaining social spending and indirectly, by restoring market confidence and smoothing output growth. However, given the lags with which some of the policy measures work, more time is needed for a full realization of the expected impacts.

PUBLIC DEBT SUSTAINABILITY

The combined financial assistance from the IMF and the EU helped to contain the increase of public debt ratio and to stabilize debt at a manageable level. In our estimate, without the combined assistance the public debt-to-GDP ratio would have peaked by about 6 percentage points higher, i.e. at above 50 percent of GDP in 2019-2020, than set by the latest IMF forecast. The positive effects of the combined assistance materialized through the confidence channel (by reducing the financing costs), and the real growth channel (by improving short and medium-term growth outlook). In the long run, the public debt ratio is expected to follow a sustainable path supported by the convergence of real GDP per capita and the anticipated prudent fiscal policy.

RECENT DEVELOPMENTS

The EU's second MFA coupled with the IMF's SBA enabled Georgia to progress with its ambitious structural reform agenda in a period when regional developments put significant pressure on the economy. The assistances helped to restore market confidence and improved Georgia's external and public debt trajectory. However, Georgia continued to face a weak external environment, which contributed to relatively subdued GDP growth and put under pressure the economy still struggling with a high current account deficit and significant balance sheet imbalances. In this context, the Georgian authorities requested a complementary MFA from the EC in June 2017. The proposal of a third MFA in the amount of EUR 45 Million was adopted in April 2018 and the EC signed the MoU with Georgia in August 2018. The new MFA programme complements the IMF EEF approved in April 2017, which commits to the disbursement of USD 285.3 million over three years. The Commission disbursed the first instalment (EUR 15 million loan component and EUR 5 million grant component) to Georgia in December 2018.

შესავალი

ამ ანგარიშში წარმოდგენილია საქართველოსთვის 2015-2017 წლებში გაწეული მაკროფინანსური დახმარების (MFA) პროგრამის რეტროსპექტიული შეფასების შედეგები. შეფასება განხორციელდა ეკონომიკურ და ფინანსურ საკითხთა გენერალური დირექტორატის (DG ECFIN) დაკვეთით. სამუშაო განახორციელა Ecorys-ის, OGResearch-ის, WiiW-ისა და NIESR-საგან შემდგარმა კონსორციუმმა, საქართველოში მოღვაწე ადგილობრივი ექსპერტის მოსაზრებების გათვალისწინებით.

შეფასების მიზანი და ფარგლები

წინამდებარე რეტროსპექტიული შეფასება მიზნად ისახავდა i) საქართველოს ეკონომიკაზე, განსაკუთრებით, საქართველოს საგარეო პოზიციის მდგრადობაზე მაკროფინანსური დახმარების ზეგავლენის ანალიზს; და ii) ევროკავშირის დახმარების დამატებული ღირებულების შეფასებას. შეფასების შედეგად შემუშავდება დასკვნები იმასთან დაკავშირებით, თუ რამდენად სათანადო იყო საწყის ეტაპზე არსებული მოსაზრებები, რომლებსაც დაეფუძნა მაკროფინანსური დახმარების პროგრამა და მისი პირობები, ეკონომიკური, პოლიტიკური და ინსტიტუციონალური კონტექსტის გათვალისწინებით; ასევე შეფასდება, პროგრამის შედეგად მოხდა თუ არა დასახული მიზნების მიღწევა. შეფასების ამოცანები განისაზღვრა ტექნიკურ დავალებაში ECFIN 2018 013/D.

შეფასება მოიცავს ანალიზის სამ ძირითად სფეროს: (i) მაკროფინანსური დახმარების ეკონომიკური ზეგავლენა საქართველოს ეკონომიკაზე საერთაშორისო სავალუტო ფონდის (სსფ) დახმარების პირობებში და მის გარეშე; (ii) ევროკავშირის დახმარების დამატებულ ღირებულებას; და (iii) დახმარების შედეგად ქვეყნის საგარეო პოზიციის მდგრადობის მიღწევას. ზემოაღნიშნული სამი სფერო შეფასდა შემდეგი კრიტერიუმების მიხედვით: რელევანტურობა, ეფექტურობა, ეფექტიანობა, ევროკავშირის დახმარების დამატებული ღირებულება, და ევროკავშირის სხვა პოლიტიკასთან შესაბამისობა. ტექნიკური დავალება ასევე მოიცავდა ორ დამატებით თემას -- სოციალურ სექტორზე და სახელმწიფო ვალის მდგრადობაზე მაკროფინანსური დახმარების ზეგავლენის შეფასებას.

შეფასების მეთოდი

მაკროფინანსური დახმარების შეფასების მეთოდოლოგიური მიდგომა ეფუძნება ევროკომისიის რეგულირების გაუმჯობესების გაიდლაინებს (Better Regulation Guidelines)[3], უშუალოდ მეთოდოლოგიური ჩარჩო კი -- მაკროფინანსური დახმარების რეტროსპექტიული შეფასების გაიდლაინებს (2015)[4].

შეფასებისათვის გამოყენებული იყო სხვადასხვა მიდგომები. შესაბამისი ლიტერატურისა და ოფიციალური დოკუმენტების შესწავლის შემდგომ, შემფასებელთა გუნდმა დაინტერესებულ მხარეებთან გამართა ფართო კონსულტაცია, რაც მოიცავდა (i) ნახევრად სტრუქტურირებულ გასაუბრებებს საკვანძო პირებთან საქართველოსა და ბრიუსელში გამართული მისიების ფარგლებში, მათ შორის, კონსულტაციებს საქართველოს მთავრობის ოფიციალურ პირებთან, ევროკომისიის ოფიციალურ პირებთან, საერთაშორისო საფინანსო ინსტიტუტების წარმომადგენლებთან, საერთაშორისო განვითარების ბანკებთან და განვითარების სფეროში მოღვაწე ძირითად პარტნიორებთან; გაიმართა (ii) ფოკუს-ჯგუფებში განხილვა პარლამენტის წევრებთან, აკადემიური სფეროს წარმომადგენლებთან, არასამთავრობო ორგანიზაციებთან და საფინანსო სექტორის ექსპერტებთან; და (iii) გამოყენებული იყო Delphi-ს მეთოდის ვერსია, მაკროფინანსური დახმარების სფეროს მცოდნე ექსპერტთა ფართო წრის ჩართულობით. ზემოაღნიშნულ თვისებრივ მიდგომებთან ერთად, გუნდმა გამოიყენა სხვადასხვა რაოდენობრივი მეთოდები: (i) მაკროეკონომიკური შედეგების

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3 იხ. http://ec.europa.eu/smart-regulation/guidelines/docs/swd_br_guidelines_en.pdf.

4 იხ. http://ec.europa.eu/dgs/economy_finance/procurement_grants/calls_for_tender/2015/015d/annex4-methodological_orientations_en.pdf.

და სტრუქტურული რეფორმების ზეგავლენის აღწერილობითი რაოდენობრივი ანალიზი; (ii) მოდელირებაზე დამყარებული შეფასება, სსფ-ის ვალის მდგრადობის ანალიზის ჩარჩოს გამოყენებით და (iii) მაკროფინანსური დახმარების ხელსაყრელი პირობებიდან გამომდინარე პოტენციური ფისკალური დანაზოგის გაანგარიშება, ბაზარზე დაფუძნებულ ალტერნატიულ ვარიანტებთან შედარებით. სხვადასხვა მიდგომების მეშვეობით გამოტანილი მიგნებები დაგვეხმარა შედეგების გადამოწმებისათვის ბაზისის მომზადებასა და შეფასებისათვის მტკიცებულებითი ბაზის შექმნაში.

მრავალფეროვანი მიდგომების მიუხედავად, ზეგავლენის გაზომვის მხრივ გამოწვევას წარმოადგენდა მონაცემთა ნაკლებობა გარკვეულ სფეროებში (მაგ., სოციალური და განსაკუთრებით -- ჯანდაცვის სექტორთან დაკავშირებული მაჩვენებლები), ასევე ის ფაქტორი, რომ მაკროფინანსური დახმარების პროგრამის მთლიანად დასრულებიდან მცირე დრო იყო გასული. ამას გარდა, სწრაფად ცვალებადმა საგარეო კონტექსტმა და იმან, რომ მაკროფინანსური დახმარების გაწევა მოხდა სსფ-ის სარეზერვო ხელშეკრულებისა (SBA) და გაფართოებული დაფინანსების მექანიზმის (EEF) პროგრამების, სხვა საერთაშორისო ფინანსური ინსტრუმენტების და ტექნიკური დახმარებების პარალელურად, ასევე ასოცირების ხელშეკრულების განხორციელების პარალელურად, გაართულა განვითარების განმაპირობებელი სხვადასხვა ფაქტორების გამორჩევა. ამ სირთულეების მიუხედავად, მიგვაჩნია, რომ დასკვნები კარგად დასაბუთებულია.

მაკროფინანსური დახმარების პროგრამის ზოგადი მიმოხილვა

2008 წელს, რუსეთთან შეიარაღებული კონფლიქტისა და გლობალური ფინანსური კრიზისის შედეგად, საქართველოს დიდი დარტყმა მიადგა. პირდაპირი უცხოური ინვეტიციების შემცირების, ბაზრის დაფინანსების შემცირებისა და კლებადი გადმორიცხვების შედეგად რისკი შეექმნა ქვეყნის გარე დაფინანსებას და წარმოიქმნა მკაცრი მაკროეკონომიკური კორექტირების აუცილებლობა. სულ რაღაც ერთ წელიწადში წმინდა საგარეო ვალის მშპ-სთან ფარდობის მაჩვენებელი შემცირდა 20 პროცენტიდან 9 პროცენტზე ქვემოთ. საგრძნობლად შენელდა მშპ-ს ზრდის ტემპი, რამაც 2009 წელს გამოიწვია რეცესია. ბიუჯეტის დეფიციტი გაუარესდა, შემოსულობების კლებისა და კონტრციკლური პოლიტიკის შედეგად, თუმცა მთავრობამ შეთანხმებას მიაღწია სსფ-სთან და უკვე 2008 წლის ბოლოს დაიწყო ფისკალური კონსოლიდაცია. კონსოლიდაციის და ზრდის სწრაფი კორექტირების მეშვეობით, 2009 წლის შემდეგ დეფიციტი მნიშვნელოვნად შემცირდა.

2008 წელს განცდილი ორმაგი რყევის შემდეგ საქართველოს ეკონომიკამ დაიწყო აღდგენა, გაიზარდა მშპ-ს ზრდის ტემპი, თუმცა, 2010 წელს ქვეყნის საგარეო და საბიუჯეტო პოზიცია კვლავ არასახარბიელო იყო. შენარჩუნდა მიმდინარე ანგარიშის დეფიციტის მაღალი მაჩვენებელი, ნაწილობრივ -- რუსეთთან კონფლიქტის შედეგების ზემოქმედების, მათ შორის, სავაჭრო ბლოკადის გამო. პირდაპირი უცხოური ინვესტიციების შემოდინების აღდგენის ნელი ტემპის გამო საგადამხდელო ბალანსი არასტაბილური დარჩა. თუმცა, 2010 წლის ბოლოს მდგომარეობით, მთავრობის მიერ აღქმული ფინანსირების წნეხი შემცირდა და გახდა ზომიერი. ამდენად, საქართველოს ხელისუფლებამ მიიღო გადაწყვეტილება, სსფ-ს მექანიზმები განეხილა, როგორც პრევენციული და არ გამოუყენებია ის ტრანშები, რომლებიც გახდა ხელმისაწვდომი.

2014 წელს გაუარესებადმა საგარეო ვითარებამ საქართველოს ეკონომიკაზე კიდევ უფრო მეტი ზეწოლა განაპირობა. რეგიონზე მძიმე შედეგი მოახდინა რუსეთში არსებული რეცესიის შედეგებმა, რაც გამოწვეული იყო სასაქონლო ფასების კლებისა და ეკონომიკური სანქციების შედეგად; რაც რეგიონში ვალუტებზეც უარყოფითად აისახა. რეგიონული ვალუტების კურსის გაუფასურებამ საქართველოს ექსპორტსა და გადმორიცხვებს მძიმე დარტყმა მიაყენა. შედეგად, ცენტრალურმა ბანკმა მიიღო ლარის გაცვლითი კურსის კორექტირების გადაწყვეტილება, რამაც ლარის მკვეთრი გაუფასურება გამოიწვია. უცხოურ ვალუტაში (FX) დენომინირებული დაფინანსების დიდი წილის გამო, გაუფასურების შედეგად სწრაფად გაიზარდა სახელმწიფო და საგარეო ვალის მშპ-სთან ფარდობის მაჩვენებლები. იმავდროულად, უცხოური ვალუტის რეზერვები სათანადო დონეზე დაბლა ჩამოვიდა. წარმოქმნილ სიტუაციაზე საპასუხოდ, საქართველოს ხელისუფლებამ სსფ-ს მიმართა ახალი სესხის გამოყოფის თხოვნით, ხოლო სსფ-მ დაამტკიცა სარეზერვო ხელშეკრულება (SBA) 2014 წლის 30 ივლისს

(დაახლოებით 154 მილიონი აშშ დოლარი). 5 თვის შემდეგ და ხელმისაწვდომი ფინანსური სახსრების 80 პროცენტის გადარიცხვის შემდეგ, პროგრამა შეფერხდა - სხვა მიზეზებთან ერთად, იმის გამო, რომ ხელისუფლების მიერ ფისკალური კონსოლიდაციის კუთხით აღებულმა ვალდებულებამ 2016 წლის არჩევნების წინ აქტუალურობა დაკარგა.

2016 წელს არჩეულმა ახალმა ხელისუფლებამ განაახლა კონსოლიდაციის პროცესი და 2017 წელს მოითხოვა სსფ-ს ახალი პროგრამა. 2017 წლის აპრილში, სსფ-მა დაამტკიცა სამწლიანი გაფართოებული დაფინანსების მექანიზმი (EFF) (დაახლოებით 285 მილიონი აშშ დოლარი), რომლის მიზანი იყო მთავრობის რეფორმის დღის წესრიგის ხელშეწყობა, ეკონომიკური მოწყვლადობის შემცირება, უფრო მაღალი და უფრო მეტად ინკლუზიური ზრდის ხელშეწყობა, მაკროეკონომიკური სტაბილურობის შენარჩუნების პარალელურად.

მაკროფინანსური დახმარების პროგრამის განხორციელება

2008 წლის ოქტომბერში, საერთაშორისო დონორთა კონფერენციაზე, ევროკავშირმა საქართველოს დაუთქვა ორი მაკროფინანსური დახმარება, თითოეულის ღირებულება 46 მილიონ ევროს შეადგენდა. პირველი მაკროფინანსური დახმარება განხორციელდა 2009-2010 წლებში, გრანტების სახით. გარედან მისაღები დაფინანსების საჭიროების არსებობიდან გამომდინარე, 2010 წლის მაისში საქართველოს ფინანსთა მინისტრმა ევროკომისიას მიმართა დათქმის მეორე ნაწილის ამოქმედების თხოვნით. ევროკომისიამ 2011 წლის იანვარში მთავრობას შესთავაზა 46 მილიონი ევროს ოდენობის მაკროფინანსური დახმარება. მისი ნახევარი გრანტების, ნახევარი კი საშუალოვადიანი სესხების სახით იყო წარმოდგენილი, რაც შეავსებდა სსფ-ის 1.17 მილიარდი აშშ დოლარის ოდენობის სარეზერვო ხელშეკრულებას (SBA), რომელიც მოქმედებდა 2008 წლის ოქტომბრიდან. ევროპარლამენტმა და ევროსაბჭომ წინადადება დაამტკიცეს მხოლოდ 2013 წლის 12 აგვისტოს (გადაწყვეტილება 778/2013/EU). დამტკიცების გადაწევა გამოწვეული იყო მაკროფინანსური დახმარების პროგრამის ჩარჩო რეგულაციისათვის კომისიის წინადადებასთან დაკავშირებული პროცედურული საკითხების გარშემო ევროპარლამენტსა და საბჭოს შორის შეთანხმების მიუღწევლობით. თუმცა, მაკროფინანსური დახმარების დაწყება ასევე შეაფერხა იმ ფაქტმა, რომ საქართველოს არ ჰქონდა სსფ-სთან შესაბამისი მოქმედი ხელშეკრულება. 2010 წლის ბოლოს, საქართველომ სსფ-ს პროგრამები განიხილა, როგორც პრევენციული და არ გამოუყენებია ხელმისაწვდომი ტრანშები. ვინაიდან მაკროფინანსური დახმარება სსფ-ს პროგრამის თანმდევია, სსფ-ს პროგრამების, როგორც პრევენციულის, განხილვის გამო ვერ განხორციელდა მაკროფინანსური დახმარების ამოქმედება. 2014 წლის ივლისში, სსფ-ს ახალი სარეზერვო ხელშეკრულების (SBA) დამტკიცების შედეგად შესაძლებელი გახდა ევროკომისიის მხრიდან მაკროფინანსური დახმარების ხელახლა ამოქმედება და მოლაპარაკებების ხელახლა დაწყება. დაბოლოს, 2014 წლის დეკემბერში ხელი მოეწერა ურთიერთგაგების მემორანდუმს, გრანტს და სესხის შესახებ ხელშეკრულებას.

მაკროფინანსური დახმარების ზოგადი და კონკრეტული მიზნები განსაზღვრულია ევროპარლამენტის და საბჭოს 2013 წლის 12 აგვისტოს საკანონმდებლო გადაწყვეტილებაში. მაკროფინანსური დახმარების ზოგად მიზანს წარმოადგენდა „ეკონომიკური სტაბილიზაციის ხელშეწყობა მოქმედ სსფ-ს პროგრამასთან კავშირში“, ხოლო მაკროფინანსური დახმარების კონკრეტული მიზნები იყო „ეფექტიანობის, გამჭვირვალობისა და ანგარიშვალდებულების, მათ შორის, საქართველოში საჯარო ფინანსების მართვის სისტემების, გაძლიერება.“ ამას გარდა, მაკროფინანსური დახმარების შესახებ გადაწყვეტილებასთან ერთად მიღებულ ერთობლივ დეკლარაციაში განისაზღვრა მაკროფინანსური დახმარების შემდეგი პრინციპები: მაკროფინანსური დახმარება „მიზნად უნდა ისახავდეს საგარეო დაფინანსების მხრივ სირთულეების მქონე შესაბამის ქვეყნებში მდგრადი საგარეო დაფინანსების მდგომარეობის აღდგენას. იგი საფუძვლად უნდა დაედოს პოლიტიკის პროგრამის განხორციელებას, რომელიც მოიცავს ძლიერ კორექტირებას და სტრუქტურული რეფორმის ზომებს, რომელთა მიზანია საგადამხდელო ბალანსის მდგომარეობის გაუმჯობესება, განსაკუთრებით პროგრამის განხორციელების

მანძილზე, და გააძლიეროს ევროკავშირთან გაფორმებული შესაბამისი ხელშეკრულებები და პროგრამების განხორციელება.“

პირველი ტრანში, 23 მილიონი ევროს ოდენობით, ემყარებოდა პირობით ვალდებულებას, რომელიც გულისხმობდა სსფ-ს სარეზერვო ხელშეკრულების (SBA) სათანადო მიმდინარეობას, ასევე ზოგადი პოლიტიკური წინაპირობების შესრულებას და გადაირიცხა 2015 წელს. გარდა სსფ-ის პროგრამასთან დაკავშირებული პირობითი ვალდებულებისა, მეორე ტრანში ემყარებოდა შემდეგი რვა სტრუქტურული რეფორმის განხორციელების პირობას, რომლებიც განსაზღვრულია ურთიერთგაგების მემორანდუმში:

რეფორმის სფეროები	სტრუქტურული რეფორმის პირობითი ვალდებულება
საჯარო ფინანსების მართვა	1. სახელმწიფო შესყიდვების შესახებ ცნობიერების გაზრდა
	2. სახელმწიფო აუდიტის სამსახურის დამოუკიდებლობის უზრუნველყოფა
სოციალური უზრუნველყოფის სისტემა	3. ჯანდაცვის სფეროში კვლევის განხორციელება
	4. ჯანდაცვის ხარისხის გაუმჯობესების სამსახურის ჩამოყალიბება
საფინანსო სექტორი	5. ბანკების კაპიტალის ადეკვატურობის უზრუნველყოფის პროცესის გაძლიერება
	6. საქართველოს ეროვნულ ბანკში რისკების მართვის პროცესების გაუმჯობესება
ვაჭრობისა და კონკურენციის პოლიტიკა	7. EUR1 სერტიფიკატების მართვის ცენტრალიზება
	8. კონკურენციის სამართალთან დაკავშირებული მეორადი კანონმდებლობის მიღება

იმის მიუხედავად, რომ საქართველოს ხელისუფლებამ სტრუქტურული პირობითი ვალდებულებები შეასრულა 2015 წლის პირველი ნახევრისთვის, მეორე ტრანშის გადარიცხვა გადაიდო, ვინაიდან საქართველოს არ დაუფიქსირებია პროგრესი სსფ-ს სარეზერვო ხელშეკრულების (SBA) პროგრამის განხორციელების კუთხით. ევროკომისიამ მაკროფინანსური დახმარების პროგრამის მეორე ტრანში გადმორიცხა მხოლოდ მას შემდეგ, რაც 2017 წლის აპრილში დამტკიცდა სსფ-ს გაფართოებული დაფინანსების მექანიზმი (EEF) საქართველოსთვის.

შეფასების მიგნებები და დასკვნები

„რელევანტურობა“

მიზნების რელევანტურობა: მაკროფინანსური დახმარების პროგრამის მიზნები, რომლებიც 2011-2013 წლებში განისაზღვრა, ჯერაც ძალიან აქტუალური იყო საქართველოს წინაშე 2014 წელს მდგარი ეკონომიკური და სოციალური გამოწვევების გათვალისწინებით. რეგიონში ეკონომიკურმა კრიზისმა გამოიწვია გარე ბალანსების მკვეთრი გაუარესება, და უცხოური ვალუტის რეზერვები სათანადო დონეზე დაბლა ჩამოვიდა. ამას გარდა, მაღალი და უპირატესად უცხოურ ვალუტაში დენომინირებული კერძო და სახელმწიფო ვალის დონეები მიანიშნებდა სერიოზულ მოწყვლადობაზე.

დაფინანსების და დახმარების ფორმის შესაბამისობა: 46 მილიონი ევროდან ნახევარი გადაირიცხა გრანტების სახით, ნახევარი კი -- საშუალოვადიანი შეღავათიანი სესხის ფორმით. გრანტისა და სესხის კომბინაცია და მაკროფინანსური დახმარების ფარგლებში დაფინანსების პირობები ძალიან ხელსაყრელი იყო და ხელი შეუწყო მნიშვნელოვან ფისკალურ დანაზოგებს (რამაც შეადგინა მშპ-ს 0.3 პროცენტი) ბაზარზე დამყარებულ ალტერნატივებთან შედარებით. ჩვენ გამოვავლინეთ, რომ როგორც დაფინანსების ფორმა, ისე პირობები იყო შესაბამისი და სათანადო. მაკროფინანსური დახმარება წარმოადგენდა საქართველოსათვის ევროკომისიის მხარდაჭერის მნიშვნელოვნად უფრო ფართო პაკეტის ნაწილს. მართალია, დაფინანსების მოცულობა შედარებით დაბალი იყო, საქართველოსათვის საერთაშორისო დონორების მიერ გაწეული დახმარების თანხასთან შედარებით, მან შეადგინა 2014 წლიდან სსფ-ს სარეზერვო ხელშეკრულების (SBA) პროგრამის 30 პროცენტი და ამდენად, არ იყო უმნიშვნელო.

სტრუქტურული პირობითი ვალდებულებების რელევანტურობა: სტრუქტურულ რეფორმასთან დაკავშირებული პირობითი ვალდებულებები მიზნად ისახავდა სწრაფი გადარიცხვის ხელშეწყობას ძალიან სპეციფიკურ სფეროებზე კონცენტრირებით, რაც ძირითადად დამყარებული იყო მთავრობის

რეფორმის დღის წესრიგზე და რომელიც მოითხოვდა დროის მოკლე პერიოდში მიღწევად ქმედებებს. ქმედებები - რომლებიც მოიცავდა რეფორმის ყველაზე მნიშვნელოვან პრიორიტეტულ სფეროებს -- შეფასებულია, როგორც რელევანტური, სტრუქტურული რეფორმის მიზნების კუთხით. თუმცა, მათი მხოლოდ ნახევარი მოიაზრება რელევანტურად მაკროფინანსური დახმარების ეკონომიკური მიზნების თვალსაზრისით. პრიორიტეტიზაცია რთულია, თუმცა ერთ-ერთი ყველაზე აქტუალური პირობა იყო სახელმწიფო აუდიტის სამსახურის დამოუკიდებლობის გაძლიერება (საქმიანობა 2). იმავდროულად, სხვა პირობით ვალდებულებებთან შედარებით, საქართველოს ეროვნულ ბანკში რისკების მართვის დეპარტამენტის შექმნის საქმიანობის (საქმიანობა 6) ფარგლები იყო შეზღუდული. ამასთან, საფინანსო სექტორის ექსპერტები თანხმდებოდნენ, რომ პასუხისმგებლიანი სესხების პრაქტიკის მხარდამჭერი საქმიანობა, განსაკუთრებით არასაბანკო საფინანსო სექტორში, იმ ეტაპზე ძალიან გამოსადეგი იქნებოდა.

ეფექტურობა

საგარეო ფინანსური პირობების გაუმჯობესების ეფექტურობა: სსფ-ს და ევროკავშირის დახმარებამ მნიშვნელოვნად შეუწყო ხელი საქართველოს საგარეო ფინანსური მდგომარეობის სტაბილიზაციას. გაანგარიშების მიხედვით, ამ მხარდაჭერების გარეშე, საგარეო ვალის ფარდობა მშპ-სთან დაახლოებით 8 პროცენტით მეტი იქნებოდა საშუალოვადიან პერიოდში. პოზიტიური ზეგავლენა მნიშვნელოვანწილად განპირობებული იყო სანდოობით: სსფ-სთან და ევროკავშირთან ხელშეკრულებას ჰქონდა სერიოზული პოზიტიური ზეგავლენა ბაზარზე არსებულ განწყობებზე, განაპირობა დაფინანსების ხარჯების შემცირება. მოსალოდნელია, რომ საქართველოს საგარეო დაფინანსების ვითარება მდგრადად შენარჩუნდება: მოსალოდნელია მიმდინარე ანგარიშის დეფიციტის შემცირება, ხოლო პირდაპირი უცხოური ინვესტიციები, სავარაუდოდ, იქნება დაფინანსების სტაბილური წყარო გრძელვადიან ჭრილში და ხელს შეუწყობს ვალის მშპ-სთან ფარდობის კოეფიციენტის შემცირებას. დახმარების პროგრამების ფარდობითი რაოდენობის შესაბამისად, დადებითი ზეგავლენის დიდი წილი სსფ-ს სარეზერვო ხელშეკრულების (SBA) პროგრამის შედეგად არის მიღებული.

ფისკალური კონსოლიდაციის ეფექტურობა: მაკროფინანსურმა დახმარებამ ხელი შეუწყო ფისკალური წნეხის შემსუბუქებას და მხარი დაუჭირა მთავრობის ფისკალური კონსოლიდაციის ძალისხმევას. სსფ-ს სარეზერვო ხელშეკრულების (SBA) პროგრამამ განსაზღვრა გონივრული ფისკალური კონსოლიდაციის გზა. ის ფაქტი, რომ სამიზნეები 2015 და 2016 წლებში ვერ შესრულდა, გამოწვეულია მთავრობის მხრიდან ფრთხილი/პრუდენციული ფისკალური პოლიტიკის განხორციელებისადმი დაინტერესების ნაკლებობით. სსფ-ს პროგრამაში პროგრესის ნაკლებობა და მაკროფინანსური დახმარების მეორე ტრანშის დროებით შეჩერება მნიშვნელოვანი წნეხი აღმოჩნდა ფისკალური დისციპლინის აღდგენის კუთხით. 2016 წელს არჩეულმა ახალმა ხელისუფლებამ დაიწყო ფისკალური კონსოლიდაცია და გეგმავს ბიუჯეტის დეფიციტის შემცირებას 3 პროცენტის ფარგლებში 2020 წლისათვის.

სტრუქტურული რეფორმების ეფექტურობა: მაკროფინანსური დახმარების პროგრამის შესაბამისად, საქმიანობები განხორციელდა მოკლე ვადაში (არაუგვიანეს 2015 წლის პირველი ნახევრისა) და პირობითი ვალდებულებების პირდაპირი ზეგავლენა გამოიხატა რეფორმის პროცესების დაჩქარებით. ამ უშუალო ზეგავლენის გარდა, პირობითმა ვალდებულებებმა არაპირდაპირ ხელი შეუწყო სტრუქტურული რეფორმების განხორციელებას, ვინაიდან გაძლიერდა საერთაშორისო საფინანსო ინსტიტუტებისა და სხვა დონორების რეფორმის ხელშეწყობისაკენ მიმართული ძალისხმევა. უნდა ითქვას, რომ სხვა პროგრამებთან მხოლოდ რამდენიმე პირობითი ვალდებულება გადაიკვეთა, ვინაიდან საერთაშორისო საფინანსო ინსტიტუტებს განსაზღვრული ჰქონდათ პირობითი ვალდებულებების გამეორების პრევენცია, და სხვადასხვა პროგრამებისა და ტექნიკური დახმარების საქმიანობების ერთმანეთის მიღწევებზე დაფუძნება და შევსება. მთლიანობაში, პირობითმა ვალდებულებებმა ითამაშა შემავსებელი როლი და კარგად იყო შეთანხმებული სხვა მხარდაჭერის პროგრამებთან და ტექნიკურ

დახმარებებთან, რაც დაინტერესებული მხარეების მიერ ძალიან დადებითად შეფასდა. რაც შეეხება საშუალოვანიან პერიოდში ზეგავლენას, საქმიანობები ხელს უწყობს მნიშვნელოვან პროგრესს საჯარო ფინანსების მართვის და საბანკო რეგულაციის სფეროებში. პროგრესი არათანაბარია ისეთ სფეროებში, როგორიცაა ჯანდაცვა, და ვაჭრობისა და კონკურენციის პოლიტიკა, სადაც დაინტერესებული მხარეები მნიშვნელოვანი დაბრკოლებების სახით აღნიშნავენ საკმარისი ადამიანური და ინფრასტრუქტურული პოტენციალის ნაკლებობას.

ეფექტიანობა

მაკროფინანსური დახმარების პროგრამის დიზაინის ეფექტიანობა: მაკროფინანსური დახმარება მჭიდროდ იყო კოორდინირებული სსფ-სა და სხვა საერთაშორისო საფინანსო ინსტიტუტებთან, რის გამოც ევროკომისიამ შეძლო გამოეყენებინა ამ ორგანიზაციების ექსპერტული ცოდნა. ამას გარდა, ევროკომისიამ მიაღწია სინერგიებს ევროკავშირის სხვა პოლიტიკებთან და ინსტრუმენტებთან, განსაკუთრებით ბიუჯეტის მხარდაჭერის ოპერაციებთან და ასოცირების ხელშეკრულებასთან. სხვა მხარდაჭერის პროგრამებთან და საერთაშორისო საფინანსო ინსტიტუტებთან სინერგიებმა ხელი შეუწყო მაკროფინანსური დახმარების ხარჯების შემცირებას.

მაკროფინანსური დახმარების პროგრამის განხორციელების ეფექტიანობა: საქართველომ მეორე მაკროფინანსური დახმარება მოითხოვა 2010 წლის მაისში; ევროკომისიამ წინადადება წარადგინა 2011 წლის იანვარში, რომელიც მიღებულ იქნა 2013 წლის აგვისტოში. დაგვიანება განპირობებული იყო პროცედურული საკითხების გარშემო ევროპარლამენტსა და საბჭოს შორის შეთანხმების მიუღწევლობით. საქართველოს შემთხვევაში, დამტკიცების განსაკუთრებით ხანგრძლივი დროით გაჭიანურება უარყოფითად არ ასახულა ეფექტიანობაზე, ვინაიდან 2010 წლის მეორე ნახევრიდან 2014 წლის ივლისამდე, ე.ი., სსფ-ის ახალი სარეზერვო ხელშეკრულების (SBA) დამტკიცებამდე, საქართველოს არ ჰქონდა სსფ-ს პროგრამა, რის გამოც ვერ მოხდებოდა მაკროფინანსური დახმარების ამოქმედება. მეორე ტრანშის გადარიცხვის გადაწევა გამოწვეული იყო სსფ-ის პროგრამის განხორციელებაში პროგრესის ნაკლებობით. მთლიანობაში, ჩვენ გამოვავლინეთ, რომ იმ ფაქტის გათვალისწინებით, რომ მაკროფინანსური დახმარება გათვლილი იყო კრიზისულ პერიოდში მართვის მხარდასაჭერად, მაკროფინანსური დახმარების საწყისი ეტაპი (ექვსი თვე ოფიციალური თხოვნიდან ევროკავშირის წინადადების წარდგენამდე) შედარებით ნელი ტემპით წარიმართა. პროცესში სხვა შეფერხებები უარყოფითად არ ასახულა ეფექტიანობაზე.

ევროკავშირის დახმარების დამატებული ღირებულება

სტრუქტურული რეფორმის პროცესის სტიმულირება. მაკროფინანსურმა დახმარებამ გამორჩეული როლი ითამაშა სტრუქტრული რეფორმის პროცესის სტიმულირებაში და ევროკავშირთან პოლიტიკის სფეროში დიალოგის გაგრძელებაში რთულ ეკონომიკურ პერიოდში, როდესაც არსებობდა დაინტერესების დაკარგვისა და რეფორმების სტაგნაციის რისკი. მაკროფინანსურმა დახმარებამ ხელი შეუწყო ხელისუფლებას რეფორმების პრიორიტეტიზაციაში, სანდო ეტაპების დადგენაში და დაეხმარა არაპოპულარული ზომების შესახებ საზოგადოების ინფორმირებაში. მაკროფინანსურმა დახმარებამ ასევე ხელი შეუწყო ევროკავშირის რეგულაციებთან ჰარმონიზაციის მოთხოვნის გამყარებას. სტრუქტურული რეფორმის ძალისხმევის მხარდაჭერით, ევროკავშირმა ასევე დააფიქსირა, რომ საქართველო სწორი მიმართულებით მიდიოდა, რამაც ხელი შეუწყო ბაზარზე ნდობის აღდგენას, და ფინანსირების ხარჯების შემცირებას.

ფინანსური დამატებული ღირებულება. მაკროფინანსური დახმარების პროგრამის მოცულობა (46 მილიონი ევრო) შეესაბამებოდა საქართველოს მშპ-ს 0.4 პროცენტს 2015 წელს. ვინაიდან იგი არ იყო მიზნობრივი, ჰქონდა ხელსაყრელი მექანიზმი და პირობები, მაკროფინანსურმა დახმარებამ ეფექტიანად შეუწყო გარე და საბიუჯეტო ფინანსირების წნეხის შემსუბუქებას საქართველოში. ამასთან, მაკროფინანსურმა მხარდაჭერამ ხელი შეუწყო უცხოური ვალუტის რეზერვების შევსებას, რაც განსაკუთრებით მნიშვნელოვანი იყო ქვეყნის მნიშვნელოვანი საბალანსო მოწყვლადობის გათვალისწინებით (საგარეო და სახელმწიფო ვალის მაღალი მაჩვენებელი, რომელიც უპირატესად უცხოურ ვალუტაში იყო დენომინირებული).

შესაბამისობა

მაკროფინანსური დახმარების შესაბამისობა: საქართველომ მნიშვნელოვანი ფინანსური მხარდაჭერა მიიღო ევროკავშირისაგან 2008 წლის აგვისტოში რუსეთთან სამხედრო კონფლიქტის შემდეგ და მაკროფინანსური დახმარება იყო ევროკავშირის ყოვლისმომცველი პაკეტის ნაწილი. მაკროფინანსური დახმარების პირობები მჭიდროდ იყო შესაბამისობაში მოყვანილი საქართველოში ევროკავშირის სხვა პროგრამებთან და საქართველოს მიერ ასოცირების ხელშეკრულებისა და ღრმა და ყოვლისმომცველი თავისუფალი სავაჭრო სივრცის შესახებ ხელშეკრულების ფარგლებში აღებულ ვალდებულებებთან. მთლიანობაში, პირობითმა ვალდებულებებმა ძალიან მნიშვნელოვანი როლი ითამაშა ამ მექანიზმების ფარგლებში შეთანხმებული რეფორმის დღის წესრიგის განხორციელების მხარდაჭერაში.

სოციალური ზეგავლენა

მაკროფინანსური დახმარების პროგრამის სოციალური ზეგავლენა: მაკროფინანსური დახმარების პროგრამა მიზნად ისახავდა საქართველოს ხელისუფლების დახმარებას გარკვეულ სოციალურ გამოწვევებზე რეაგირებაში. დახმარება ითვალისწინებდა სამ მიმართულებას. პირველ რიგში, სოციალური რეფორმის დღის წესრიგის დაფინანსების ხელშეწყობას, რაც იმ დროისათვის განსაკუთრებით მწვავე პრობლემას წარმოადგენდა, ვინაიდან საქართველო ჩამორჩებოდა სხვა ქვეყნებს სოციალური დანახარჯების კუთხით. ამასთან, პირობითმა ვალდებულებამ ხელი შეუწყო ჯანდაცვის სერვისების სფეროში რეფორმების პრიორიტეტიზაციას. დაბოლოს, მაკროფინანსურმა დახმარებამ, სხვა მხარდამჭერებთან ერთად, ხელი შეუწყო მშპ-ს ზრდას და შესაბამისად, მოახდინა პოზიტიური ზეგავლენა დასაქმებაზე, განკარგვად შემოსავალსა და ზოგადად სოციალური მიმართულებით.

მოკლევადიანი სოციალური ზეგავლენა: რაც შეეხება ჯანდაცვის სექტორთან დაკავშირებულ მოკლევადიან მიზნებს, დახმარებამ ხელი შეუწყო სისტემის ხარისხის და მოცვის გაუმჯობესებას. თუმცა, ჩვენ ვერ აღმოვაჩინეთ ჯანდაცვის მომსახურების ხარჯთეფექტიანობაში პროგრესის მტკიცებულება. ამ სფეროში წინსვლის ნაკლებობა ძირითადად განპირობებული იყო სტიმულირების არაეფექტიანი სტრუქტურებითა და ადამიანური და ინსტიტუციური პოტენციალის ნაკლებობით, რაც აბრკოლებდა სისტემის აუცილებელ კორექტირებას. ჩვენ აღმოვაჩინეთ, რომ მაკროფინანსურმა დახმარებამ ხელი შეუწყო სოციალური დანახარჯების შენარჩუნებას, რომლებიც გაიზარდა დახმარების პროგრამის განხორციელების პერიოდში.

საშუალოვადიანი სოციალური ზეგავლენა: მაკროფინანსურ დახმარებას, სსფ-ს პროგრამასთან ერთად, ჰქონდა პოზიტიური, თუმცა ზომიერი ზეგავლენა ყველაზე რელევანტურ საშუალოვადიან სოციალურ ინდიკატორებზე. უმუშევრობის მაჩვენებელი დარჩა მაღალი და თითქმის არ შეცვლილა, ხოლო სიღარიბის მაჩვენებელი და ჯინის კოეფიციენტი, რომელიც ზომავს უთანასწორობას, ზომიერად შემცირდა განორციელების პერიოდში. ეს უმნიშვნელო პოზიტიური შედეგები უპირატესად მაკროფინანსური დახმარების ზეგავლენის მეშვეობით განხორციელდა სოციალური დანახარჯების შენარჩუნებით და არაპირდაპირ, ბაზრისადმი ნდობის აღდგენით და წარმოების ზრდის გათანაბრებით. თუმცა, თუ გავითვალისწინებთ, რომ პოლიტიკის ზოგიერთი ზომის განხორციელება დიდ დროს მოითხოვს, მოსალოდნელი ზეგავლენის სრულად რეალიზებისათვის საჭიროა მეტი დრო.

სახელმწიფო ვალის მდგრადობა

სსფ-სა და ევროკავშირის მხრიდან კომბინირებულმა ფინანსურმა დახმარებამ ხელი შეუწყო სახელმწიფო ვალის მაჩვენებლის ზრდის შეკავებას და ვალის დასტაბილურებას მართვად დონეზე. ჩვენი გაანგარიშებით, კომბინირებული დახმარების გარეშე ვალის ფარდობა მშპ-სთან მიაღწევდა პიკურ მაჩვენებელს და იქნებოდა დაახლოებით 6 პროცენტით მაღალი, ე.ი., მშპ-ს 50 პროცენტზე მეტი 2019-2020 წლებში, ვიდრე განსაზღვრული იყო სსფ-ს უახლესი პროგნოზის მიხედვით. კომბინირებული დახმარების პოზიტიური ზეგავლენა განპირობებული იყო ნდობის ფაქტორის

მოქმედებით (დაფინანსების ხარჯების შემცირებით), და რეალური ზრდის ფაქტორის მოქმედებით (მოკლე და საშუალოვადიანი ზრდის პროგნოზის გაუმჯობესებით). გრძელვადიან ჭრილში, მოსალოდნელია სახელმწიფო ვალის მაჩვენებლის მდგრადად შენარჩუნება, რასაც ხელს შეუწყობს ერთ სულზე რეალური მშპ-ს დაახლოება და მოსალოდნელი ფრთხილი (პრუდენციული) ფისკალური პოლიტიკა.

უახლესი პროცესები

ევროკავშირის მეორე მაკროფინანსური დახმარება, სსფ-ს სარეზერვო ხელშეკრულებასთან (SBA) ერთად, დაეხმარა საქართველოს ამბიციური სტრუქტურული რეფორმის დღის წესრიგში პროგრესის მიღწევაში იმ პერიოდში, როდესაც რეგიონში მიმდინარე პროცესები მნიშვნელოვან წნეხად აწვებოდა ეკონომიკას. დახმარებამ ხელი შეუწყო ბაზრისადმი ნდობის აღდენას და საქართველოს საგარეო და საშინაო ვალის მდგომარეობის გაუმჯობესებას. თუმცა, საქართველოში გარე კონტექსტი მაინც არასახარბიელო დარჩა, რის გამოც მშპ-ს ზრდა იყო შედარებით მოკრძალებული და განაპირობა ეკონომიკაზე წნეხი; მაშინ, როცა ეკონომიკა ისედაც მაღალი მიმდინარე ანგარიშის დეფიციტისა და მნიშვნელოვანი დისბალანსის გამოწვევების წინაშე იმყოფებოდა. ამ კონტექსტში, საქართველოს ხელისუფლებამ 2017 წლის ივნისში ევროკომისიას მიმართა დამატებითი მაკროფინანსური დახმარების თხოვნით. 45 მილიონი ევროს ოდენობის მესამე მაკროფინანსური დახმარების წინადადება დამტკიცდა 2018 წლის აპრილში და 2018 წლის აგვისტოში ევროკომისიამ ხელი მოაწერა საქართველოსთან ურთიერთგაგების მემორანდუმს. ახალი მაკროფინანსური დახმარების პროგრამა შეავსებს სსფ-ს გაფართოებული დაფინანსების მექანიზმით გათვალისწინებულ ღონისძიებებს, რომელიც დამტკიცდა 2017 წლის აპრილში, და რომელიც სამი წლის მანძილზე ითვალისწინებს 285.3 მილიონი აშშ დოლარის ევროს გადარიცხვას. ევროკომისიამ პირველი ტრანში საქართველოს (15 მილიონი ევრო სესხის კომპონენტი და 5 მილიონი ევრო გრანტის კომპონენტი) 2018 წლის დეკემბერში გადაურიცხა.

ამ შეფასებაში წარმოდგენილი ინფორმაცია და მოსაზრებები ეკუთვნის ავტორებს და შესაძლოა არ ასახავდეს ევროკომისიის ოფიციალურ პოზიციას. კომისია არ იძლევა გარანტიას ამ კვლევაში ჩართული მონაცემების სიზუსტეზე. კომისია, ან კომისიის სახელით მოქმედი ნებისმიერი პირი არ იქნება პასუხისმგებელი ამ ანგარიშში ჩართული ინფორმაციის გამოყენების გამო.

Preface

This Final Report is the last document to be submitted under the current assignment of the ex-post evaluation of the macro-financial assistance (MFA) 2 operation to Georgia. Its main objective is to present the final results of the assignment. It contains a complete analysis of the data and information and gives a list of conclusions. It also presents a complete overview of the observed effects of the MFA operation in Georgia and answers the evaluation questions.

The first document, the so-called Inception Report was submitted on 15 October 2018 and presented to the Inter-Service Steering Group (ISG) on 18 October 2018. The ISG approved the Inception Report at the Inception meeting. The second document, the Intermediate Report was built on the foundations of the Inception Report and it also incorporated the comments of the ISG on the Inception Report. The Intermediate Report was submitted on 17 December and presented to the ISG on 20 December 2018. The ISG approved the Intermediate Report at the meeting. At the same time, the ISG provided comments both at the meeting and later in writing (sent to the Evaluation team on 21 December 2018).

The third document, the Draft Final Report was submitted on 19 of February 2019 and presented to the ISG on 26 February 2019. It followed the same structure as the two previous reports and provided further analysis and triangulation, as well as a dedicated chapter to conclusions.

This Final Report is the fourth and last document of the evaluation. It is based on the Draft Final Report and takes into account all comments and amendments made by the ISG.

Chapter 1 Introduction

1.1 Objectives of the Evaluation

The evaluation assesses the macro-financial assistance (MFA) operation to Georgia governed by Decision No. 778/2013/EU of the European Parliament and of the Council of 12 August 2013 (OJ L 218/15, 14.8.2013) providing macro-financial assistance to Georgia. Under the MFA, operation running over the period 2013-2017, a total of EUR 46 million (including EUR 23 million in the form of grants and EUR 23 million in the form of loans) were disbursed to Georgia.

Under its Financial Regulation (article 30 point 4), the European Commission (EC) is legally obliged to evaluate its main programmes, including MFA operations. More specifically, Decision No. 1351/2013/EU (OJ L 341, 18.12.2013, p. 4) says that: *"Not later than two years after the expiry of the availability period referred to in Article 1(4), the Commission shall submit to the European Parliament and to the Council an ex post evaluation report, assessing the results and efficiency of the completed Union's macro-financial assistance and the extent to which it has contributed to the aims of the assistance."*

The Terms of Reference (TOR, ECFIN 2018 13/D) for this evaluation further specify that the objective of the exercise is two-fold:

- to analyse the impact of MFA 2[5] on the economy of the beneficiary country and in particular on the sustainability of its external position;
- to assess the added value of the European Union’s (EU) intervention.

In general, terms, the evaluation should aim to draw lessons with respect to the EU's financial assistance:

- whether the ex-ante considerations determining the design and terms of the operation were appropriate, taking due account of the economic, political and institutional context;
- and whether the outcome of the programme met the objectives.

1.2 Scope of the evaluation

Our overall methodological approach for evaluating the MFA 2 operation in Georgia is guided by the Commission’s Better Regulation Guidelines.[6] The ‘MFA Guidelines’ from 2015[7] provide the specific methodological framework that shapes our approach for this evaluation. While the Guidelines include a number of indicative questions and sub-questions to be answered in each evaluation, the evaluation mandate for this specific assignment is set out in the TOR. Hence, the generic questions as presented by the Guidelines are adjusted to be fully in line with the TOR.

Based on the TOR and our takeaways from the kick-off meeting with EC stakeholders in Brussels, the evaluation largely covers three main areas of analysis:

1. Economic impact of the MFA assistance operation on the economy of Georgia; with and without the involvement of the International Monetary Fund (IMF). This concerns macroeconomic, fiscal and structural policy developments and achievements that can be linked to the provision of MFA (in

[5] MFA 2 refers to the second MFA package for Georgia that is the subject of this evaluation. The first and the third MFA packages are not covered by this assignment.

[6] See: https://ec.europa.eu/info/law/law-making-process/planning-and-proposing-law/better-regulation-why-and-how/better-regulation-guidelines-and-toolbox_en.

[7] See: http://ec.europa.eu/dgs/economy_finance/procurement_grants/calls_for_tender/2015/015d/annex4-methodological_orientations_en.pdf.

conjunction to IMF assistance). The analysis should take into account both endogenous factors (design appropriateness, rationale and implicit objectives, efficiency in implementation, etc.) and exogenous factors (e.g. political and global economic developments, dialogue of the recipient country with the IMF). Besides the economic impact, we also assess the related social impact to specific programme conditions. It is important to bear in mind that the ultimate objective of the MFA policy intervention in Georgia was to alleviate adverse economic and social consequences brought about by the armed conflict with Russia in 2008 and the international financial crisis in 2009.

2. **Value added of EU intervention (stand-alone, and/or in combination with IMF intervention) provided through the operation.** A second important aspect of the evaluation is to look at the net additional effects and benefits beyond what could have been achieved with other interventions by other international donors. The scope of the analysis then goes beyond the pure economic impact analysed in the first area, as issues related to complementarity and political support also play a role here. Georgia received financial and technical support via multiple channels from different international donors, as well as from other EU financial assistance instruments besides the MFA operation. At the same time, MFA is conditional and complementary to the IMF financial support and related reform programmes. Therefore, the coherence and alignment of the MFA operation with other support programmes, as well as its value added are also assessed.

3. **Sustainability of the country's external position as a result of the assistance.** The third focus of this evaluation is to see how the programme contributed to covering the external financing needs of Georgia. Besides the direct effect of the financing envelop, the impact on the sentiments of market participants regarding Georgia's sustainability and the resulting change in the external financing cost are important factors in this respect. In order to understand the overall impact of the MFA on the sustainability of the external position, besides the evolution of the external position and the financing costs we examined the dynamics of the related macroeconomic variables as well (factors determining the longer term evolution of the saving-investment position, exchange rate, etc.).

These three areas of analysis were assessed along the lines of the following key evaluation criteria: relevance, effectiveness, efficiency, EU added-value, and EU coherence. As commended in the TOR, we have added two additional topics, assessing the impact of the MFA 2 on the social developments and on public debt sustainability.

1.3 Structure of the Report

The remainder of this report is structured along the same lines as proposed by the Better Regulation Guidelines:[8]

- **Chapter 2** provides a background to the MFA 2 operation in Georgia. It briefly outlines the political and economic context, the relationship between Georgia and the EU and the involvement of EU and other donors in providing support to Georgia;
- **Chapter 3** presents the main evaluation questions as proposed by the TOR;
- **Chapter 4** provides an overview on the methodology, describes the evaluation methods that were employed throughout the evaluation and the risks and assumptions behind the conclusions;
- **Chapter 5** discusses the situation in the core areas of interest (macroeconomic situation, fiscal policy, structural reforms and social policy);
- **Chapter 6** presents preliminary answers to most of the questions (and sub-questions) set up in the evaluation mandate and presented in Chapter 3;
- **Chapter 7** provides the preliminary conclusions of this MFA evaluation.

[8] Tool #47: The Staff Working Document for Evaluation, see: http://ec.europa.eu/smart-regulation/guidelines/tool_47_en.htm.

Additional to the main body text, we included several annexes to provide further details. Annexed to this Intermediate Report are the Consultation Strategy (Annex I) and the list of interviewees (Annex II). Annex III contains an overview of the cross-conditionality and complementarities between the MFA and other operations. Moreover, we include the feedback to our Delphi questionnaire (Annex IV), along with the list of participants (Annex V). In Annex VI, we provide a more thorough description of the methodology to carry out the debt sustainability analysis (DSA). Annex VII presents two case studies: one on the financial sector, and one on trade policy. Finally, Annex VIII presents a table on the detailed timeline of the MFA 2 operation to Georgia.

Chapter 2 Background to the MFA operation to Georgia

This chapter briefly sets out the political and economic context to the MFA 2 operation (focusing on the period until 2017, i.e. the end of the MFA implementation period), and provides an overview of the EU support instruments for Georgia, as well as the outline of the simultaneous IMF programmes, and summarizes other creditors' and donors' involvement. Finally, it discusses the timeline and milestones of the MFA 2 operation itself.

2.1 Political and economic context

2.1.1 Political situation in Georgia

Given that Georgia was a country covered by the European Neighbourhood Policy (ENP), it was eligible for MFA in accordance with Principle 2 of the Joint Declaration of the European Parliament and the Council on MFA of 2013 (OJ L 218, 14.8.2013, p. 18). As a multi-party democracy[9], Georgia was considered to respect democratic mechanisms[10], the rule of law and human rights and to therefore fulfil the political pre-conditions for MFA.

Georgia has relatively developed liberal institutions, which has nevertheless suffered from concentration of power in recent years. The ruling party, Georgian Dream (GD), has been governing the country since 2012 replacing the United National Movement (UNM) that had been in power since the Rose Revolution in 2003. The GD won the 2016 October elections by a landslide, exploiting persisting public dissatisfaction with its predecessor, the UNM. With its three-fourth constitutional supermajority during the reporting period, the GD was able to overcome the legislative veto of President Margvelashvili, its vocal critic, and govern largely unconstrained[11].

Notwithstanding, the country is still performing well in developing democratic institutions, in particular compared to other former Soviet republics. Elections are mostly free and fair and the rule of law (which has been the weakest point throughout Georgia's post-Soviet transition) is reaping benefits from the ongoing judiciary reforms, although important challenges remain.

Thanks to the long-standing political consensus in the Georgian elite regarding business-friendly economic policies, the country has been the best-performer developing country in the Ease of Doing Business ranking by the World Bank (WB), reaching the overall 6th place in 2018 starting from the 37th place in 2007 out of 190 countries.[12] Other competitiveness indicators that measure economic fundamentals have also improved gradually throughout the past decade, albeit in a less spectacular manner. In the World Economic Forum's competitiveness ranking, the Georgian economy ranked 67th in 2018[13], having

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9 Democracy index of Georgia calculated by Economist Intelligence Unit averaged at 5.9 out of 10 in the period 2013-2017 (higher score represents the higher democratic progress See, https://infographics.economist.com/2018/DemocracyIndex/). The Freedom House's democracy score averaged at 4.66 out of 7 in the same period (lower score represents the higher democratic progress, see https://freedomhouse.org/report/nations-transit/2017/georgia). Based on both indexes, Georgia performs significantly better than other countries in the region.

10 Respect of the democratic mechanism is one of the political preconditions for a MFA.

11 In 2019, a number of Georgian Dream MPs have recently left the party leaving the Georgian Dream for the first time since 2016 without a constitutional majority. On 16 December 2018 Margvelashvili was succeeded by Salomé Zourabichvili].

12 See http://www.doingbusiness.org/en/rankings.

13 See http://reports.weforum.org/global-competitiveness-index-2017-2018/competitiveness-rankings/.

improved by 19 positions since 2012. At the same time, with more than 50 percent of GDP, the share of the shadow economy in Georgia in 2015 was still among the highest in the world.[14]

Georgia's geopolitical position remains delicate. With the strong back-up of the Russian Federation, the breakaway regions of Abkhazia and South Ossetia continue rejecting the state authority of Georgia as well as prospects for resolving the conflict upon the principle of reintegrating into Georgian statehood. While the current status quo prevails, the broader geopolitical context and in particular, the relations between the US and the Russian Federation could, in case of major deterioration, impact on the conflict situation in Georgia.

In recent years, Georgia has been strengthening its geopolitical position by diversification. It has concluded an Association Agreement with the EU and is cooperating closely with the NATO, but is also developed closer ties with China, Iran and Turkey, thus having intentions to benefit from its geographic and cultural position between Europe and Asia.

2.1.2 Economic situation in Georgia

In 2008, Georgia has been heavily hit by the armed conflict with Russia and the global financial crisis. Besides a persistently high current account deficit, the fall in foreign direct investment (FDI) inflows, drop in market financing and shrinking remittances put the country's external financing under severe pressure. In addition to the trade embargoes set by Russia, the export was negatively affected by the impact of the global crisis: the falling export demand together with the drop in external financing forced a severe macroeconomic adjustment, putting under pressure the fiscal sustainability as well.

Apart from the disruption caused by the 2008 war and the global financial crisis, the Georgian economy has displayed decent progress over the past decade. GDP growth has averaged 4.5 percent annually (Figure 2.1.), underpinned by government capital spending, reviving foreign direct investments (FDIs) attracted by positive business environment, as well as household consumption fuelled by remittances from the large Georgian diaspora. At the same time, the economy has witnessed an increase in the mining and manufacturing output, trade and tourism. Inflation had declined from the pre-war levels, averaging around 4 percent annually in the period of 2009-2012, reaping the benefits of the nascent Inflation Targeting framework of the central bank and supported by a strong lari (the name of the Georgian currency), but remained highly volatile mainly due to large swings in food prices (see Box 1).

The fruits of the economic recovery have not been widely shared across the society, however. The rapid output growth in the period had not led to a reduction in the unemployment rate, which has remained stubbornly high exacerbating the social imbalances and pressures characterizing the current Georgian society. In an effort to ease social imbalances, the Georgian authorities have over years been shifting the public spending priorities towards social expenditures, which had traditionally been among the lowest compared to the country's peers.

[14] See https://www.imf.org/en/Publications/WP/Issues/2018/01/25/Shadow-Economies-Around-the-World-What-Did-We-Learn-Over-the-Last-20-Years-45583.

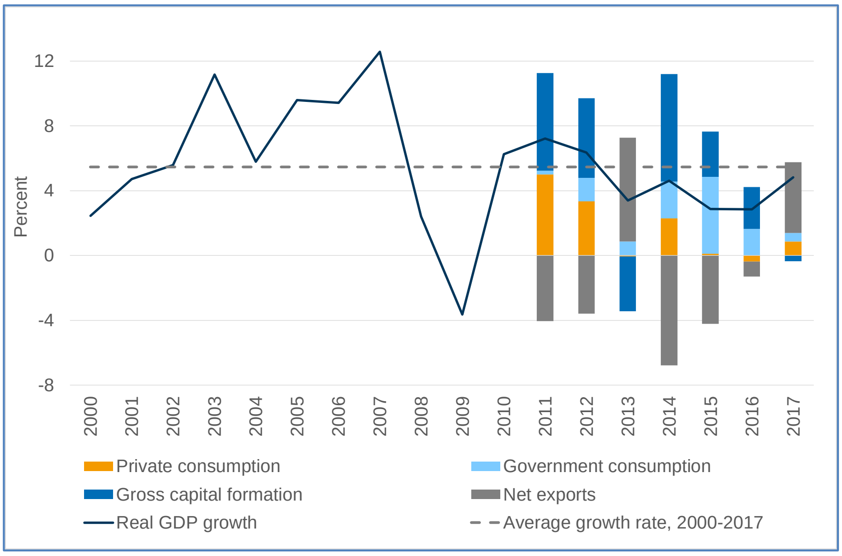
Georgia fact sheet

Geographic Indicators			
Region	Caucasus region; Eurasia		
Area	69,700 sq km		
Demographic indicators	2000	2007	2017
Population, million	4.4[±]	4.1[±]	3.7[±]
Infant mortality rate (per 1,000 live births)	30.9[±]	18.6[±]	9.7[±]
Life Expectancy at birth	71.9[±]	72.7[±]	73.3[±a]
Macroeconomic Indicators			
Real GDP growth in %	1.83[±]	12.3[±]	4.8[±]
Real GDP per capita, 2011, Int. USD PPP	3263.9[±]	6183.3[±]	9745.1[±]
Inflation, CPI, growth rate %	4.1[±]	9.2[±]	6.0[±]
Value added, agriculture (% of GDP)	20.6[±]	9.2[±]	7.0[±]
Value added, manufacturing (% of GDP)	8.5[±]	10.9[±]	10.6[±]
Value added, industry (% of GDP)	21.0[±]	20.9[±]	22.1[±]
Value added, services (% of GDP)	52.3[±]	55.9[±]	56.6[±]
Trade			
Export of goods and services, in % of GDP	24.5[±]	31.2[+]	50.4[+]
Import of goods and services, in % of GDP	38.9[±]	58.0[+]	62.2[+]
Main export products: Copper ores, hazelnut, ferro-alloys, motor cars' parts			
Main import products: Petroleum oil, gas, copper ores, medicament, automobile			
Labour Market			
Labour force participation rate, % of total population ages 15-64[1]	66.2[±]	67.6[±]	72.9[±]
Unemployment rate, % of total labour force[1]	10.8[±]	13.3[±]	11.6[±]
Fiscal sector			
Government deficit, in % of GDP	-2.0*	0.8*	-0.5*
Primary balance, in % of GDP	0.8*	1.4*	0.7*
Government debt (gross) in % of GDP	67.7*	25.1*	44.9*
Credit rating (sovereign)[#]			
Standard & Poor's	-	B+	BB-
Fitch	-	BB-	BB-
Moody's	-	-	Ba2
External Sector			
Current Account Balance, current USD billion	-0.18[×]	-1.99[×]	-1.33[×]
Current Account Balance, in % of GDP	-5.8[×]	-19.6[×]	-8.8[×]
FDI stock (inward, including intercompany loans), % of GDP	40.6[×]	140.0[×]	139.2[×]
Exchange rate GEL/USD, Annual average	1.98[×]	1.67[×]	2.50[×]
Investment Climate			
Ease of doing business (WB) – Rank (1=most business-friendly)	-	37[±]	9[±]
Global Competitiveness Index WEF Rank	-	90[‡]	59[‡]
Social Indicators			
Net Enrolment Rate, primary	84.5[±]	93.1[±]	99.6[±a]
Net Enrolment Rate, secondary	77.9[±]	87.8[±]	95.5[±a]
Poverty headcount ratio at $1.90/day (2011 PPP, % of population)	21.0[±]	13.3[±]	4.2[±]

Note: [a] refers to 2016, [1]modelled ILO estimate.

Sources: The data comes from various sources. * refers to IMF; [±] refers to World Bank; [†] refers to UNCTAD; [+] refers to GEOSTAT; [‡] refers to the World Economic Forum; [#] refers to Trading Economics; [×] refers to the National Bank of Georgia.

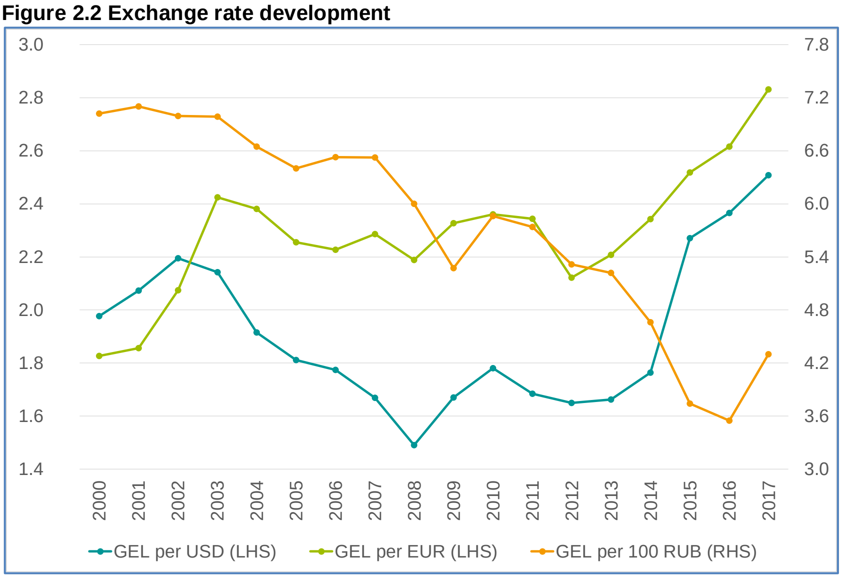
Figure 2.1 Real GDP growth of Georgia



Source: Geostat, IMF, World Economic Outlook Database, October 2018.
Memo: Expenditure side decomposition of GDP is not available for the years before 2010.

The vulnerability of the Georgian economy to the political situation was once more demonstrated in 2013, when GDP growth decelerated to 3.4 percent due to uncertainties around the shifting of power after the 9 years of the UNM rule and large cuts in fiscal spending implemented by the new government.[15] Firms and foreign investors postponed their investment projects, while households also cut back on spending. Inflation turned negative in 2012 and 2013 due to low food prices, low imported inflation and weak demand. Additionally, in spite of the below-target inflation, the election-related uncertainties compelled the central bank to keep a tight stance in both the money and foreign exchange markets until the end of 2012.

Figure 2.2 Exchange rate development



Source: National Bank of Georgia.

The strategy of trade and political diversification helped, to some extent, to protect the Georgian economy in the next regional economic crisis, starting in 2014. The region was hit hard by the spill-overs from the recession in Russia in the wake of the oil price decline and economic sanctions, which sent the regional currencies tumbling. The depreciation of the regional currencies weighed heavily on Georgia's exports and remittances. As a consequence, the central bank allowed the lari to adjust, leading to a cumulative

15 IMF. (2015). First Review Under the Stand-by Arrangement and Request for Modification of a Performance Criterion—Staff Report. https://www.imf.org/external/pubs/ft/scr/2015/cr1517.pdf.

depreciation of about 50 percent between November 2014 and December 2016, thus partially restoring the competitiveness of exporters. Notwithstanding, the remittances declined substantially due to the tensions in the region, with a negative impact on domestic demand. Growth slowed to 2.9 percent and 2.8 percent in 2015 and 2016, respectively. While the growth rate was well below the historical average, it was still the highest in the region due to Georgia's relatively low dependence on Russia and ongoing large investment projects.[16]

Inflation, close to 3 percent in 2014 contained by low international food and oil prices, accelerated on the back of the sharp depreciation of the lari and hikes in electricity tariffs (Figure 2.3). This triggered a strong monetary policy response from the National Bank of Georgia (NBG) in line with its 5 percent inflation target mandate. The refinancing rate was gradually raised from 4 percent in January to 8 percent in December 2015, putting inflation on check in 2016.

Box 1 Inflation Targeting and De-dollarization Strategy

The National Bank of Georgia has implemented the Inflation Targeting framework gradually since 2009. The new framework was a response to the low trust the Georgian public, having witnessed periodic high inflation bouts and devaluations in 1990s and 2000s, had in the national currency. Given the low trust, much of the financial sector and price formation mechanisms had traditionally operated in a foreign currency (the dollar), which has reduced the effectiveness of the macroeconomic policy mix and rendered the financial sector highly vulnerable to swings in the currency. Indeed, as much as 60-70 percent of bank deposits and loans were denominated or linked to the dollar. Especially vulnerable to the dollarization risks were the households who would often borrow in the FX, despite uncertain FX income flows (mostly from remittances).

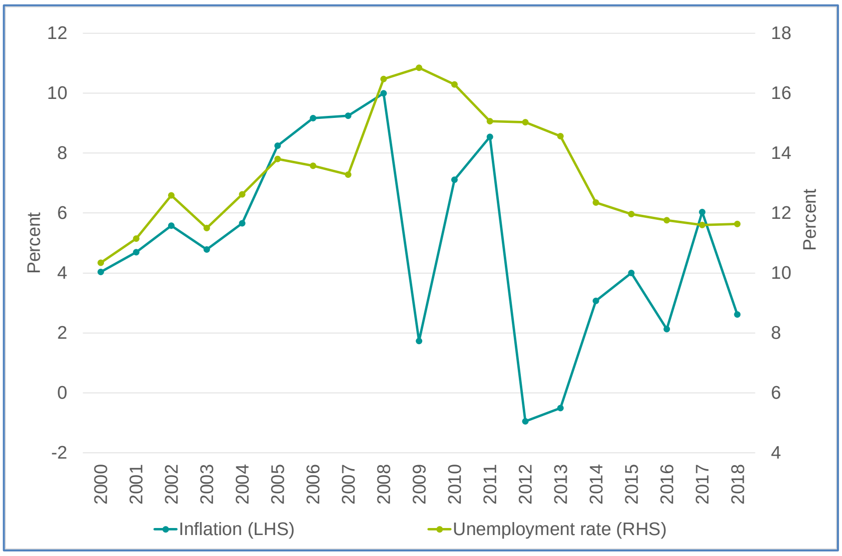
The Inflation Targeting framework was therefore an attempt to regain the control of the macroeconomic management through creating a predictable environment based on low inflation and interest rates. The main long-term objective of the reform was to anchor public inflation expectations in low single digits – a daunting task given the turbulent past and a high share of volatile food prices in the consumption basket. Such an environment would renew the trust in the national currency and promote its use in financial transactions, thus reducing the systemic vulnerabilities of the economy.

Despite a difficult beginning (in middle of the global financial crisis), the Inflation Targeting framework has been largely successful to date. The National Bank of Georgia has modernized its financial market infrastructure, re-gained control over the money market interest rates, and its external policy communication has contributed to a predictable and reliable yield curve, which serves a pricing benchmark for the lari-based products of the financial sector. The exchange rate has become more flexible and gradually ceased to be the main objective of policy management, although the central bank still regularly intervened in the FX market until 2017.

Reaping the benefits of these reforms, annual inflation has been in single digits since 2011. The success with the Inflation Targeting implementation (together with the accompanying financial sector reforms) also contributed to a falling share of dollarization of deposits and loans in the last few years. Finally, although more flexible than a decade ago, the exchange rate has been more stable overall in the recent years than that of Georgia's peers.

16 The most notable projects included the construction of the Poti and Anaklia ports, the South Caucasus Pipeline expansion, and the development of the Nenskra hydropower plant (HPP) and the Tskhenistskali HPP cascade.

Figure 2.3 Inflation and unemployment



Memo: Unemployment in percent of total labour force, modelled ILO estimate.
Source: NBG, World Bank.

In 2017, GDP growth accelerated to 5 percent, driven by a broad array of positive external and domestic factors. Exports and remittances both increased by over 20 percent year on year, driven by the economic expansion of the country's main trading partners. FDI inflows reached about 12.6 percent of GDP and tourism revenue (in USD) increased by 28.1 percent in 2017. An increase in the remittances, coupled with ongoing domestic credit growth, have propelled domestic demand. A sudden surge in prices was largely caused by one-off seasonal factors and a hike in indirect taxes. With monetary policy kept tight, once the one-off pressures faded out, inflation decelerated quickly by early 2018.

2.1.3 EU and Georgia relations

Cooperation between the EU and Georgia has started after the EU recognised Georgia's independence in 1992. The Partnership and Cooperation Agreement (PCA) entered into force in 1999, and was subsequently replaced by the EU-Georgia Association Agreement (AA) and the Deep and Comprehensive Free Trade Area (DCFTA) signed in June 2014. AA/DFCTA have been provisionally in force since 1st September 2014 and fully entered into force on 1st July 2016. Georgia committed to an ambitious reform agenda with the aim of reaching political association and a closer economic integration with the EU. Visa liberalisation for Georgia came into effect in March 2017 (Georgia unilaterally abolished the visa requirement for EU citizens already couple of years earlier). The EU has also been cooperating with Georgia since 2009 also in the framework of the ENP and its eastern regional dimension, the Eastern Partnership (EaP).[17]

The EU cooperates with Georgia mainly through bilateral, regional and multi-country Action Programmes. Moreover, several EU member states (Austria, Germany, France, Czech Republic, Estonia, Poland, Sweden, etc.) also provide bilateral technical assistance to Georgia.

In 2007-2013, the EU committed EUR 452 million (approximately 0.7 percent of GDP on average per year) for bilateral assistance to Georgia under the European Neighbourhood Policy Instrument. This included EUR 49 million granted in 2012-2013 through the Eastern Partnership Integration and Cooperation (EaPIC) programme (now replaced by the 'umbrella programme'). The indicative allocation for the period 2014-2020 is EUR 610 million to EUR 746 million under the ENI (European Neighbourhood Instrument). The three priority areas for bilateral cooperation, as set out in the Single Support Framework for 2014-

[17] See https://ec.europa.eu/neighbourhood-enlargement/neighbourhood/countries/georgia_en.

2017, were Public Administration Reform, Agriculture and Rural Development, and Justice Sector Reform. These priority areas also encompassed support for the implementation of the AA/DCFTA.[18] The Single Support Framework 2014-2017 was already replaced by a new Single Support Framework for the period 2017-2020 in 2017. There are four priority areas for support:

1. Economic development and market opportunities, including smart, sustainable and inclusive growth;
2. Strengthening institutions and good governance, including consolidating the Rule of Law, addressing security;
3. Connectivity, energy efficiency, environment and climate change;
4. Mobility and people-to-people contacts, including support to the continuous implementation of the visa liberalisation benchmarks and to vocational education and training.

Complementary support for the modernisation of public institutions and civil society has been provided outside the priority sectors. Past bilateral programmes under the European Neighbourhood and Partnership Instrument (ENPI) also include reforms in the management of public finances, regional development, vocational education and training (VET), and on conflict settlement and assistance for internally displaced persons. Furthermore, civil society initiatives were supported with the Neighbourhood Civil Society Facility. Georgia benefitted from the Neighbourhood Investment Facility, which contributed some EUR, 86 million to projects during 2008-2017.[19]

Georgia also benefitted from additional financial assistance granted through the multi-country 'umbrella programme': the incentive-based mechanism that rewards progress in building deep and sustainable democracy with supplementary financial allocations. For instance, additional funds were provided under the Eastern Partnership Integration and Cooperation Programme (EaPIC), following the principle of "More for More" in 2012 and 2013 in recognition of its progress in deep democracy and respect for human rights.

2.1.4 Other creditors and donors involved

International Monetary Fund (IMF)

In September 2008, the IMF pledged an USD 750 Million 18 months support for Georgia. This first Stand-by Arrangement (SBA) after the armed conflict with Russia aimed at stabilizing the economy in the wake of the regional and the global financial crisis, and restoring conditions for strong economic growth. As of end 2010, despite the successful programme reviews, the authorities treated the arrangement as precautionary and did not draw the instalments that became available. After the expiry of the SBA in 2011, Georgia requested a SBA and Stand-by Credit Facility (SCF). The IMF Executive Board approved a 24-month SBA and SCF for Georgia with total access of up to USD 386 million in April 2012. Again, the authorities treated the arrangements as precautionary and did not borrow from it, which prevented the activation of MFA 2.

After the expiry of the combined SBA and SCF in April 2014, the Georgian authorities requested a new SBA. On July 30th 2014 the Executive Board of the IMF approved a 36-month SDR 100 million (about USD 154 million) SBA with Georgia to support the authorities' economic programme.[20] The Executive Board's decision enabled the immediate disbursement of SDR 40 million (about USD 62 million), while the remaining amount was planned to be phased over the programme, subject to reviews.

The IMF programme aimed at lessening Georgia's macro vulnerabilities by facilitating external adjustment and supporting growth by reaching the following goals: 1) reduce the fiscal deficit to ensure fiscal sustainability and create space for countercyclical policies; 2) lower the current account deficit and build foreign reserves, including by providing Fund financial assistance; 3) strengthen the monetary policy

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18 For a comprehensive assessment of AA/DCFTA content and implementation see Emerson, M., & Kovziridze, T., (2018). Deepening EU-Georgian Relations. CEPS, Brussels. https://www.ceps.eu/publications/deepening-eu%E2%80%93georgian-relations-what-why-and-how-second-edition.

19 See http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1538745520.

20 See https://www.imf.org/en/News/Articles/2015/09/14/01/49/pr14377.

framework through greater exchange rate flexibility and improved inflation targeting; 4) contain fiscal risks from quasi-fiscal activities; 5) support reforms in revenue administration; and 6) bolster financial sector stability. The structural benchmarks of the IMF programme were as follows:

Structural benchmark	Date for completion
FINANCIAL SECTOR	
With the support of the World Bank, conduct a thorough assessment of the presence, nature, and remedies for credit market imperfections.	September 2014
FISCAL POLICY	
Include in the 2015 state budget a statement of fiscal risks.	December 2014
Approve the budget for 2015 with 3 percent of GDP deficit.	December 2014
Abolish the alternative tax audit programme.	April 2015
Introduce a single taxpayer account system in the General Revenue Service.	June 2015
Consolidate Legal Entities of Public Law (LEPLs) in the government financial statements.	June 2015
STATISTICS	
Publish GDP by expenditure in constant prices.	December 2015

On 19th December 2014, the IMF completed the first review of Georgia's economic performance under the SBA, enabling the disbursement of SDR 40 million (about USD 58.1 million), bringing total disbursements under the programme to SDR 80 million (about USD 116.3 million) [21]. The programme was heavily front loaded as 80 percent of the approved amount had been disbursed in the first 5 months of the arrangement. The remaining funds were expected to be disbursed in 2015-2016.

No further reviews were completed under this programme, for several reasons, notably disagreements between the IMF and the Georgian authorities on: (i) the transfer of responsibility for banking supervision from the central bank to the new financial supervision agency; (ii) the fiscal strategy in the context of a growing fiscal deficit; and (iii) the failure by the Georgian authorities to put in place a clear legal framework for the granting of state guarantees, including for public private partnerships (PPPs).[22] The issue regarding the role of the central bank (i) had been resolved in 2017[23]. Likewise, a new government, which took office after the elections in October 2016, has committed to tackling issues (ii) and (iii), as part of its reform programme. Due to the lack of agreement with the IMF, EC MFA 2 programme was delayed as well.

Only in April 2017, the IMF Executive Board approved a three-year EFF programme of SDR 210.4 million (about USD 285 million, or 100 percent of the quota) aimed at supporting the reform programme, reducing economic vulnerabilities, promoting higher and more inclusive growth while maintaining macroeconomic stability. USD 41 million were immediately disbursed. The remaining amount was planned to be disbursed over the duration of the programme – subject to six semi-annual reviews.[24] In terms of fiscal consolidation, the IMF insisted on the need for measures to offset the budgetary impact of the corporate income tax

[21] See IMF. (2015). First Review Under the Stand-by Arrangement and Request for Modification of a Performance Criterion — Staff Report; and Press Release. https://www.imf.org/en/Publications/CR/Issues/2016/12/31/Georgia-First-Review-Under-the-Stand-by-Arrangement-and-Request-for-Modification-of-a-42606.

[22] https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:52017SC0321.

[23] In September 2015 the Georgian Parliament adopted amendments to the Organic Law on the NBG to transfer banking supervision functions from the central bank to a new Financial Supervisory Agency. The entry into force of the amended law was, however, suspended in October 2015, pending a ruling by the Constitutional Court on the constitutionality of the law. The EU, the IMF and other IFIs approached the government to support the NBG's independence. The IMF set as a prior action to the EFF programme to amend the law, reverting back to the original version assigning financial supervision responsibilities to the NBG. The government submitted the legislative proposal in February 2017 ensuring that the financial supervisory function would remain with the central bank regardless of the Court's judgment.

[24] See https://www.imf.org/en/News/Articles/2017/04/12/pr17130-georgia-imf-executive-board-approves-us-285-3-million-extended-arrangement-under-eff.

reform and the public investment programme. The programme includes a deficit reduction path from 4.1% of GDP in 2016 to 3.1% of GDP in 2020.[25]

The following detailed structural benchmarks were envisaged for the IMF EFF programme:

Structural benchmark	Date for completion
FINANCIAL SECTOR	
• Introduction of Liquidity Coverage Ratio (LCR) for commercial banks, with preferential treatment of GEL-deposits; • Adoption of regulation on capital add- for systemically important banks; • Submit to Parliament legislation giving NBG oversight over credit information bureaus; • Increase in minimum regulatory capital for banks to GEL50 million, phased in by 2019; • Create a medium-term debt strategy, including i) restrictions on new borrowing to projects which increase growth potential and have positive social impact, ii) keep debt at sustainable levels, iii) keep borrowing anchored and in line with macroeconomic stability.	December 2017
Introduce regulation on leverage ratio based on Basel Principles and EU regulation.	September 2018
Introduce regulation on banks corporate governance in line with Basel Principles.	September 2018
Introduce regulation on bank's real estate appraisal in line with International Valuation Standards.	June 2018
Submission to Parliament legislation establishing deposit insurance as of January 1, 2018.	June 2017
Publication of a multi-year calendar for government benchmark bonds.	December 2017
Signing of a Memorandum of Understanding between the Ministry of Finance (MoF) and the NBG on information sharing for liquidity forecasting purposes.	June 2017
Submit to Parliament amendments to NBG Law that will give it the authority to resolve a bank through a temporary administration at an early stage of a bank's financial difficulty, in line with good international practices as identified in the 2014 FSAP recommendations.	September 2017
FISCAL POLICY	
Submission to Parliament a 2018 budget consistent with the fiscal deficit in the Fund-supported programme.	December 2017
Adopt a remuneration law for public civil service.	December 2017
Action plan to address accumulated outstanding value-added tax (VAT) refunds in an orderly manner over time (including analysis, refund, set-offs, and write-offs).	September 2017
Propose necessary legal amendments or ministerial decrees to facilitate the implementation of the action plan to address outstanding VAT claims.	March 2018
Create a new specialized VAT unit focusing on validating VAT claims.	June 2018
Restructure Georgia's Revenue Service (GRS) headquarters into a function-based organization.	February 2018
• Submission of a public-private partnership (PPP) law to Parliament, establishing reporting, monitoring and requiring a ceiling on government exposure from such partnerships; • Include all PPP and power purchase agreements (PPA) liabilities, and expand the analysis of contingent liabilities from SOEs, reporting quasi-fiscal activity in the 2018 Annual Fiscal Risk Statement.	December 2017
Issue guidelines for budget lending operations requiring reasonable expectation of commercial returns.	December 2017
PENSION REFORM	
Submission of a pension law establishing a 2nd pillar pension system, and introducing indexation of basic public pensions.	December 2017
Establishing an independent pension agency.	June 2018

Source: IMF.

25 For the latest (June 2018) IMF assessment of Georgia see: https://www.imf.org/en/Publications/CR/Issues/2018/06/28/Georgia-2018-Article-IV-Consultation-Second-Review-under-the-Extended-Fund-Facility-46036.

Program implementation through end-June 2018 was satisfactory according to the IMF review from December 2018. All end-June 2018 performance criteria were met—some with significant margin. All structural benchmark but one were observed, and the missed one was completed with a two-week delay.[26]

World Bank

The WB has been a key development partner for Georgia since 1992, supporting investment projects and the reform agenda in various sectors. In the period of 1992-2017, the WB has provided concessional credits and loans to finance 69 projects, totalling over USD 2.7 billion, across different sectors of Georgia's economy. The WB portfolio consisted of 11 active investment projects and development policy operations totalling USD 699 million in 2017.[27] Although the WB's investment portfolio is mainly in infrastructure, its overall partnership with Georgia is broader. Activities in other areas reflect the two active DPOs:

The Second Programmatic Inclusive Growth DPO – of EUR 47.2 million approved in April 2017 – targets improvements in the public sector (oversight of public institutions, improved budgeting, a framework for civil service reform, improved coverage and quality of social services, and strengthened monitoring of outcomes). The Second Private Sector Competitiveness DPO – of EUR 44.6 million approved in July 2017 – aims to increase private sector competitiveness (through business environment reforms, financial sector deepening and diversification, and increasing firms' capacity to innovate and export).

The WB is also active in Georgia through the International Finance Corporation (IFC), which finances and provides advice for private sector projects.[28] Georgia became an IFC member and shareholder in 1995. As of December 31, 2016, the IFC has provided around USD 1.64 billion in long-term financing, of which USD 774 million was mobilized from partners, in 59 projects in financial services, agribusiness, manufacturing, and infrastructure. In addition, IFC has supported more than USD 331 million in trade through its trade finance programme, and implemented a number of advisory projects focused on developing the private sector. As part of the World Bank Group Country Partnership Strategy for Georgia, IFC works to increase access to finance for Micro, Small & Medium Enterprises (MSMEs), promote sustainable private sector-driven growth through increased trade and competitiveness, develop Georgia's significant renewable energy potential, support improvements in productivity for agricultural processing and food safety, and foster the development of public-private partnerships. IFC has also provided assistance in the health care reforms by providing finance for hospitals.[29]

Other donors

- The Asian Development Bank (ADB) has been supporting Georgia's development since 2007. The key development priorities of ADB in Georgia are to foster inclusive and sustainable economic growth, accelerate poverty reduction, and enhance regional connectivity. Priority sectors include transport, water supply and sanitation, energy, public sector management, and finance.[30] In October 2016, Georgia became the 11th member of the Central Asia Regional Economic Cooperation (CAREC). Approved sovereign loans to Georgia total around USD 1.8 billion: USD 900 million from the concessional Asian Development Fund (ADF) and USD 885 million from ordinary capital resources (OCR). In January 2017, Georgia graduated from concessional ADF resources, as it is now classified as a middle-income country. However, Georgia is still eligible for the regular OCR lending, of which the indicative resources available for 2017- 2019 amount to USD 600 million. The ADB also provides direct

[26] See https://www.imf.org/en/Publications/CR/Issues/2018/12/19/Georgia-Third-Review-Under-the-Extended-Fund-Facility-Arrangement-Press-Release-Staff-Report-46484.

[27] See http://www.worldbank.org/en/news/feature/2017/08/24/world-bank-georgia-25-years-of-partnership.

[28] See https://www.ifc.org/wps/wcm/connect/region__ext_content/ifc_external_corporate_site/europe+and+central+asia/resources/ifc+in+georgia+fact+sheet.

[29] See https://www.ifc.org/wps/wcm/connect/news_ext_content/ifc_external_corporate_site/news+and+events/news/impact-stories/georgia-health-care-system-overcomes-growing-pains.

[30] See https://www.adb.org/countries/georgia/main.

financial assistance to the non-sovereign public sector and the private sector in Georgia. Non-sovereign ADB loans to Georgia total USD 330 million;

- The European Bank for Reconstruction and Development (EBRD) has invested more than EUR 3 billion in more than 200 projects Georgia between 1994 and 2017.[31] The Bank primarily focuses on the following areas: (1) supporting private competitiveness; (2) deepening financial intermediation and developing local currency and capital markets; (3) expanding markets through inter-regional connectivity; (4) renewable energy, resource efficiency and climate change adaptation. According to its new strategy in Georgia for 2017-2021, the EBRD will continue supporting private sector development through innovation, enhanced value added and convergence with DCFTA standards and obligations; financial sector development through deepening of financial intermediation as well as local currency and capital markets; inter-regional connectivity, notably through investments under PPPs; and renewable energy, resource efficiency, sustainable agriculture and tourism, as well as the climate change adaptation;
- The European Investment Bank (EIB) has been active in Georgia since 2010 and has provided to the country more than EUR 1550 million of loans. Mandated by the EU, the EIB is funding infrastructure projects, the development of the local private sector and climate action investments.[32] In the past 10 years, 21 operations in a wide range of sectors of the economy have been supported. For instance, the EIB is funding several sections of an East-West highway that will connect Georgia's border with Azerbaijan in the east with Batumi on the Black Sea. The latest section of the highway is funded with a EUR 49.5 million loan signed in February 2016. The EIB also finalised a EUR 100 million deal in October 2015 to rehabilitate the waste-water network and construct a new waste-water treatment plant in Kutaisi. Following the signature of the AA and the DFCTA between Georgia and the EU, the EIB stepped up its support and effectively doubled its lending portfolio in the country;
- The U.S. Agency for International Development (USAID) mission to Georgia opened in 1992. Since then Georgia have received assistance amounting to more than USD 1.8 billion supporting economic growth, democratic institutions, health and education. USAID continues to dedicate its resources to new programs in Georgia aimed at achieving its major development objectives: democratic checks and balances, inclusive and sustainable growth, healthy society. In present, the largest USAID supported activities in Georgia are ZRDA Activity, Promoting Rule of Law in Georgia (USD 3.5 million) and Restoring Efficiency in Agriculture Production (USD 3.5 million). ZRDA activity supports with USD 4.2 million projects to strengthen the skills, productivity, and networks of local actors to contribute to broad-based economic growth and strengthened resilience in target communities. USAID works also on public procurement and assists the SPA in training corporate officials;
- The Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH has been working in Georgia since 1992. On behalf of the German Federal Ministry for Economic Cooperation and Development (BMZ), GIZ has distributed USD 455,000 to support Georgia in the following priority areas: sustainable economic development; democracy, civil society and public administration; environmental policy, conservation and sustainable use of natural resources;
- The World Health Organisation (WHO) is providing assistance in carrying out regular health and well-being reviews and surveys,[33] advice on vaccination rates and the selective contracting process for hospitals in Georgia.

31 See https://www.ebrd.com/georgia.html.

32 See http://www.eib.org/infocentre/publications/all/supporting-georgia.htm.

33 See http://www.euro.who.int/en/countries/georgia/publications/georgia.-profile-on-health-and-well-being-2017; and http://www.euro.who.int/en/countries/georgia/publications/georgia-hit-2017.

2.2 Timeline and milestones of the MFA 2 operation

At the International Donors' Conference in October 2008, the EU pledged two MFAs for Georgia of EUR 46 million each. The first MFA was implemented in 2009-2010 in the form of grants. In view of the continuing residual external financing need, the Georgian Minister of Finance requested the activation of the second part of the Commission pledge in May 2010. The EC proposed the assistance package for Georgia in January 2011, and the European Parliament and the Council adopted it on 12 August 2013 (Decision 778/2013/EU). Delay in the adoption was related to the blockage between the European Parliament and the Council on procedural issues regarding the Commission proposal for a MFA Framework Regulation. Due to these difficult negotiations on a draft Framework Regulation on MFA, the Commission proposal for MFA to Georgia was taken "hostage" by the co-legislators and only when the blockage on the parallel negotiations on the MFA Framework Regulation was solved through the withdrawal of the Commission proposal, the co-legislators could adopt Decision No 778/2013/EU providing MFA to Georgia. However, this decision could only be adopted in a conciliation procedure in third reading within the ordinary legislative procedure, which is very rare in the EU.

Table 2.1 Timeline of the MFA operations to Georgia

Date	Operation	Action
October 2008	-	EU pledges two MFA operations for Georgia at the International Donors' Conference
November 2009	MFA 1	Council approves MFA 1 operation
December 2009 – August 2010		Implementation of MFA 1 operation
May 2010	MFA 2	Official request for MFA 2
January 2011		EC adopted the Proposal and submitted it to the Parliament and the Council
August 2013		European Parliament and the Council adopted the Proposal
January 2015 – April 2017		Implementation of MFA 2 operation
June 2017	MFA 3	Official request for MFA 2
September 2017		EC adopted the Proposal and submitted it to the Parliament and the Council
April 2018		European Parliament and the Council adopted the Proposal
December 2018		Implementation started by the disbursement of the 1st instalment

Besides the delay in the adoption of the Proposal, as of end 2010 until July 2014 Georgia did not have a disbursing IMF support programme, as Georgia authorities treated the ongoing IMF programmes (both the SBA approved in 2008 and the SBA/SCF approved in April 2012) as precautionary and did not use it. As the MFA operation is complementary to a disbursing IMF programme, the precautionary treatment of the IMF programmes prevented the activation of MFA 2. The IMF eventually approved a new SBA in July 2014 allowing the EC to start the negotiations on the Memorandum of Understanding (MoU). The MoU, the Loan Facility Agreement (LFA) and the grant agreement were signed on 11th December 2014 and, where necessary, ratified by the Georgian Parliament (see detailed timeline in Annex VIII).

The first instalment of the MFA 2 was disbursed in two tranches. Firstly, the EUR 13 million grant component was disbursed in January 2015. Secondly, in April 2015, the EUR 10 million loan component was released (with a delay, which allowed the EU to obtain more favourable financing conditions for Georgia). The disbursement of the second instalment, foreseen for 2015, was delayed because of the lack of Georgia's progress in the implementation of the IMF programme. Only after the approval by the IMF Executive Board of a new EEF loan to Georgia in April 2017 the EC decided to proceed with the disbursement of the second MFA 2 instalment (EUR 10 million in grants and EUR 13 million in loans). The last tranche of the MFA 2 was disbursed in April 2017.[34]

Continuing to face external weaknesses, the Georgian authorities requested a complementary MFA from the EC in June 2017. The proposal of a third MFA in the amount of EUR 45 million MFA was adopted in April 2018[35] and the EC signed the MoU with Georgia in August 2018.[36] The EC has disbursed the first instalment (EUR 15 million loan and EUR 5 million grant component) to Georgia in December 2018.

Form

The EU's macro-financial assistance should be an exceptional instrument for balance of payments (BOP) support, aiming at help to restore a sustainable external financial situation. It should complement the programmes and resources provided by the IMF and the WB. In general, MFA takes the form of loans or grants, or their combination, depending on the country-specific context. The EC borrows the necessary funds in capital markets under preferential rates and on-lends them to the beneficiary country under similarly preferential rates. Grants are financed by the EU budget. Therefore, MFA represents a source of external financing on highly preferential terms. In the case of Georgia, the MFA 1 (EUR 46 million) was disbursed in grants during 2009-2010, while the MFA 2 operation (subject to this evaluation) took the form of both grants (EUR 23 million) and loans (EUR 23 million) disbursed during 2015-2017. In the MFA 3 operation, the grant component (EUR 10 million) is lower relative to the loan component (EUR 35 million).[37]

Conditionality

The MFA is one of the key instruments at the discretion of the EU to provide visible support with conditionality attached, but at the same time it is flexible as the beneficiary country is free to use the funds as it sees fit under the broader conditionality set out by the reform programme. As MFA is complementary and conditional on IMF funding and is smaller in scale, the marginal impact of MFA *per se* is often not clear and needs to be assessed as a part of the overall progress of reform and macroeconomic stabilisation.

As a general conditionality, MFA is extended to countries that satisfy criteria for the respect for human rights and effective democratic mechanisms.[38] In this context, Georgia should commit itself to values shared with the Union and to respect effective democratic mechanisms. It should also strengthen the efficiency, transparency and accountability of the public finance system and promote structural reforms, including those stipulated in the AA/DCFTA.[39] MFA funding is disbursed in instalments, each conditional on the successful implementation of reform measures aimed at returning the beneficiary country's economy to a long-term sustainable path.

Specific conditions are determined in the MoU. The disbursement of the assistance was conditional upon a satisfactory track record in the implementation of the non-precautionary IMF arrangement and a positive assessment by the EC of progress made with respect to economic stabilisation and structural reforms. The MoU outlines a range of specific policy benchmarks against which progress is to be evaluated (see the detailed introduction of the structural reform criteria in section 5.3). The MFA should also support

34 See Brussels, 4.1.2018; COM(2017) 559 final/2, 2017/242 (COD).
35 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32018D0598.
36 See https://ec.europa.eu/info/sites/info/files/economy-finance/signed_mou_final.pdf.
37 See https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1538745520540&uri=CELEX:32018D0598.
38 This is also relevant to Georgia. For instance, in February 2018 the European Parliament called on Georgia to fully respect effective democratic mechanisms, including a multi-party parliamentary system exercising effective oversight over the executive, a strict separation of powers and a clear separation between politics and economic interests, a free, independent and pluralistic media with transparent media ownership, and the rule of law which should be supported by an independent judiciary capable of effectively fighting against corruption, and which guarantees respect for human rights, including freedom of expression and international social and environmental standards.
39 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A22014A0830%2802%29.

measures related to the implementation of the AA, including the DCFTA. The fulfilment of the conditionality should be regularly monitored. If conditions are not met or if the aims and principles of the AA are generally disregarded, the EC should suspend or cancel the disbursement of the MFA.[40]

Regarding the applicability of the political pre-conditions for MFA, according to established practice in line with the so-called Genval criteria of the ECOFIN Council Conclusions of 8 November 2002, the EC disbursed MFA in the understanding that the political pre-conditions are fulfilled by Georgia. The full disbursement of both instalments of the MFA after review has indicated that (i) the EC has been satisfied with the progress made along the lines of reforms prior to the second instalment and (ii) the financing needs of Georgia have not decreased and the second instalment was therefore necessary.

Amount of the MFA 2 operation

In purely monetary terms, the MFA 2 operation represented just a fraction of the total financial assistance provided to Georgia. The MFA 2 operation amounted to EUR 46 million. This amounts to about 11 percent compared with resources provided by the Union's ENI instrument (EUR 335-410 million) during the period 2014-2017, and to about 30 percent of the SBA credit provided by the IMF in the same period. Compared to other assistance totalling some USD 7.6 billion provided by other IFIs and bilateral credits to Georgia (WB, IFC, ADB, EBRD and EIB), the MFA 2 represents just a tiny fraction (0.6 percent) of the overall financial assistance.

40 Ex ante evaluation of macro-financial assistance to Georgia was published in January 2011 –: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52010SC1617&from=EN.

Chapter 3 Evaluation questions

This chapter presents the main evaluation questions matched to the evaluation criteria, i.e. the backbone of our analysis.

The ex-post evaluation of MFA 2 to Georgia has addressed the following main evaluation questions:

Table 3.1 Main evaluation questions matched to the evaluation criteria

Evaluation questions	Evaluation criteria
EQ1. To what extent was the MFA operation design (including adequateness of financing envelope, focus of conditionality) appropriate in relation to the objectives to be achieved?	Relevance
EQ2. To what extent have the objectives of the MFA operation been achieved? This question considers the global picture (macroeconomic developments, fiscal policy, structural reforms, other sector reforms, etc.) to determine what have been the quantitative and qualitative effects. It also assess to what extent the operation contributed to achieving its specific objectives outlined in the Directive and Memorandum of Understanding.	Effectiveness
EQ3. In what way has the design of the MFA assistance conditioned the performance of the operation in respect to its cost and its objectives? Was the disbursement of the financial assistance appropriate in the context of the prevailing economic and financial conditions in the beneficiary country? To what extent did the MFA operation design enable the intervention to be carried out efficiently?	Efficiency
EQ4. What was the rationale for an intervention at EU level? To what extent did the MFA operation add value compared to other interventions by other international donors? This question aims to assess the EU added-value of the intervention.	EU added- value
EQ5. To what extent was the MFA operation in line with key principles, objectives and measures taken in other EU external actions towards Georgia? This question aims to assess the coherence of the intervention with other EU policies.	Coherence
EQ6. What was the social impact of the MFA operation? Analysis of social impact of the MFA operation (more specifically in relation to the policy measures included in the MoU relating to the social sector and by including social variables in the analysis), including in combination with IMF programme measures.	Social policy
EQ7. What was the impact of the MFA operation on public debt sustainability? Analysis of the impact of the MFA operation (also in combination with the IMF programme) on the debt sustainability of the country, by drawing on the IMF's DSAs.	Debt sustainability

Please note that in addition to the main generic evaluation questions on relevance, effectiveness, efficiency, added-value and coherence, the TOR required to further elaborate on two aspects:

- The social impact of the MFA operation, in combination with the IMF programme measures; and
- The impact of the MFA operation on the public debt sustainability of the country, also in combination with the IMF programme.

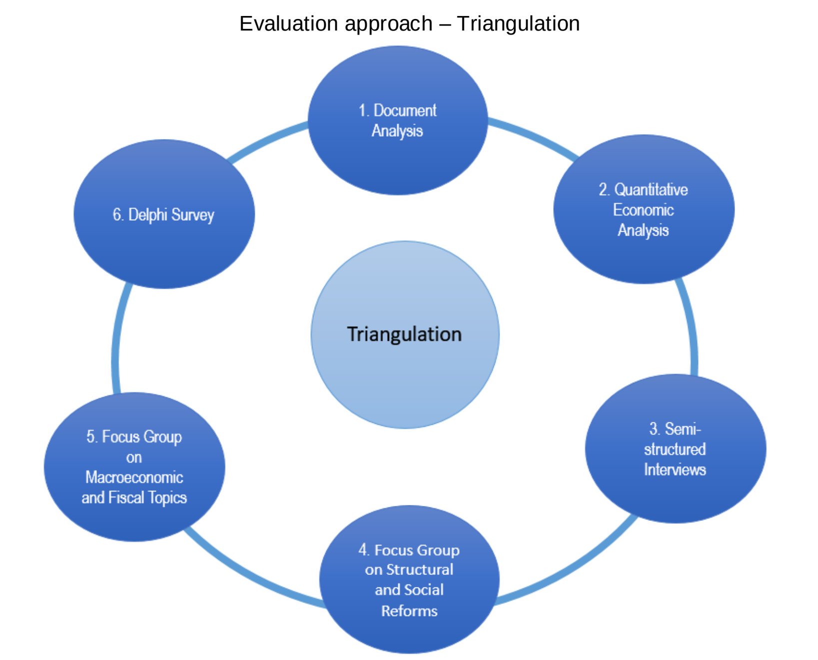
We included the analysis of these two issues in EQ6 and EQ7, and added sub-questions to address them. The sub-questions related to the questions above and the answers are presented in Chapter 6.

Chapter 4 Evaluation methods

This chapter presents the selected evaluation methods used in throughout the analysis. The evaluation consisted of four phases as stated in the ToR: the inception phase, the data collection phase, the analysis phase and a finalization phase. The work commenced in September 2018, including a desk research segment. Data collection was completed during the inception phase, and it covered the period from 2010 to 2017, however in some cases the timeframe of the exercise was broadened further to include the most recent data for 2018.

The following graph presents the techniques that are used in carrying out this evaluation. The parallel use of several tools and different information sources allow the findings to be triangulated:

Figure 4.1 Evaluation techniques



Triangulation of findings from different evaluation methods:

a. Desk research:
   - Document analysis;
   - Quantitative analysis.
b. Semi-structured interviews;
c. Two focus groups:
   - Structural and Social Reforms;
   - Macroeconomic, fiscal and financial sector.
d. Delphi survey to key experts.

Triangulation of findings from different evaluation methods is expected to increase the internal and external validity of results. The application of these tools is closely linked to the Consultation Strategy, which is presented in Annex I.

4.1 Desk research: Literature review, and document analysis[41]

The main data sources we used are the Decision of the European Parliament and the Council on the MFA 2, the MoU, the Staff Working Document (SWD) of the Directorate-General for Economic and Financial Affairs (DG ECFIN), the reports on the implementation of MFA and internal files of DG ECFIN. In addition, we used documentation on the IMF support programmes, Reports of the World Bank, the WHO and the UNICEF, as well as relevant analysis of research institutes. With regard to cross conditionality, we also assessed DPLs of the World Bank and the Financing Agreements of the EU Budget support programmes and other documents (e.g. Association Agreement).

[41] See a detailed lis of the key MFA documents reviewed in Annex I.

4.2 Quantitative analysis

Quantitative economic analysis is an integral part of the MFA evaluation. It appears most prominently in the following parts of the evaluation report:

- Chapter 5 (State of play in core areas of interest) covers the fact-finding and describes developments in the area of the external financial situation (5.1), the fiscal situation (5.2) and the social developments (5.4). These subchapters include the descriptive parts of the quantitative analysis by laying out stylized facts, presenting statistical evidence and analysing country-specific developments in the areas mentioned above. They examine, among other things, the developments of GDP, BoP, exchanges rates and fiscal balances, as requested by the ToR;
- Chapter 6 (Answers to the evaluation questions) includes the analytical parts of the quantitative methods. Quantitative analysis is used in addressing the following evaluation questions:
  - EQ2. (Effectiveness of the MFA operation) covers the analysis of macroeconomic conditions (including the developments of output), with a focus on the BOP, the external debt, the exchange rate, and the process of fiscal consolidation;
  - EQ6 (Social impact of the MFA operation) analyses the impact of the MFA operation (in combination with the IMF programme) on the evolution of the social and labour market indicators;
  - EQ7 (Impact of the MFA operation on public debt sustainability) contains our analysis of public debt sustainability and aims to quantify the impact of the MFA operation (also in combination of the IMF programme) on the evolution of the public debt-to-GDP ratio in the medium to longer term. This chapter contains the calculations of the fiscal savings related to the concessional terms of the MFA assistance compared to market-based alternatives as well.

Data collection and descriptive quantitative analysis

The quality and coverage of economic data for Georgia is acceptable, comparable to its regional peers and to countries with similar level of development. We collected statistical data from the NBG, the National Statistics Office of Georgia (GEOSTAT), the MoF and other relevant ministries, as well as from the IMF and the WB. Evaluation work included the analysis of: the dynamics of macroeconomic fundamentals; fiscal indicators; external sustainability variables; financial sector variables; and structural reforms (dynamics of variables measuring institutional development – control of corruption, rule of law, government effectiveness and others, as well as qualitative assessment of the reform implementation progress, including the criteria outlined in the MoU).

Debt sustainability analysis

In addition to the use of descriptive quantitative analysis and in line with the ToR, we use a structured macroeconomic tool developed by the IMF[42], in particular with regards to the external and fiscal sustainability analysis. External and public debt sustainability are two interrelated concepts, where we analyse the trajectory of the external and public debt-to-GDP ratios, both under a baseline scenario and alternative scenarios exploring the hypothetical cases of no intervention from IMF, EU or both.

No counterfactual macroeconomic modelling is used to determine the path of the external or the public debt under the alternative scenarios. The use of a small-scale macroeconomic model is confined to providing consistent macro inputs to the DSA. The methodology of the DSA is based on the experience of our previous assignment (Ex-post Evaluation of the Macro-Financial Assistance to Jordan, 2017), and, the analytical tools are presented in detail in the Annexes.

[42] To assess medium to longer-term macroeconomic and fiscal vulnerabilities, the IMF has developed a framework for external and public DSA for emerging market economies such as Georgia. The assessment of external debt sustainability continues to be anchored by the IMF's framework introduced in June 2002, while the guidance on the implementation of the public debt framework was introduced in May 2013.

Quantification of the fiscal savings

An important part of the quantitative analysis is quantification of fiscal savings related to the highly concessional terms of the MFA operation compared to market-based alternatives, which pertains both to the grant and the loan components of the operation. This exercise calculates the net present value of the MFA package (based on realistic assumptions about the yield curve for market-based bonds) and compares this to the face value of the MFA programme. The difference between the two values provides a fair assessment of the savings related to the MFA operation, and helps to quantify both the efficiency of the operation and the contribution of the operation to the sustainability of public debt.

4.3 Qualitative analysis[43]

Semi-structured interviews

Our objective with the semi-structured interviews was to extract information on the MFA design and implementation; its results on the macroeconomic and fiscal situation and in the fields of the structural reform conditions, as well as on the social impact and on debt sustainability.

Interviews were confidential and anonymously reported to achieve the best result. We carried out interviews with those stakeholders in particular, who are well aware of the MFA instrument and its implementation:

1. Georgian authorities: the officials who were involved in preparing and implementing the MoU;
2. IFIs: the IMF and the WB. They are key stakeholders since they were to some extent involved in the preparation and implementation of the MFA. In addition, we targeted other main donors to get an outside opinion on the coherence of the MFA operation. Besides higher-ranking officials, we interviewed officials who operate in the background but actually prepare, draft and analyse the relevant agreements, reports and other documents. Interviews were confidential and anonymously reported to achieve the best result.

Our experience was that pre-interview questionnaires improve the quality of the interviews. During the inception phase of the evaluation, the evaluators drew up different questionnaires, whose target audience are the representatives of:

- EC (Brussels and delegation);
- IFIs and other donors (IMF, WB, USAID, GIZ, other donors);
- Georgia beneficiary authorities (NBG, MoF, MoESD, etc.);
- External actors (for example, experts from economic research institutes).

Over the evaluation period, we have done 37 interviews with more than 65 interviewees in total. We conducted a teleconference interview with the IMF mission chief of Georgia and interviewed IMF and WB experts in Tbilisi. As for other donors, we interviewed the representatives of the USAID, the WHO and the German Development Agency, GIZ as well.

The Delphi technique

The Delphi method is essentially a forecasting methodology relying on the views expressed by a panel of experts familiar with the matter at hand. The method is inherently iterative: experts are interviewed on the basis of a structured questionnaire and results are then circulated, inviting panel members to reconsider their position in the light of other respondents' opinions. Through this process, the variance of answers is normally reduced and consensus among the experts established.

43 For a detailed introduction of the stakeholder consultation strategy please consult Annex I.

We applied a light version of the Delphi method with the objective of gaining insight into the value added of the MFA operation. For more information on Delphi, please refer to the Consultation Strategy (Annex I). The Delphi questionnaire is added in Annex IV, while the list of the invited respondents is presented in Annex V.

Focus groups

Two focus group sessions were organised in Tbilisi with a distinct focus. The first session covered structural and social reforms in Georgia, and on the relevance of the MFA conditions, the reforms in public financial management, health care as well as in the area of trade and competition. The participants were Parliamentarians, academics and non-governmental organisations (NGOs). The second session focused on macroeconomic and fiscal developments, including topics like Georgia's financing needs, debt sustainability as well as on the financial sector conditions. Our target group in this case were mostly officials from banks and financial institutions. See the list of participants in Annex I.

4.4 Risks and limitations of the exercise

During the evaluation process, we identified the following limitations and risks of the exercise:

- While the general data coverage is relatively good we have to face data limitation in certain areas of interest (e.g. health care quality and efficiency, and social indicators in general);
- Furthermore, the budgetary statistics are not harmonised with the international standards. The MoF publishes several budget deficit indicators with different content without sufficient explanation on the differences in the methodology. IFIs and Georgian authorities use varying deficit indicators;
- The fact that relatively short time has passed since the full implementation of the MFA operation (i.e. May 2017) provides challenges in terms of impact measurement;
- Furthermore, the rapidly changing external environment and the fact that the MFA was provided in parallel with a SBA and an EFF from the IMF and other international financing instruments encumbered the disentangling of the different factors behind the developments and the impact of the EU intervention;
- The evaluation is further complicated by the fact that the implementation of the MFA operation was delayed significantly by the lack of a non-precautionary IMF agreement and the parallel procedural disagreements between the EU Parliament and the Council. Further interruption was caused by the fact that the IMF SBA agreement approved in 2014 went off track. Due to these hold-ups the implementation and the inception phase of the MFA 2 operation took place in very different macroeconomic and political circumstances;
- Furthermore, the domestic political situation heavily affected the implementation of the financial support programmes;
- Finally, the fact that the MFA 2 decision-making process was launched in early 2011 also presents challenges due to the lack of longer time series data on certain fields and methodological changes/structural breaks in certain time series. This makes our work more complicated and may require relying on estimates provided by external sources, particular those of the IMF.

With regards to the reliability of the information obtained from the different evaluation approaches, we have to note that the necessary broadening of the Delphi panel might have resulted in the inclusion of a number of participants with a less comprehensive or detailed knowledge of the MFA operation. This is reflected of the relatively high proportion of "no opinion" answers.

In our assessment, the identified risks and limitations, as well as the use of assumptions in the different scenarios and the related risks have not drawn into question the overall robustness and reliability of our analysis. Accordingly, the conclusions made on the aforementioned challenging fields can be considered valid.

Chapter 5 State of play in the core areas of interest

This section describes and summarises main developments up to the most recent phases in the core areas of interest: external financial situation, fiscal policy, structural conditions and social impact.

5.1 The external financial situation in Georgia

One of the common objectives of Georgia's financial assistance programmes was to help return the country's external financial position to a sustainable path. The country was hit by a series of severe shocks in the period of 2006-2015, which exerted heavy pressure on the country's external balances. These conditions were in fact of key importance to receiving MFA 1 and 2 from the EU as well as the SBAs and the EEF of the IMF. In order to have a better understanding of the country's background, this section describes the developments in Georgia's external financial position.

Firstly, we describe the circumstances, which led to a build-up of external imbalances, in the form of significant current account deficits. Secondly, we examine the development of the external financing with a focus on foreign direct investment (FDI) and discuss the changes of FX reserves. We also elaborate on how these developments have impacted or interacted with the changes in the country's risk premium and financing costs. Finally, we analyse the dynamics of the external debt and the net international investment position (NIIP) and assess FX reserve adequacy.

1. External financing need[44]

The net external borrowing[45] (flow) had been increasing rapidly in the period preceding the global financial crisis (exceeding 20 percent of GDP in net terms by 2008). The worsening of the external balances was mainly due to the continuous deterioration of the balance of trade and services (see Figure 5.1). Before 2006, this tendency was mainly rooted in intensive gross fixed asset accumulation, which was reflected both in import and GDP dynamics, as well as in the heavy FDI inflow (see Figure 5.4).

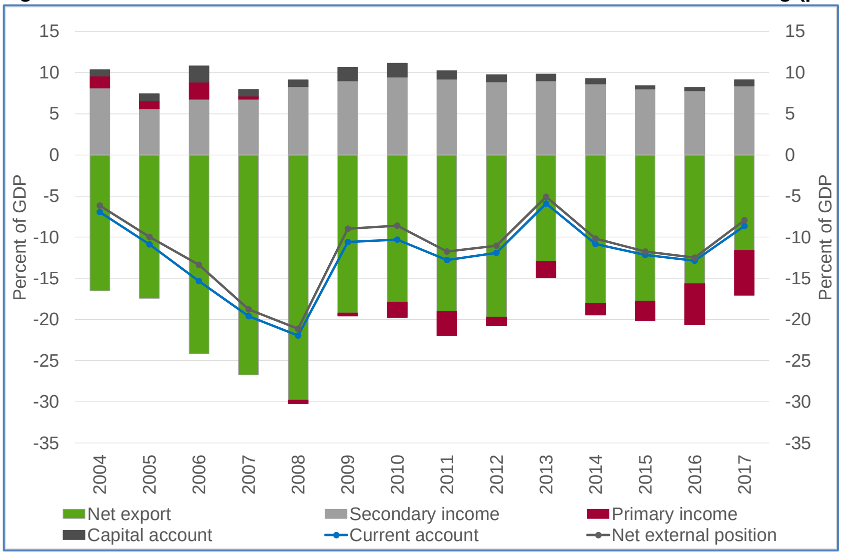
As of 2006, the worsening of the trade balance was primarily originated in the weakening export performance. In 2006, Russia imposed embargo on Georgian export. In 2008, the armed conflict with Russia and the global financial crisis hit heavily the country. Export demand has fallen sharply, while commodity prices have decreased, which was reflected in a sharp drop in export revenues. The global and regional crisis enforced an abrupt economic adjustment in Georgia. The sharp drop in domestic absorption decreased the import demand, leading to a 10 percentage points improvement in the net export from 2008 to 2009. Despite this remarkable improvement, the deficit remained at a very high level, hovering close to 10 percent of GDP in the period of 2009-2012.

After a temporary correction in 2013, the balance of trade and services deteriorated again on the back of the regional economic downturn. The region was hit hard by the spill-overs from the recession in Russia and economic sanctions, as well as falling commodity prices, which sent the regional currencies into deep depreciation. Slowdown in Russia and most CIS countries, sluggish growth in the EU, stagnation in Turkey accompanied with decreasing commodity prices and sharp appreciation of lari against regional currencies resulted in a severe contraction of Georgian exports in 2015 (Figure 5.2).

44 See 7.2 Case study for further details on external trade.

45 I.e. the sum of the current and the capital account balances.

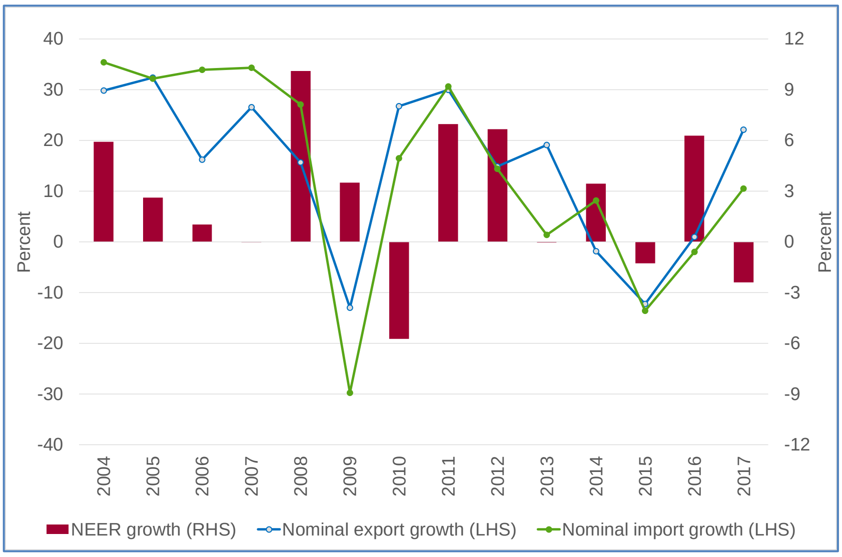
Figure 5.1 The structure of the current account and the net external borrowing (percent of GDP)



Source: NBG, own calculations.

The quick recovery of trade was supported by the re-opening of the Russian market to Georgian products; the country's accession to the EU's goods market (DFCTA); the revival of export markets and the accommodative monetary policy allowing the lari to depreciate in a significant extent (See section 2.1). On the back of these favourable developments, net exports position improved by more than 6 percentage points of GDP between 2014 and 2017. However, the long-standing problem of the high trade deficit is far from being solved (See Case study on trade policy in Annex VII).

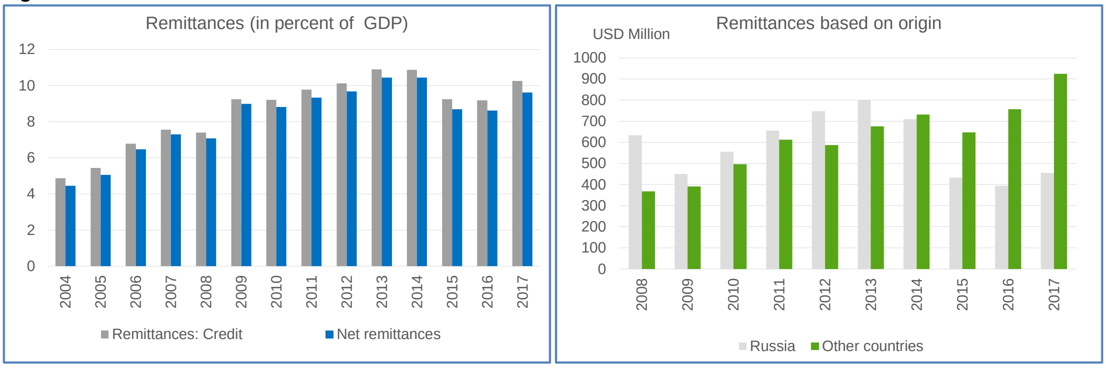
Figure 5.2 Export and import growth and change of nominal effective exchange rate (NEER)



Memo: Export and import of goods and services.
Source: NBG.

Besides the significant fluctuations of the net exports, the country's external position has been affected by the income balances, more specifically by the income flows related to debt, FDI and remittances. As a result of the rapid accumulation of external liabilities, the primary income balance – which had been positive until 2007 – has deteriorated and reached a deficit of 5.4 percent of GDP in 2017 (Figure 5.1).

Figure 5.3 Remittances



Source: NBG BoP statistics, Institute for Development of Freedom of Information (IDFI), Georgia.

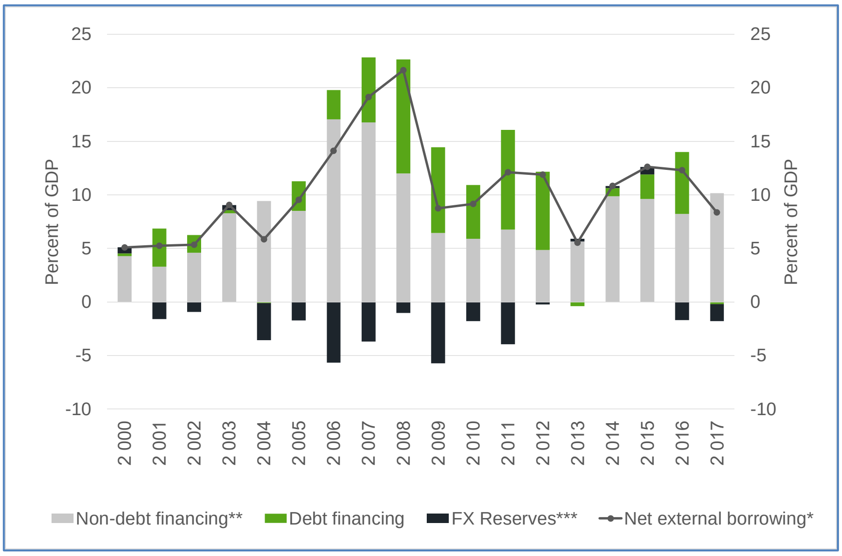
Workers remittances (i.e. the income transfers of migrants and short-term employees and other current and capital transfers mainly accounted in the BoP in the secondary income balance) had traditionally played an important role in Georgia's external balances and was a key source of household disposable income (Figure 5.3). Net remittances inflow exceeded 7 percent of GDP by 2007. As the largest diaspora of Georgian migrants is settled in Russia, the Russian economic developments has had significant effect on external balances through remittances as well. In 2008 and in the period of 2013-2016 remittances originated from Russia declined markedly. The decline in 2014-2015 was also reinforced by the depreciation of the lari against the Russian Rouble and other regional currencies. However starting from 2014 remittances sent from other countries increased rapidly as well (see Figure 5.3, right panel). Net inflow of remittances approached 10 percent of GDP by 2017, a level still below the one measured in 2013-2014. In 2017, a significant – but compared to the previous years decreasing – part of the remittances arrived from Russia (33 percent), while the shares of Italy, Greece, US, Israel and Turkey are also substantial.

2. Structure of external financing and the cost of financing

Before 2008, the main sources of external financing were FDI – fuelled partly by the privatisation process - and non-FDI (portfolio) equity flows, ensuring a healthy financing structure for the persistently high external borrowing need. The double crisis in 2008 changed dramatically the financing structure. The net external borrowing fell from a level above 20 percent to below 9 percent of GDP in barely one year. Despite this drop, the financing required a significant increase in debt borrowings (in foreign currency), as the non-debt, generating financing fell to close to 5 percent of GDP. The average yearly debt creating financing (including the financial support provided by IFIs and other donors) had reached 8 percent of GDP in the period 2008-2012. At the same time, a substantial part of the international financing support was used to replenish foreign exchange reserves (FX reserves).

While as of 2014 the weakening external environment put further pressure on the external position of the Georgian economy, the FDI inflows recovered, reaching a level of around 10 percent of GDP per year in 2014-2017. This helped to contain reliance on debt creating financing and hence to mitigate the negative impact on debt dynamics.

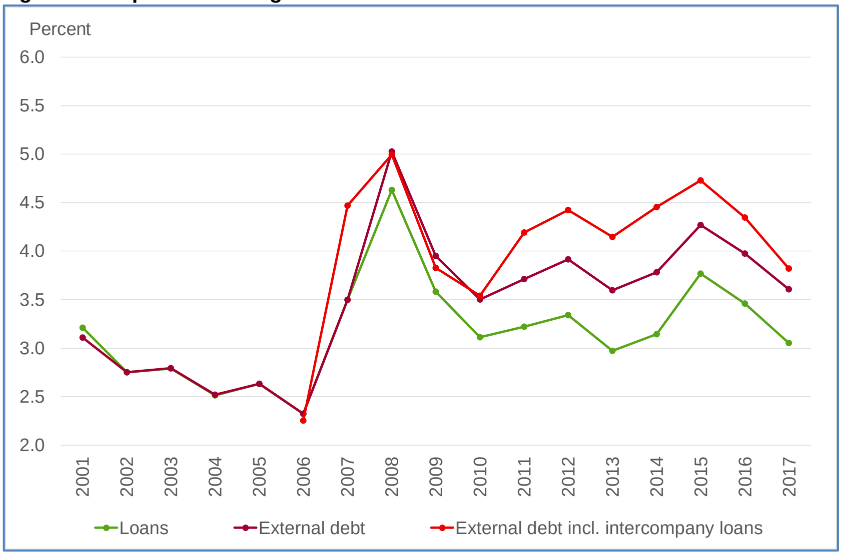
Figure 5.4 Structure of external financing (percent of GDP)



Source: NBG, Geostat.
Memo:* Balance of the financial account (sum of current and capital account, plus net errors and omissions). ** Includes FDI and portfolio equity investments. *** Net decrease of FX reserves.

Looking at the sectorial structure of inward FDI, despite the significant volatilities, some pattern can be observed in the period of 2007-2017. The FDI inflow to transportation, real estate and financial sectors has increased and over 2014-2017 these sectors accounted for more than 50 percent of the total FDI inflow on average. On the other hand, manufacturing and the energy sector proved to be less attractive for FDI as before. The increase in the share of FDI inflow to less import intensive sectors suggests that FDI financing can have a more significant overall positive impact on external financing.

Figure 5.5 Implicit financing costs of external liabilities

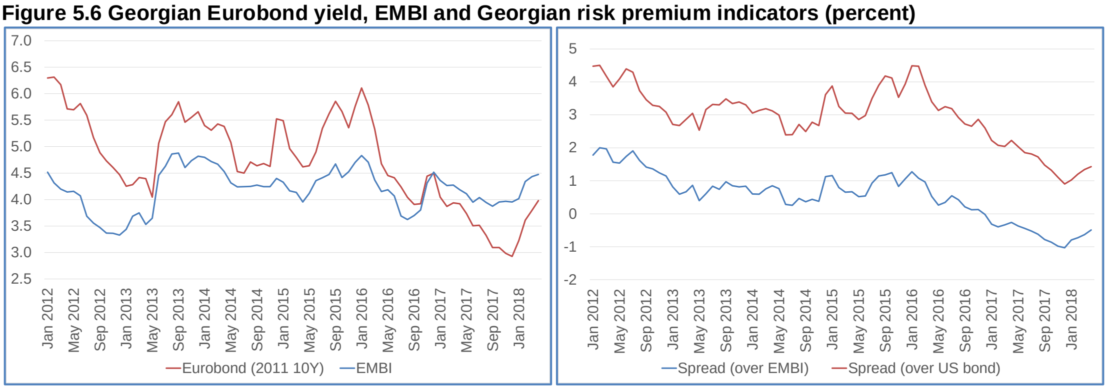


Memo: Implicit financing cost is calculated as the ratio of interest payment on debt liabilities to the stock of debt (without intercompany loans). It shows the average financing cost of the outstanding debt.
Source, NBG BoP statistics, own calculations.

The external financing situation as well as changes in global risk appetite affected the dynamics of external financing costs. Starting from 2006 the average cost of the outstanding external debt (implicit interest rate) increased dramatically and practically doubled by 2008. However, after the peak recorded in 2008, i.e. in the year of the double crisis, implicit financing costs decreased rapidly, and fluctuated between 3.5-4 percent until 2014. In 2014, the increasing Georgian risk premium as well as an increasing global risk aversion elevated the financing costs again. However, the implicit interest rate payed for the outstanding debt remained well below market rates in the whole period. Furthermore, average financing costs proved to be relatively resilient to the external premium shocks. These developments might reflect the dominant role of long-term concessional financing in external financing as well as the impact of international financial support programmes.

Risk premium increased in the wake of the regional economic downturn and deteriorating external position in 2014 (See Figure 5.6). However at the time of the approval of the IMF SBA (July 2014) risk premium indicators showed a distinct decline. In 2015 the deteriorating external situation accompanied with the fact that the IMF programme - and hence the MFA 2 as well - went off track resulted in a marked, more than 100 basis points increase in risk premium indicators. After the peak in the beginning of 2016, risk premium decreased steadily until the end of 2017, resulting in a 300-basis improvement in less than 2 years. This improvement can be in a part attributed to the change in government politics and the new EEF agreement with the IMF (see section 2.1) as well as the reactivation and successful termination of the MFA in 2017.

Figure 5.6 Georgian Eurobond yield, EMBI and Georgian risk premium indicators (percent)



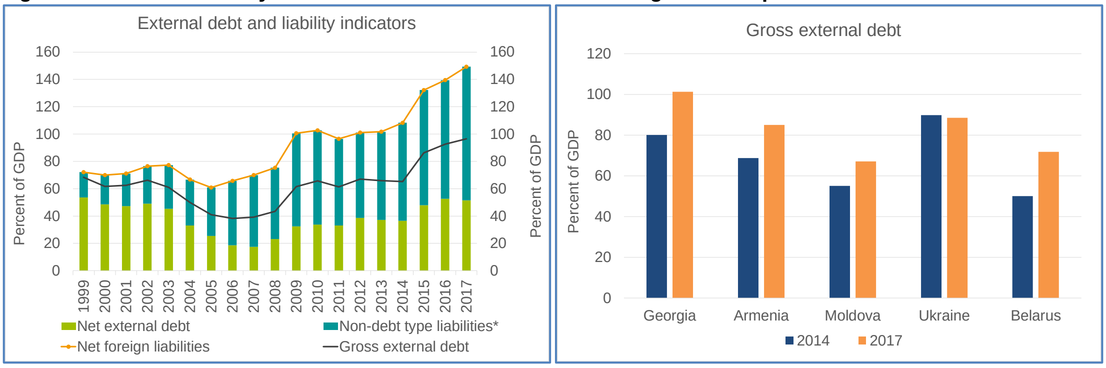
Note: Emerging Market Bond Index (EMBI) is a benchmark index for measuring the total return performance of international government bonds issued in foreign currency by emerging market countries that meet specific liquidity and structural requirements.
Source: Bloomberg.

3. External debt dynamics and FX reserve adequacy

Before 2008, the persistently high GDP growth and moderate debt inflows resulted in a substantial decrease of net and gross external debt ratios (Figure 5.7). In 2008-2009 net foreign liability and net external debt, ratios increased substantially, but stabilized afterwards around 100 and 35 percent of GDP, respectively. However, due to the high proportion of foreign exchange denominated financing, the sharp depreciation of lari in 2014-2016 was reflected in an increase of the external debt and liability ratios again. Net foreign liabilities approached 150 percent of GDP, while the gross external debt was close to 100 percent of GDP, signalling an accumulation of serious external balance sheet vulnerabilities (See Figure 5.7).

Since 2009, the ratio of public external debt has decreased continuously and by 2017, about 40 percent of the external debt was public, while about 20 percent of the external debt was related to the financial sector. Almost 90 percent of the external debt is foreign exchange denominated, which signals the presence of significant balance sheet mismatches in terms of exchange rate risks.

Figure 5.7 External liability indicators and the external debt in regional comparison

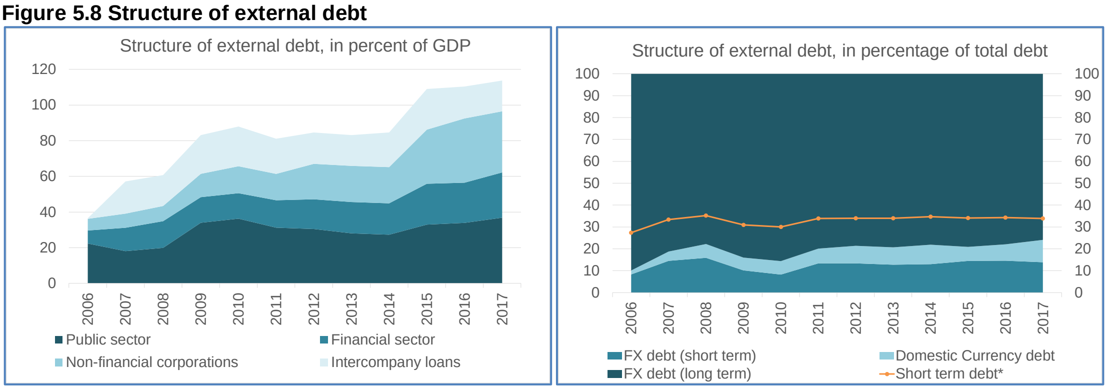


Source: NBG, Geostat, IMF.

Memo:* Net foreign direct investment including the intercompany loans and net portfolio equity.

As for the maturity structure of the external debt, the share of long term-debt at original maturity is above 80 percent. This mainly reflects the fact that both the public and the non-financial private sector have access to long-term financing. While the rollover risk is contained by the maturity, the high level of gross external debt suggest that the ratio of short-term debt at remaining maturity – an indicator which cannot be calculated based on the available data – compared to the total external debt has been between 30-40 percent of GDP in the period examined. Therefore, the external roll over need has exceeded 20 percent of GDP in 2012 and in 2017, it could be well above 30 percent.

Figure 5.8 Structure of external debt



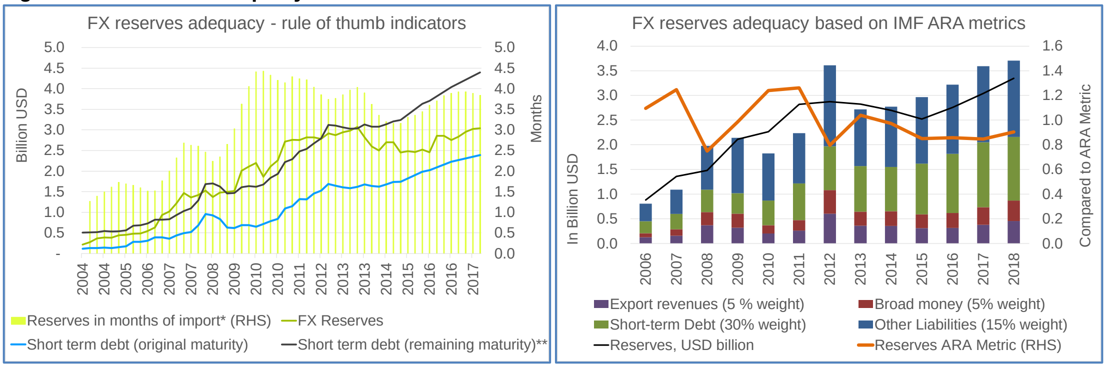
Memo: *Proportion of short term debt to total debt at remaining maturity calculated assuming an average 5 year maturity of the originally long term debt.

Source: NBG BoP statistics, own calculations.

Georgia entered into the global financial crisis with relatively low level of FX reserves. Despite the authorities' intentions to replenish it in the period of 2004-2007, the reserves covered neither the short-term external debt[46], nor the 3 months import bill in 2008 (Figure 5.9). As of 2009, the reserve adequacy has improved, reflecting the combined effects of the IMF programmes, the EU MFA, as well as the financial support from other international donors. However, in 2014-2015, FX reserves declined again, as the authorities were cushioning the depreciation of the lari in trying to strike the balance between the need for a structural adjustment of the exchange rate to regain competitiveness and the need to preserve the balance in heavily dollarized financial sector. As a result, the level of FX reserves (though still covering the 3 months import bill) has fallen below the estimated short term external debt (at remaining maturity).

[46] Short term debt at remaining maturity estimated as a sum of originally short term debt and the one-sixth of the originally long term debt, i.e. assuming 6 years average maturity of the originally long term debt.

Figure 5.9 Reserves adequacy based on rule of thumb indicators and IMF ARA metrics



Source: National Bank of Georgia, IMF.

Memo: *4 quarters moving average. ** Short term debt at remaining maturity estimated assuming 6 years average maturity of originally long-term debt.

FX reserve adequacy measure based on the IMF ARA metrics also suggests that reserves has been below the adequate level. ARA metrics defines a composite index for assessing reserve adequacy. The indicator sets the minimum level of necessary FX reserves using the rule of thumb indicators, which are taken into account with different weights depending on the characteristics (e.g. exchange rate regime, dollarization, etc.) of the given country. As a second step, the actual FX reserves level is compared to the minimum required level. IMF states that reserves level is adequate if this ratio is in the range of 1 and 1.5. In case of Georgia, the ratio has been constantly below 1 since 2013 (Figure 5.9).

Overall Georgia has accumulated significant external vulnerabilities in the period starting from 2006. The persistently high current account deficit resulted in a dynamic increase of net external liabilities. Furthermore, the global financial crisis and regional tensions had negatively impacted FDI inflow, increasing the reliance on debt financing in the period of 2008-2013. External indebtedness increased on account of the sharp depreciation of the lari in 2015-2016 as well. Thus, net external debt ratio has increased above 51 percent of GDP, while the gross debt-to-GDP ratio (without intercompany loans) approached 100 percent by 2017. Despite the fast growing indebtedness, the structure of external debt remained relatively favourable. The implicit financing costs remained at a fairly low level (compared to market based financing costs) and the ratio of long-term financing is above 80 percent. These characteristics can be partly attributed to the dominant role of concessional financing as well as the impact of international financial support. At the same time, the external roll over need of Georgia is estimated to reach 20 percent of GDP by 2012 and to increase above 30 percent by 2017. High roll over need, together with a large current account deficit indicates severe external vulnerability. Therefore, the financial support provided by the EU, IMF and other donors had an important role in external financing.

5.2 The fiscal situation in Georgia

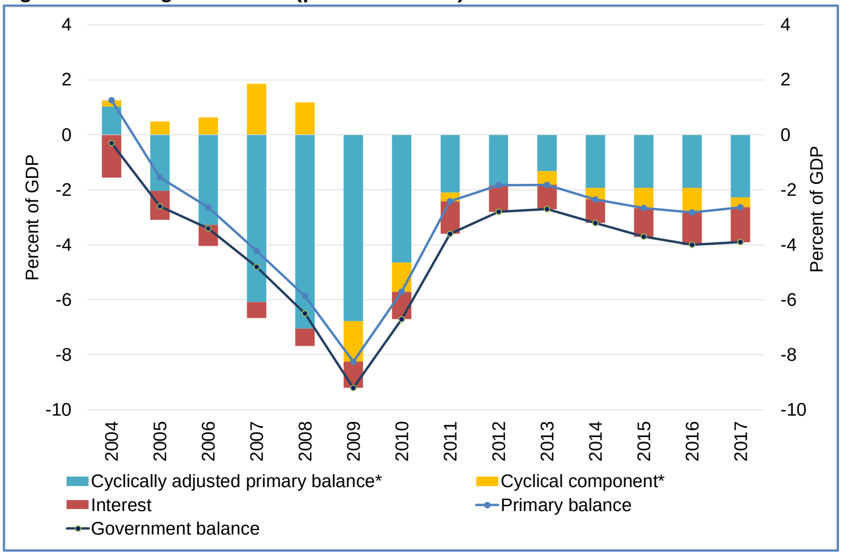
The fiscal situation of Georgia leading up to the MFA operation in 2014, as well as its later developments constitute a key area of interest in this evaluation. In fact, the deteriorating fiscal situation of the country was among the reasons why Georgia was eligible for support from the EU. In this section, we first analyse the developments of budget deficit[47] and describe how the budget's expenditure and revenues evolved. Finally, we describe the tendencies in deficit and debt financing as well as the dynamics of public debt. For a full assessment of how the MFA impacted, the fiscal situation of the country please also refer to Section 6.2., while our DSA is presented in Section 6.7.

[47] In our analysis, we used the "Budget deficit GFSM 1986" indicator published by the MoF (https://mof.ge/en/4555). While the MoF publishes four different budget balance indicators, we decided to use the GFSM 1986 statistic as this is the data used by the European Commission in its MFA related reports.

1. Government balances

Following the trade embargos introduced in 2006 and the double shocks of the armed conflict with Russia and the global financial crisis, the government had conducted a countercyclical fiscal policy, trying to mitigate the adverse external shocks with accommodative spending increases. After several years of surpluses, Georgia recorded a primary deficit of 5.6 percent of GDP in 2009, and the general government deficit reached 6.5 percent of GDP. The sharp deterioration in public balances was primarily due to the increase in expenditures on defence, but cyclical revenue loss was also sizable.

Figure 5.10 Budget balances (percent of GDP)



Source: MoF, Geostat, own calculations.

As of 2008, the government agreed with the IMF and started the fiscal consolidation. Thanks to the consolidation efforts and the rapid correction in growth, the deficit decreased to below 3 percent of GDP by 2012 (Figure 5.10). As of 2013, the deficit has started to increase moderately again on account of the cyclical downturn, the rise in social spending aiming to reduce poverty, and the increase of expenditures in various fiscal policy chapters (e.g. health care, defence, local government).

Fiscal policy decisions have been heavily influenced by the strict constraints on the revenue collection. As since 2008, Georgia does not collect social security contributions, total revenues generally remain below that of its peer countries – below 30 percent of GDP. In addition, Georgia has introduced a set of fiscal rules in the Economic Liberty Act (ELA) – adopted in 2011 and came into force in 2014 – in order to ensure sound fiscal policy and the sustainability of the public debt. Furthermore, fiscal policy was guided by the government's national development strategy "Georgia 2020"[48] and the Government Platform 2016-20[49]. The budget deficit, public debt and public spending were capped by the ELA, at 3 percent, 60 percent and 30 percent of GDP respectively.[50] The Georgia 2020 and the Government Platform set a stable debt-to-GDP ratio of about 40 percent as a medium to long term target.

The revenue rule is rather strict on revenue collection: any permanent increases in state taxes other than excises or administrative fees are subject to a referendum. As such, the state has to rely on improvements in the efficiency of revenue collection and sound debt management as the main tools solidifying the revenue base in the long-term. Authorities have started implementing a reform programme in 2016 to improve the efficiency of the tax administration and enhance revenue mobilisation.

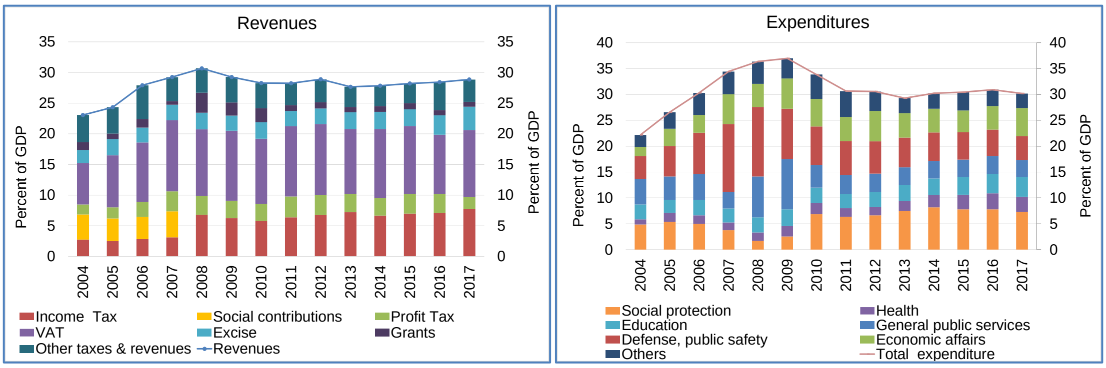
48 Government Ordinance No. 400 of June 17, 2014 on approving the Socio-economic Development Strategy of Georgia - "Georgia 2020" and Associated Activities.

49 New governments are required to present to the Parliament their platform for their parliamentary term. The Government Platform 2016-2020 was presented in November 2016.

50 2018 amendment of Organic Law on Economic Freedom abolished the 30 percent expenditure rule as of 2019.

Revenue collection relies mainly on taxes with flat tax rate. The most important form of revenue is the VAT: since 2008, around 38-40 percent of the revenues are originated from this source, while income taxes provide about the quarter of the public revenues (Figure 5.11). Due to the design of the revenue rule (i.e. only changes in excise taxes and fees are exempt from referendum), the role of excise revenues increased. The corporate tax reform introduced in 2016 also saw an increase in excise taxes in order to keep the reform revenue neutral. Besides taxes, grants also played a key role in government financing, particularly in the period of 2008-2010.

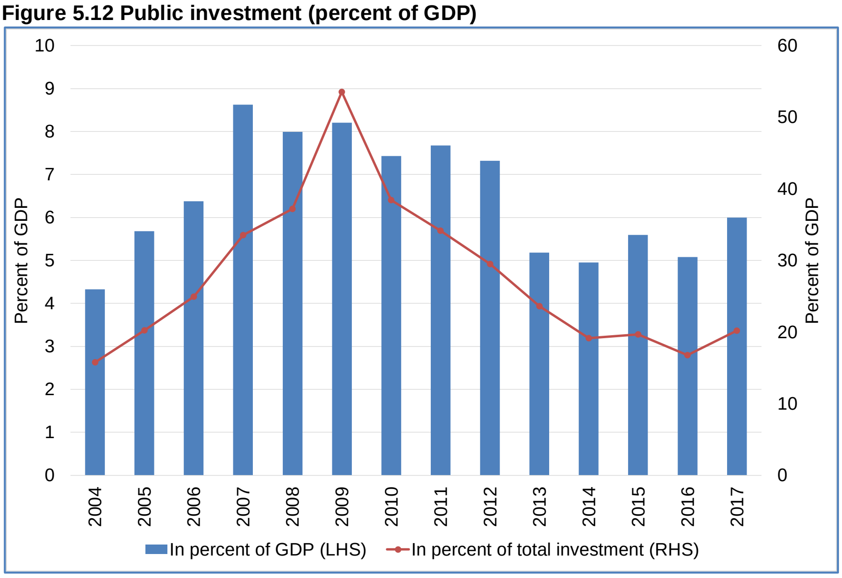
Figure 5.11 Structure and level of public revenues expenditures



Source: MoF, own calculations.

Given the low level of revenue flexibility, the government's fiscal policy relies on a periodic realignment of spending priorities as the main tool of conducing fiscal policy. From 2012 to 2017, government increased spending on social protection (at the start of the period one of the lowest in the region at around 7.5 percent of GDP), and partly financed it by redirecting spending from public infrastructure investments (Figure 5.12). However, the rapid increase of expenditures especially after the introduction of the Universal Health Care (UHC) Reform in 2013 had a marked impact on the public deficit as well.

Figure 5.12 Public investment (percent of GDP)



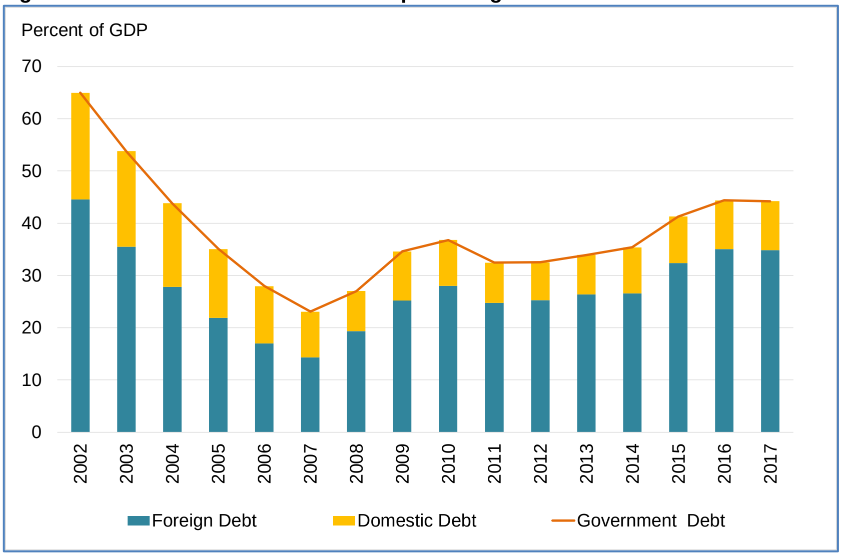
Source: Geostat, ADB database, own calculations.

Public investments increased to around 8 percent of GDP by 2007 and remained around this level until 2012 (Figure 5.12). In 2013, reflecting the changes in the priorities of fiscal policy, investment decreased to 5 percent of GDP. Increase in investment spending in 2017 reflects the changing priorities of the government outlined in its four-point reform programme. Regarding the structure of investments, about two-thirds of Georgia's public investment is devoted to economic infrastructure (e.g., roads, ports, electricity). Overall Georgia spends more on economic infrastructure and less on social infrastructure (e.g., schools, hospitals) than the average of emerging markets (EMEs)[51].

2. Public debt and financing costs

Until 2007, the dynamic output growth and primary surpluses had led to a rapid decline of public debt-to-GDP ratio. By 2007, the ratio approached 23 percent of GDP. The sharp decrease of public indebtedness had also been supported by the appreciation of the lari. Economic slowdown and increasing primary deficits resulted in a growing debt ratio in the period of 2008-2010, which stabilized around 33 percent of GDP. Despite budget deficits having been kept under control, the public debt ratio has started to increase again as of 2014, approaching 45 percent in recent years (Figure 5.13). Besides the impact of lower nominal GDP growth (near zero inflation and real growth deceleration discussed above), the debt dynamics mostly deteriorated due to the significant depreciation of the lari. The FX denominated debt has traditionally played a dominant role in the government financing, resulting in the accumulation of exchange rate mismatches in the public balance sheet.

Figure 5.13 Government debt ratio as a percentage of GDP

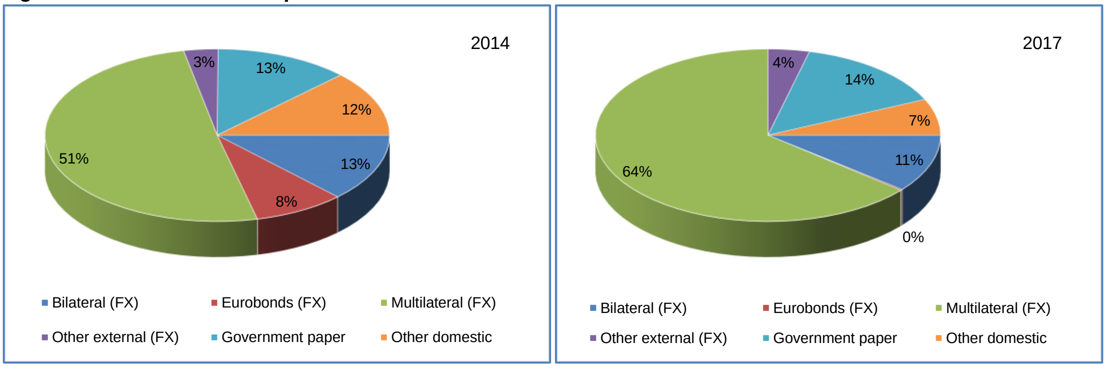


Source: MoF, Geostat.

As for the structure of the public debt, in 2014 about 50 percent of the outstanding debt was held by multilateral investors (17.9 percent of GDP), At that time, the most important multilateral creditors in terms of the amount were the IDA, ADB, IBRD, EIB and the IMF. 13 percent of the public debt was held by bilateral creditors, mainly Germany, Japan, Russia and France. Only about one fifth of the public debt was financed from the market, namely by Eurobonds and by domestic government papers (Figure 5.14).

51 See IMF (2018). Georgia Technical assistance report — public investment management assessment. Country Report No. 18/306. https://www.imf.org/en/Publications/CR/Issues/2018/11/07/Georgia-Technical-Assistance-Report-Public-Investment-Management-Assessment-46338.

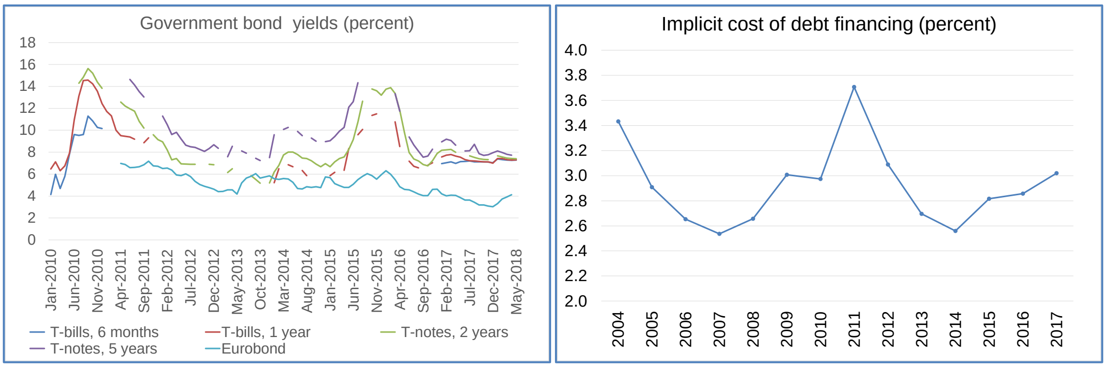
Figure 5.14 Structure of the public debt



Source: MoF, own calculations.

By 2017, about three-quarter of the outstanding debt was held by multilateral (64 percent) and bilateral creditors (the main creditors were Turkey, Azerbaijan, US, and France) and the proportion of market based financing decreased to below 15 percent of the outstanding debt.

Figure 5.15 Government bond yields and the implicit cost of public debt financing



Memo: Implicit cost of debt is the average interest rate of the outstanding debt calculated as the fraction of yearly interest payment to the outstanding debt.
Source: MoF, Bloomberg, own calculations.

Lari denominated government bond yields have performed significant swings in the period 2010-2017. After a sharp increase in 2010, yields decreased until mid-2013. In parallel with the economic slow-down in the region, domestic interest rates started to increase again, reaching their peak in the middle of 2014, at the time of the approval of the IMF SBA programme. The IMF/EU programme has visibly helped to restore market confidence as despite of the unfavourable regional and global developments, the domestic yields decreased by about 100 basis points by the beginning of 2015. In the second half of 2015 yields increased sharply – reaching levels around 12-14 percent - on the back of the political tensions, the depreciation of lari and its consequences, (i.e. increasing inflationary pressure, perceived exchange rate risk and debt ratios). However, a part of the spectacular, more than 500 basis point rise in yields could be attributed to the fact that the IMF programme - and hence the MFA operation as well – went off track. The consolidation of the bond yields started in the second quarter of 2016 and, afterwards, the interest rates stabilized around 7 percent. Eurobond interest rate remained well below the lari yields and has been much more stable in the same period. Still, Eurobond yields also showed a sizable increase in 2015, reaching a level of 6 percent at the peak. Since then, yield decreased steadily, reaching 3 percent by the end of 2017.

Due to the dominant role of concessional financing, the implicit financing cost of public debt remained well below market yields and were resilient to interest rate shocks. The average cost of financing of the outstanding debt remained between 2.5 and 3.7 percent in the period of 2004-2017.

Overall, due to the fiscal consolidation efforts and the fast recovery of the economy after the crisis in 2008, the government deficit decreased below 3 percent by 2012. As of 2013, the fiscal balance has started to deteriorate again mainly due to cyclical revenue losses and increase in social spending. Even so, the deficit remained moderate, below 4 percent of GDP - mainly on account of the Georgian government's commitment to prudent fiscal policy. The dominant part of the public debt has been financed by concessional FX denominated debt. The proportion of market-based financing has been relatively low, reaching a level below 15 percent in 2017. As a result of the debt structure, the public sector has a significant exchange rate exposure, while the debt service is just marginally sensitive to changes in interest rates. Public debt dynamics have been supported by low financing need, low financing costs and the relatively high GDP growth. However, the significant depreciation of lari resulted in a sharp decrease in the debt-to-GDP ratio, pushing the ratio above the 40 percent midterm ceiling set by the fiscal rules.

5.3 Progress with structural reforms

As agreed in the MoU, the macroeconomic and structural adjustment policy conditions attached to the MFA were based on the economic stabilisation and reform programme endorsed by the Georgian authorities and were consistent with the agreements reached by the country with the IMF. The first instalment of the MFA was conditional on the SBA being on track as well as on the fulfilment of the general political pre-conditions. The second instalment was, in addition, subject to the fulfilment of a set of actions specified in the MoU. The authorities should accomplish these eight structural reform conditions in the following four policy fields before disbursement of the second tranche:

Public Finance Management (PFM):
- Improve awareness about public procurement;
- Ensure independence of State Audit Office (SAO).

Social Safety Net:
- Carry out a Health care survey;
- Establish a Unit for Health Care Quality Improvement.

Financial Sector:
- Strengthen the process of ensuring banks' capital adequacy;
- Improve the risk management processes at NBG.

Trade and competition policy:
- Centralizing the management of EUR1 certificates;
- Adoption secondary legislation related to the Law on Competition.

This section presents the intervention logic of each conditions and describes their implementation. The analysis is based on the Review of Compliance of the EU, IMF and WB reports, relevant documents published by the Georgian authorities and interviews with different stakeholders.

Action 1: Improve awareness about public procurement

Action 1: "Consistent with the Strategic Plan of the State Procurement Agency, increased efforts will be made to improve awareness about public procurement legislation and procedures on the part of both public agencies organising tenders and potential bidders. This will include, in particular, the creation of a training centre on public procurement at the new premises of the State Procurement Agency and/or the development, in close co-operation with the State Procurement Agency, of the permanent training module on public procurement at the Academy of the Ministry of Finance. Also, substantial progress will be made towards the introduction of a certification system".

Table 5.1 Intervention Logic – Condition 1

Rationale for the Reform	Output(s)	Short-term effects	Medium-term effects
Lack of qualified public procurement specialists, in both the public and private sectors.	Training of contractors of public procurement and suppliers.	Establishment of a training centre. Introduction of certification system that simplifies the process of recognition of knowledge.	Improvement of the functioning of the e-procurement system.

Implementation

The authorities decided to create a training centre on public procurement at the new premises of the State Procurement Agency (SPA). The provisions for the establishment of the training centre, as an independent structural unit within the SPA, were laid down by the Charter of the SPA adopted in April 2014, while the Decree on Arrangements for the Functioning of the Training Centre of the SPA was adopted in September 2014. Since its establishment, the Training Centre provided training sessions to approximately 3000 people, including procurement managers operating at public sector, civil society actors, businesses and conducts special workshops and seminars. Upon completion of the training, attendees have been awarded a certificate based on a computer-based assessment. Based on the progress the EC considered this condition to be fulfilled.

Action 2: Ensure independence of State Audit Office (SAO)

Action 2: "In order to protect the operational independence of the State Audit Office (SAO), as enshrined in the Constitution of Georgia, and consistent with the International Organization of Supreme Audit Institutions (INTOSAI) Mexico Declaration, the Parliament will amend article 35 of the Law on the SAO to ensure that the Parliaments' oversight of the SAO's activities is limited to auditing of its financial and economic performance based on SAO's annual financial statements."

Table 5.2 Intervention Logic – Condition 2

Rationale for the Reform	Output(s)	Short-term effects	Medium-term effects
Parliamentary oversight of SAO was considered excessive, infringing on the operational independence of the SAO.	Revert the text of Article 35 of the Law on the SAO to its previous form.	Strengthen operational independence of the SAO.	Strengthening external audit and public financial management.

Implementation

After coming to power in 2012, the government broadened the scope of the parliamentary oversight of SAO to performance audit by giving a special parliamentary committee the power to check SAO's professional activities. This led to an excessive interference of the Parliamentary Committee in the definition of the main priorities of the audit plan of the SAO. In November 2014, in line with the recommendations of international experts, the Law on the SAO was amended to remedy this anomaly. Specifically, Article 35 of the Law, which defines the scope of the parliamentary oversight over the SAO, was amended to limit it to financial audit in accordance with international auditing standards. As a result, the independence of the SAO has been strengthened through the revision of Georgia's State Audit Office Law (Article 35). Overall, the Parliament's attitude towards the SAO has improved. In its Development Strategy 2018-2022, published in December 2017, the SAO states it aims "to actively cooperate with the Parliament of Georgia on issues related to SAO's audit report presentation, its understandability and clarity."[52] However, the Financial and Budgetary Committee of the Parliament kept overstepping its legal authority by asking the SAO to supply data that go beyond the annual financial audit. Nevertheless, the amendment of Article 35 of the Law represented an important step towards strengthening the operational

52 SAO Georgia (2017). Development Strategy 2018-2022. https://sao.ge/files/chvens_shesaxeb/ENG-WEB.pdf.

and political independence of the SAO. Based on this progress the EC considered this condition to be fulfilled.

The establishment of the State Procurement Agency, the SAO and other institutional reforms in the area of PFM, among others, have also been stipulated by the AA/DCFTA agreement from 2014 (mainly in the Chapter 10 of the DCFTA).[53] The corresponding legislation was adopted and later amended by the Parliament in 2014 and 2017.

Action 3: Carry out a Health care survey

Action 3: "The Ministry of Labour, Health and Social Affairs will complete, with technical assistance from the World Bank, USAID and the World Health Organisation, the Health Utilisation and Expenditure Survey. The results of the Survey will provide input for the evaluation of the impact of health sector reforms on accessibility, utilisation, satisfaction and the financial protection of the population vis-à-vis health care and serve as a basis for further refining the design, operation and financial management of the UHC programme introduced in 2013."

Table 5.3 Intervention Logic – Condition 3

Rationale for the Reform	Output(s)	Short-term effects	Medium-term effects
Collecting detailed information on the functioning of the UHC; Detecting strengths and weaknesses and identify development needs.	Completion of the health care survey.	Documenting strengths and weaknesses of the UHC programme. Support government health care reform initiative.	Further refinement of the design and management of the UHC programme.

Implementation

In 2013, the government launched the UHC programme aimed at improving health care access and strengthening financial protection of Georgian citizens. In order to assess the impact of the reform in September 2014 the authorities launched the third round of the Health Utilization and Expenditure Surveys conducted with financial and technical assistance from the World Health Organization, the World Bank and the USAID. Field works were completed in December 2014 and the main results and recommendations of the Survey were presented in May 2015. The main findings of the survey are presented in Section 5.4.

Action 4: Establish a Unit for Health Care Quality Improvement

Action 4: With a view to improving the efficiency and cost-effectiveness of the Universal Health Care and other State Health Care Programmes, the Ministry of Labour, Health and Social Affairs (MoLHSA) will establish a special Unit for Health Care Quality Improvement."

Table 5.4 Intervention Logic – Condition 4

Rationale for the Reform	Output(s)	Short-term effects	Medium-term effects
Increasing costs and sub-optimal efficiency and quality of UHC services.	Setting up a special Health Care Quality Improvement Unit by the MoLHSA.	Establishment of a robust infrastructure for controlling and improving quality of health care.	Increase quality, cost efficiency and coverage of health care services.

Implementation

Instead of creating a separate unit for health care quality improvement, the authorities assigned these responsibilities to the Executive Department of MoLHSA at the end of 2014. The internal rules of MoLHSA were amended in January 2015 to expand the Executive Department's scope of activities to cover tasks related to quality improvement. Three additional experts were employed, out of which two quality

[53] For a detailed assessment of implementation see Emerson, M., & Kovziridze, T., (2018). Deepening EU-Georgian Relations. CEPS, Brussels. https://www.ceps.eu/publications/deepening-eu%E2%80%93georgian-relations-what-why-and-how-second-edition.

improvement specialists from private hospitals, and a new Deputy Minister with substantial experience in the field was appointed in November 2015 to head the work on quality improvement. Efforts to develop the human resource and institutional capacity for managing quality control have been pursued since 2014.

Action 5: Strengthening the process of ensuring banks' capital adequacy

Action 5: "Consistent with the regulation on capital adequacy adopted by the NBG in 2013 and Basel II rules on capital adequacy, banks in Georgia will submit to the NBG Internal Capital Adequacy Assessment Process (ICAAP) reports. Based on the ICAAP reports submitted by banks, the NBG will provide two largest banks assessments and recommendations in the context of the Supervisory Review and Evaluation Process (SREP)."

Table 5.5 Intervention Logic – Condition 5

Rationale for the Reform	Output(s)	Short-term effects	Medium-term effects
Need to strengthen banks' capital adequacy and risk management.	Banks submitted their ICAAP reports.	Increased bank specific capital requirement.	Improves banks' risk management practices.
	Banks developed own internal risk models.	Harmonized Georgian regulatory approaches with relevant Euro directives; Improved alignment with the international best practices.	Reduces banking system's vulnerability.
	NBG completed the Supervisory Review and Evaluation Process (SREP) for the two largest banks.		

Implementation

Prior to the MFA 2, the NBG had already made a considerable progress toward strengthening banking supervision and adoption of Basel II practices. Consistent with the regulation on capital adequacy adopted by the NBG in 2013 and Basel II rules on capital adequacy, banks in Georgia were required to submit to the NBG ICAAP reports. The NBG in return was to provide the two largest banks, i.e. Bank of Georgia and TBC Bank, accounting for about 60 percent of total banking assets with assessments and recommendations under the SREP.

Under the Internal Capital Adequacy Assessment Process (ICAAP), banks are required to define the adequate capital levels that they should hold based on their own risk profile, and need to develop internal models for each specific risk. In order to support banks throughout the process, NBG distributed guidelines outlining the minimum expectations of the supervisor for the risks, which should be covered by the ICAAP reports. All Banks submitted their ICAAP reports in September 2014 as defined by the 2013 Regulation on Capital Adequacy Requirements of the NBG (See the 2014 Annual Report of the NBG).[54] In line with the NBG expectations, banks developed their own internal models for various risks. The practice of developing of models and benchmarks by banks better aligned Georgian practice with the international best practice and harmonized Georgian regulatory approaches with Euro directives.

NBG completed the SREP for the two largest banks. In order to provide feedback and recommendations to the banks and encourage them to develop risk management techniques, in 2015 formal letters were sent to these banks with recommendations regarding the methodologies, models used for computing capital for certain types of risks. Expectations and views of the supervisors on the level of involvement from the supervisory board and management in the development and use of ICAAP were also provided.

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54 See https://www.nbg.gov.ge/uploads/publications/annualreport/2015/annual_eng_2014_131015.pdf.

Action 6: Improving the risk management processes at NBG

Action 6: "The NBG will implement the centralized risk-management framework action plan approved by the NBG Council in April 2013. As part of this plan, a Centralized Risk-Management Department (CRMD) will be established at the NBG. The Department will be in charge of managing operational risks, including Business Continuity Management Procedures."

Table 5.6 Intervention Logic – Condition 6

Rationale for the Reform	Output(s)	Short-term effects	Medium-term effects
A need to strengthen NBG's risk management procedure.	Centralized Risk Management Department (CRMD) was established within the NBG.	Risk management framework is consistent with international best practices.	Improved risk management and business continuity processes at the NBG.
		Three-line defence model has been implemented.	

Implementation

The NBG expressed a strong drive for organizational improvement as well as considering the recommendation of "Safeguards assessment report of IMF Financial Department, 2011". The Bank identified risk management activities as a strategic priority and the CRMD was established in November 2014.

The CRMD is accountable to the governor and acts as an independent body. The department ensures that the risk management framework is consistent with international best practices in risk management. A three-line defence model has been adopted to improve risk management at the NBG. Responsibility for the first line of defence lies with operational managers, who own and manage risks. The CRMD represents the second line of defence and is responsible for the implementation, assessment, monitoring and improvement of the centralized risk management system across the NBG. The CRMD ensures that identified risks are addressed appropriately, in close cooperation with first-line risk-owners. Internal audit is the third line of defence and ensures the effectiveness of the CRM system. Internal auditors are indeed entitled to challenge and effectively assess the centralized risk management practice of the NBG.

Action 7: Centralizing the management of EUR1 certificates

Action 7: "In order to be able to fully exploit the opportunities offered by the DCFTA, following its entering into force on 1 September 2014, the Ministry of Finance will adopt a new internal order centralising in the Revenue Service the issuance and ex-post control of EUR1 certificates of origin."

Table 5.7 Intervention Logic – Condition 7

Rationale for the Reform	Output(s)	Short-term effects	Medium-term effects
• Management of EUR 1 certificates was inefficient; • Supporting the implementation of the DCFTA.	• The government centralized the issuance and control of EUR1 certificates exclusively in the Revenue Service.	• Improved transparency and efficiency of the EUR1 management.	• Improvement of export performance by decreasing administrative burden.
		• Supported the implementation of the DCFTA.	• Support EU integration.

Implementation

The DCFTA was scheduled to enter into force in September 2014 and, in that context, it was necessary for Georgia to adopt a ministerial decree centralising the issuance and ex-post control of the certificates of origin (EUR1 certificates) needed for accessing the EU market. Before the new decree, there were five different agencies that could issue the EUR1 certificate.

On August 26, 2014, the Government of Georgia issued Decree No. 510 amending the Decree No. 420 and in doing so centralized the issuance and control of EUR1 certificates exclusively in the Revenue Service. The new decree supported the implementation of the DCFTA and therefore contributed to EU integration, also helping to build investor's confidence in the country. Between 2014 and 2018, nearly 5,000 certificates of origin were issued and accepted annually by the Revenue Service.

Action 8: Adoption secondary legislation related to the Law on Competition

Action 8: "Consistent with the commitments under the DCFTA, the Government or, where appropriate the Competition Agency, will adopt all normative secondary legislation foreseen in the Law on Competition adopted in March 2014."

Table 5.8 Intervention Logic – Condition 8

Rationale for the Reform	Output(s)	Short-term effects	Medium-term effects
Adoption of all the secondary legislation foreseen in the Law in order to make the Competition Agency fully operational.	Two regulation of Government of Georgia (No.525 and No.529) and five orders of the Chairman of Competition Agency of Georgia were adopted.	Establishment of a legal framework for competition policy in Georgia consistent with the EU framework.	Strengthen anti-monopoly and competition regulation in Georgia. Support EU integration.

Implementation

Prior to the DCFTA negotiations Georgia lacked a true competition and anti-trust framework. The authorities adopted Law on Competition in March 2014. This condition stipulated that it was necessary to adopt addition secondary competition legislature foreseen by the Law on Competition in order to make the Competition Agency fully operational and harmonize Georgia's competition regulation framework with the EU framework.

The Government approved two regulations: (1)Regulation №526 "On Exemptions from Prohibition On Competition Restricting Agreements" (1 September, 2014); (2)Regulation №529 of Government of Georgia "On Approving Small Amounts of Individual State Aid and General Procedure for Granting State Aid" (1 September, 2014). In addition, the authorities approved five orders of Chairmen of Competition Agency:

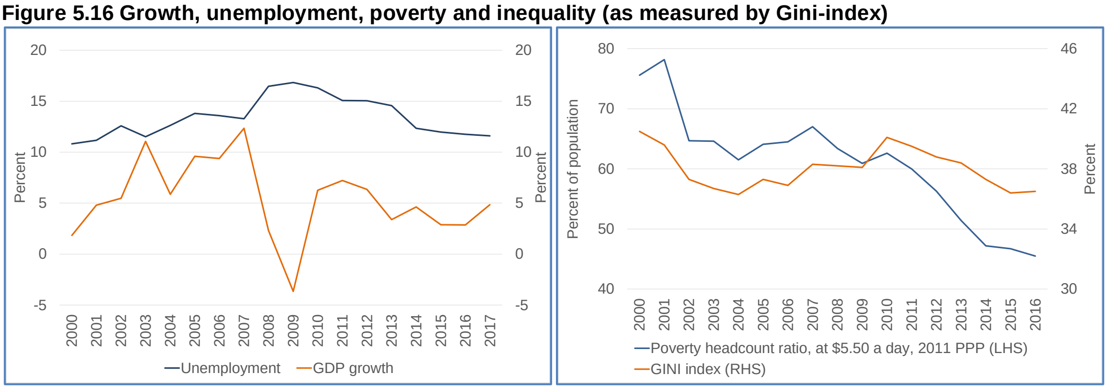
1. Order №30/09-1 - "On approval of the forms of applications and complaints, rules for their submission and procedures and deadlines related to the admissibility of the application and complaint" (30 September, 2014);
2. Order №30/09-2 - "On Approving the Procedure for Applying the Leniency Programme and Benefiting from Exemption from Liability" (30 September, 2014);
3. Order №30/09-3 - "On approval methodological guidelines of market analysis" (30 September, 2014);
4. Order №30/09-4 - "On approval the procedure on submission and consideration of notification on concentration" (30 September, 2014);
5. Order №30/09-5 - "On approval of the rule and procedure of investigation" (30 September, 2014).

5.4 Social developments

Since the collapse of the Soviet Union unemployment, poverty and inequality have been the three major social challenges of Georgia. In the period between 2002 and 2007 unemployment rate[55], poverty rate and Gini index[56] measuring income inequality averaged at around 13 percent, at 64 percent, and at 37 percent respectively (Figure 5.16). Unemployment was especially acute among younger generation: unemployment ratio among 20 – 29 year-olds averaged at around 30 percent in the same period. Total unemployment rate decreased to below 12 percent by 2017, still Georgia remained the second worst performer compared to its regional peers. Despite recent improvements, youth unemployment also remained high (Figure 5.18).

While employment opportunities have been created in new growth sectors, especially in tourism and other services, high unemployment persists due to challenges associated with skill mismatches, the poor quality of the educational system, and the significant regional disparities accompanied with low labour force mobility (within the country). A large share of the labour force has been concentrated in low productivity sectors. In the period between 2008 and 2016, 45 percent of the labour force worked in the agriculture, while the sector's share in GDP was about 10 percent on average.

Figure 5.16 Growth, unemployment, poverty and inequality (as measured by Gini-index)



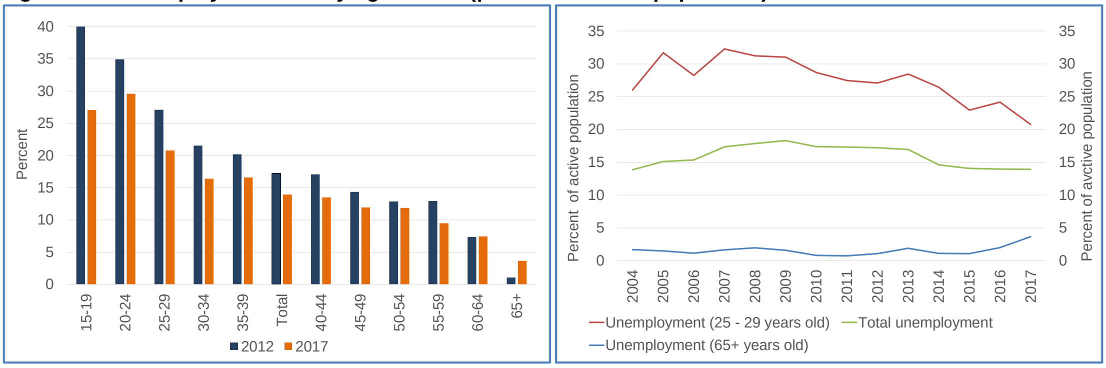
Source: World Development Indicators, World Bank.

Unemployment declined by about 3 percentage points to 12 percent from 2012 to 2014 and remained closely stable until 2017. In the period of 2014-2017, unemployment among young people showed a pronounced, 5 percentage points decrease (on average for 20-29 year age cohorts). However, unemployment among older generations (aged above 55 years) increased significantly. As a result, the overall unemployment remained stable. These dynamics stem from the fact that the major drivers of growth in Georgia in recent years were tourism and trade sectors that provide disproportionately more employment opportunities to younger people.

55 World Bank, ILO modelled estimate.

56 Gini index measures the extent to which the distribution of income among individuals or households within an economy deviates from a perfectly equal distribution. A Lorenz curve plots the cumulative percentages of total income received against the cumulative number of recipients, starting with the poorest individual or household. The Gini index measures the area between the Lorenz curve and a hypothetical line of absolute equality, expressed as a percentage of the maximum area under the line. Thus, a Gini index of 0 represents perfect equality, while an index of 100 implies perfect inequality.

Figure 5.17 Unemployment rate by age cohort (percent of active population)



Source: Geostat.

The findings from the Skills Toward Employment and Productivity (STEP) Survey[57] by the World Bank in 2015 pointed to significant skill gaps in Georgia resulting from the poor quality of education system and its unresponsiveness to employment demands. The 2015 Program for International Student Assessment (PISA) by the Organisation for Economic Co-operation and Development (OECD) underscored that in such areas as reading, science and math, Georgian students lag significantly behind not only OECD average but also student from other relatively poor European countries such as Moldova or Albania (Figure 5.18). The government has realised the need for improving education and skill matching. Georgia 2020 Strategy approved in 2014 identified “enhancing skills” as one of the three overarching goals of the country’s socio-economic development. In 2015, the government introduced an education reform programme, sponsored by the WB. The programme set curriculum standards, adopted a new teacher policy framework, and developed vocational training and adult learning. With EU support, Georgia developed the VET programmes, improved occupational standards, and trained VET teachers. Furthermore, Georgia achieved notable results in developing a Labour Market Information System (LMIS). LMIS allows citizens to get information on in-demand professions in different sectors and regions, supporting the communication between employers and jobseekers. The EU noted a 51.6 percent increase in the number of citizens registering for VET programmes in the 2014-2017 period.[58] In 2016 in its four point, action plan (2016-2020) the government set education as a priority reform area. Despite previous efforts, IMF (2018) [59] identifies deficiencies and the need for further reforms in the education sector and for strengthening labour market policies.

Persistently high unemployment has been one of the main reasons behind high level of poverty and inequality. Despite visible improvements in recent years, in 2016 more than 40 percent of the population lived below the poverty line (see poverty headcount ratio at USD 5.5 a day), remaining the second highest in the region. Poverty rates are particularly high in rural parts of the country, where subsistence farming is predominant. Despite improvements in unemployment and poverty, inequality remains the highest in the region. World Bank’s Gini index suggests only a small improvement in inequality – the index decreased by 2 percentage points in the period between 2012 and 2016. High inequality suggest that rapid economic growth achieved by Georgia in recent years has not been inclusive (Figure 5.16).

Poverty and inequality was also exacerbated by the underdeveloped social security system, the lack of unemployment benefit scheme and the traditionally low level of social expenditures in general. Georgia had the lowest levels of public social spending compared to its regional peers in 2012 (Figure 5.18). Therefore, the social safety net has operated with low coverage and low quality services.

57 The extensive survey of households and employers was carried out in 2012 and 2013 and covered Georgia’s urban population.

58 Delegation of the European Union to Georgia. https://eeas.europa.eu/delegations/georgia/37923/eu-transfers-gel-140-million-eur-481-million-georgia-support-reforms_en.

59 IMF (2018). Georgia: Selected Issues. IMF Country Report No. 18/199. https://www.imf.org/en/Publications/CR/Issues/2018/06/28/Georgia-Selected-Issues-46037.

In an effort to ease social imbalances, the Georgian authorities have over years been increasing social spending and shifting the public spending priorities towards social expenditures (Figure 5.11). The government has launched several reforms since 2008 to address social issues. Most of these reform initiations were suggested or supported by IFIs and some of them were set as structural conditions as well. Before 2013, a substantial portion of the population had no access to health public health care[60]. Implementation of universal healthcare was a top priority of the new government after the election in 2012. In 2013, the government launched the UHC programme. The UHC has led to a major expansion in population entitlement to publicly financed health services.

The 2014 health care utilisation survey initiated by the MFA 2 MoU (condition 3) indicated that over 90 percent of the population benefited from publicly financed health coverage in 2014, up from 40 percent in 2012 and 25 percent in 2010.[61] The depth of the coverage of the services package varied depending on the groups covered, with the lowest income groups enjoying the most comprehensive benefits.[62] The state-supported universal healthcare prioritizes certain groups, in particular socially vulnerable people living under the poverty line, internally displaced people, children under 5, students, teachers, people with disabilities, military personnel, and pensioners.[63] These groups account for approximately 50 percent of the whole population.

The survey also indicated that people became more likely to consult a health care provider when sick. In addition, financial barriers to accessing hospital care had decreased, out-of-pocket (OOP) payments fell[64] and user experience of the health system improved.[65] Decline in the OOP expenditures was an important progress as households' health care financing burden had been historically high in Georgia, on average exceeding 70 percent of current health care expenditures (Figure 6.14). WHO (2018) found that in 2015 Georgia had the highest incidence of so called catastrophic health care spending (i.e. when the OOP compared to the household total expenditures is above 10 percent) in Europe, amounting to 33 percent.[66] The rate halved by 2017 owing to the introduction of UHC. Nonetheless, the OOP spending on outpatient pharmaceuticals doubled in the same period, putting pressure on the impoverished. [67]

The UHC has led to an improvement in overall financial protection, driven primarily by lower hospitalization costs. However, inequality in the use of health services and prescription drugs remained high (poorer people in rural areas being at disadvantage). The survey recommended the protecting, and if possible further increasing the health budget by developing health-sector specific resources (e.g. earmarking excises, increasing co-payments) and improving efficiency.

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60 Between 2007 and 2013 state allocations for health insurance for targeted groups of population (the poor, teachers, law enforcement officers and military personnel) that amounted to 40 percent of population were managed by private companies.

61 Chanturidze, T., & Jensen, C. (2017). Learning for Action across Health Systems: Georgia Case Study. https://learningforaction.org/wp-content/uploads/Learning-for-action-across-health-systems_Georgia-case-study-1.pdf.

62 Richardson, E. & Berdzuli, N. (2017), Georgia Health system review. *Health Systems in Transition*, Vol. 19, No. 4. http://www.euro.who.int/__data/assets/pdf_file/0008/374615/hit-georgia-eng.pdf?ua=1.

63 See https://www.elrha.org/wp-content/uploads/2018/01/HRU-Survey-Report.pdf.

64 Nevertheless, current health expenditure is still dominated by OOP payments (57 percent in 2015). See Richardson, E. & Berdzuli, N. (2017), Georgia Health system review. *Health Systems in Transition*, Vol. 19, No. 4. http://www.euro.who.int/__data/assets/pdf_file/0008/374615/hit-georgia-eng.pdf?ua=1.

65 Chanturidze, T., & Jensen, C. (2017). Learning for Action Across Health Systems: Georgia Case Study. https://learningforaction.org/wp-content/uploads/Learning-for-action-across-health-systems_Georgia-case-study-1.pdf.

66 WHO. (2018). Catastrophic health spending in Europe: equity and policy implications of different calculation methods. Bulletin of WHO, Volume 96, Number 9, September 2018. http://www.euro.who.int/__data/assets/pdf_file/0007/380680/who-bulletin-vol96-9-r-health-spending-eng.pdf.

67 Richardson, E., & Berdzuli, N. (2017). Georgia Health system review. *Health Systems in Transition*, Vol. 19, No. 4. http://www.euro.who.int/__data/assets/pdf_file/0008/374615/hit-georgia-eng.pdf?ua=1.

Figure 5.18 Labour market and social indicators in regional comparison

Source: World Development Indicators, World Bank; Geostat; OECD; Country specific statistical agencies.

Despite its positive effects on health care services, the UHC put a significant pressure on the budget deficit. Health care spending became the regularly underestimated component of the budget, leading to consecutive overshooting of the public deficit.[68] In the period of 2012-2016, spending on health has doubled, from 1.6 percent of GDP to over 3 percent. Negative impact of the rapidly increasing social spending on fiscal sustainability hampered the reform initiations at other areas (e.g. reform of unemployment benefit scheme). This warranted measures to increase efficiency of the UHC, to limit the rise in costs. In 2017 the government decided to limit the universality of the health services by excluding

68 World Bank. (2017). Georgia Public Expenditure Review 2017. http://documents.worldbank.org/curated/en/630321497350151165/pdf/114062-PER-P156724-PUBLIC-PERFINAL.pdf.

individuals with annual income of over GEL 40000 (ca. 32,000 people) from the coverage and limiting coverage for middle-income citizens (with an income level above GEL 1,000 per month but under GEL 40,000 per year, ca. 400,000 people). These measures intended to limit health care costs and to make the spending more efficient in terms of targeting the poor.

Georgia's public pension scheme was basic with lump sum pensions being paid to all citizens above a certain age limit, regardless of the number of years worked though. In 2013, the government increased the pension allowances from EUR 55 to EUR 70. Nonetheless, the replacement rate (ratio of pension to pre-retirement salary) remained low, marginally above 20 percent. After several years of planning, the Georgian parliament adopted a contribution pension scheme (2nd pillar) as a part of the IMF EFF reform agenda in December 2018.[69] The new system started to operate in 2019 and it is mandatory for legally employed people under 40 and voluntary for people above 40 and for self-employed people. The system works with 2+2+2 scheme: employees pay 2 percent pension contribution of their salaries, and employers and the government add another 2 per cent.

Georgian Targeted Social Assistance (TSA), the second largest public assistance program after pension as of 2017[70], has been another key feature of Georgia's social safety net.[71] After its introduction in 2006, it became important in poverty reduction. World Bank (2014) praised the scheme for being well targeted and meaningful, while it also emphasized that its scope was limited and reached only 40 percent of the poorest decile.[72] The government implemented a new system of TSA in 2015 with a modified targeting formula and benefit scheme. Furthermore, a Child Benefit Programme was also introduced.[73]

Overall, the social reforms, the improving growth performance, the international financial support and technical assistance programmes as well as the favourable development of food prices have supported the improvement of social indicators. At the same time, the relatively high level of unemployment and Gini-index signal that growth has not been inclusive enough. Though employment opportunities have been created in new growth sectors, skills mismatch, lack of qualified labour and large regional disparities are still the primary obstacles of inclusive growth and inequality reduction (see 2017 IMF EFF report[74], 2017 EC SWD[75]). Furthermore, while the coverage and quality of the public health care system improved significantly on account of the introduction of the UHC reform, the financial sustainability of the system has not been ensured.

69 See IMF. (2018). Georgia Third Review under the Extended Fund Facility Arrangement - Press release; Staff report; and Staff supplement. https://www.imf.org/en/Publications/CR/Issues/2018/12/19/Georgia-Third-Review-Under-the-Extended-Fund-Facility-Arrangement-Press-Release-Staff-Report-46484.

70 See UNICEF. (2018). The Welfare Monitoring Survey 2017. https://www.unicef.org/georgia/media/1226/file.

71 See World Bank. (2018). Georgia Systematic Country Diagnostic (SCD) Concept Note. Washington, DC. http://documents.worldbank.org/curated/en/496731525097717444/pdf/GEO-SCD-04-24-04272018.pdf.

72 See EC. (2014). Report on mission to Georgia: Memorandum of Understanding, negotiations for Macro-Financial Assistance to Georgia. (Tbilisi, 10-14 June 2014).

73 See World Bank. (2018). Georgia Systematic Country Diagnostic (SCD) Concept Note. Washington, DC. http://documents.worldbank.org/curated/en/496731525097717444/pdf/GEO-SCD-04-24-04272018.pdf.

74 https://www.imf.org/en/Publications/CR/Issues/2017/04/13/Georgia-Request-for-Extended-Arrangement-Under-the-Extended-Fund-Facility-and-Cancellation-44834.

75 See EC. (2017). Commission Staff Working Document. Background Analysis per beneficiary country. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017SC0233&from=DE.

Chapter 6 Answers to the evaluation questions

This chapter presents the detailed answers to evaluation questions structured around the above evaluation criteria. For a general overview of the structure of questions and sub-questions, please refer to the table below, which not only shows the ordering of our questions, but also their connections to the questions found in the TOR ECFIN (2018 013/D) and the questions found in the Guidelines for the Ex-Post Evaluation of Macro-Financial Assistance Operations (June 2015).

Table 6.1 Evaluation question and sub-questions matched to TOR and MFA Guidelines

Evaluation Question	Evaluation criteria and themes	TOR Question	MFA Guidelines Question
EQ1	Relevance	Q1	Q1; Q2; Q3
EQ1.1	Relevance of the objectives		Q1.1 – Q1.2
EQ1.2	Relevance of the financial envelope		Q2.1 – Q2.2
EQ1.3	Relevance of the conditions		Q3.1 – Q3.3
EQ1.4	Impact of timing on relevance		Q1; Q2; Q3
EQ2	Effectiveness	Q2	Q5
EQ2.1	Effectiveness – macroeconomic conditions		Q5.1.1 – Q5.1.5
EQ2.2	Effectiveness – fiscal consolidation		Q5.2.1; Q5.2.3
EQ2.3	Effectiveness – structural reforms		Q5.3
EQ3	Efficiency	Q3	Q4.3; Q2.3
EQ4	EU added-value	Q4	Q6
EQ5	Coherence	Q5	Q7
EQ6	Social impact	Q6	NA
EQ7	Impact on debt sustainability	Q7	

6.1 EQ1: Relevance of the operation

In this section, the overall appropriateness of the MFA's design, including the definition of objectives, the adequateness of the financial envelope and of the conditions are addressed. The main evaluation question on relevance (as presented in Chapter 3 above) is broken down in four sub-questions, looking at the relevance of (i) the objectives, (ii) the financial envelope and (iii) the conditionality, as well as (iv) the impact of the long timeline of the operation on its relevance. The respective sub-questions are further specified below. The analysis is based on the first three questions of the MFA guidelines. The analysis is both qualitative and quantitative, relies on data analysis and interviews with stakeholders.

Table 6.2 Evaluation question and sub-questions on the relevance of the MFA operation design

Evaluation question and sub-questions	Evaluation criteria and themes
EQ1. To what extent was the MFA operation design and outcomes appropriate in relation to the outputs to be produced and the objectives to be achieved?	**Relevance**
EQ1.1 To what extent can the MFA design and outcomes considered to have been appropriate?	Relevance of the objectives
EQ1.2 Were the amounts and terms of the financial assistance provided to Georgia adequate?	Relevance of the financing envelope
EQ1.3 Was the conditionality of the MFA operation appropriate in relation to the objectives to be achieved?	Relevance of the conditionality
EQ1.4 How did the long timeline of the MFA operation impact its relevance?	Impact of timing on relevance

6.1.1 EQ1.1: Relevance of the objectives

The first sub-question (EQ1.1) focuses on the overall relevance of the operation and its design.

Table 6.3 Evaluation sub-question on the relevance of the objectives of the MFA operation design

EQ1.1 To what extent can the MFA design and outcomes considered to have been appropriate?
EQ1.1.1 Were the objectives of the MFA operations relevant in relation to the economic challenges of Georgia?
EQ1.1.2 In what way has the design of the MFA assistance conditioned the performance of the operation in respect to its objectives?

EQ1.1.1 Were the objectives of the MFA operations relevant in relation to the economic challenges of Georgia?[76]

The objectives of the MFA 2 are stated in the legislative Decision No 778/2013/EU of the European Parliament and the Council of 12 August 2013. The Decision states that the MFA shall be consistent with the agreements reached between the IMF and Georgia and with the key objectives of economic reform set out in the EU-Georgia PCA. The document cites the following, as the general objective of the MFA: "support economic stabilisation in conjunction with the current IMF programme". In addition to this, the following specific objectives are mentioned: "strengthening the efficiency, transparency and accountability, including public finance management systems in Georgia." Furthermore, the Joint Declaration adopted together with the MFA 2 Decision defined the guiding principles of the MFA operations. The declaration states that MFA "should aim to restore a sustainable external finance situation for eligible countries and territories facing external financing difficulties. It should underpin the implementation of a policy programme that contains strong adjustment and structural reform measures designed to improve the balance of payment position, in particular over the programme period, and reinforce the implementation of relevant agreements and programmes with the Union". The MoU set list of structural criteria to achieve these objectives, which is further elaborated on in Section 6.2.3.

The Commission's SWD "Ex-ante evaluation statement on further macro-financial assistance to Georgia" explains the objectives of the MFA operation in more detail[77]:

- Contribute to covering the external financing needs of Georgia and to alleviating budgetary financing needs;
- Support the fiscal consolidation effort and external stabilisation in the context of an IMF programme;
- Support structural reform efforts aimed at raising sustainable growth and increasing the transparency and efficiency of PFM;
- Facilitate and encourage efforts by the authorities of Georgia to implement measures identified under the EU-Georgia ENP Action Plan and the EaP so as to promote closer economic and financial integration with the EU, also in line with the plan to conclude a DCFTA between the two parties.

The Commission submitted its proposal for the second MFA operation to Georgia at the beginning of 2011 while the implementation of the operation started almost four years later, at the end of 2014. The MoU signed in December 2014 specified the following objectives of the MFA 2 operation: (1) to alleviate Georgia's BOP and budgetary needs; (2) to strengthen its foreign exchange reserve position; and (3) to support reforms aimed at reinforcing economic governance, raising sustainable growth and increasing social inclusiveness.

The above mentioned documents suggest that the primary objectives of the MFA 2 was to alleviate short-term external financing pressure and support the country in returning to a sustainable path.

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76 The relevance of the objectives at the beginning of the implementation of the programme is examined under EQ1.4.

77 See EC. (2011). Commission Staff Working Document; Ex-ante evaluation statement on further macro-financial assistance to Georgia; COM(2010) 804 final; Brussels, 13.1.2011. https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A52010SC1617.

Based on the economic and social developments in 2011 (presented in detail in chapter 2 and 5), it can be concluded that the objectives of the MFA 2 operation set in 2011 were relevant. While the GDP growth showed the signs of recovery, the current account deficit has increased again and approached 13 percent of GDP. The deterioration of external balances was mainly due to the growing trade deficit fuelled by a still subdued export performance; dynamic growth of import on account of increasing food prices. FDI financing remained subdued, signalling that investor's confidence had still not returned after the double crisis of 2008 and left the country to rely heavily on debt creating external financing. At the same time, the donor financing pledged in 2008 at the Donors' Conference has been mostly disbursed in the period of 2008-2010. While the level of FX reserves were adequate, covering the short term external debt of the country, the net FX reserves, i.e. reserves excluding IMF financing and short term FX liabilities of the NBG has decreased. On the back of the economic recovery and the government's continued fiscal consolidation efforts, the public deficit has decreased to below 4 percent of GDP, but the high level of FX denominated government debt has remained a source of vulnerability.

Overall, our analysis and the results of stakeholder consultations suggest that in 2011, the external financing was under pressure and balance sheet vulnerabilities were still high in Georgia. However, as of the second half of 2010 Georgian government decided to handle the IMF agreements (both the one approved in 2008 and the new arrangement agreed in 2012) as precautionary and has not drawn-down funds (See section 2.1.4). This indicates that there was no immediate financing gap and the overall pressure as perceived by the authorities decreased in this period.

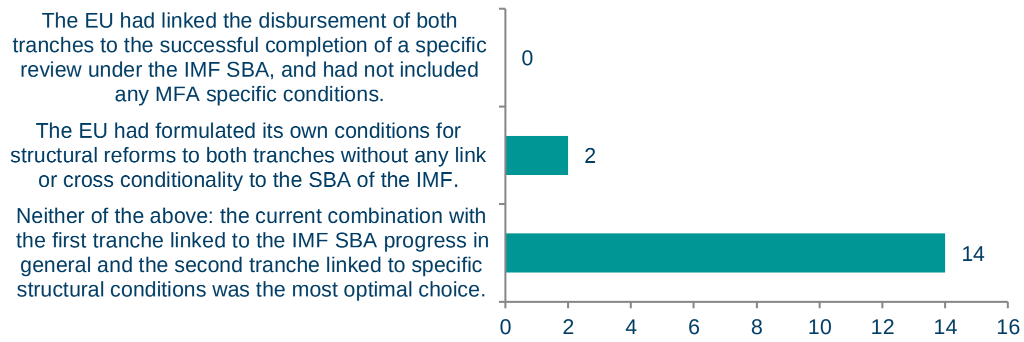
EQ1.1.2 In what way has the design of the MFA assistance conditioned the performance of the operation in respect to its costs and objectives?

The overall design of the MFA programme was relevant with respect to the objectives. The disbursement criteria of the two instalments were linked to the indicators for assessing fulfilment of the objectives. The criteria for the release of the first instalment allowed for quick disbursement, as it relied on a satisfactory track record in the implementation of the IMF SBA. Therefore, this was in line with the MFA's objective to provide short-term BoP and budgetary support, allowing for quick disbursement.

In general, terms, the conditions formulated for the second instalment were in line with the objectives of the MFA 2. Furthermore, due to the general design of the MFA operation – i.e. the beneficiary country can access financing only if all conditions attached are met – it proved to be an instrument highly suitable for pushing forward structural reforms. The actions targeted very specific, well-defined reform areas, which supported the accomplishment of the actions as well as the assessment of the compliance. Finally, the un-earmarked nature of budget support was relevant in terms of alleviating financing pressure and thus helping to smooth the macroeconomic adjustment process.

An ample majority of 14 out of 16 respondents participating in the Delphi questionnaire agree with the statement in Question 8 that the current design of the MFA "with the first tranche linked to the IMF SBA progress in general and the second tranche lined to specific structural conditions, with some links to SBA benchmarks was the most optimal choice." Only two respondents believed that the EU formulated its conditions without any link or cross conditionality to the SBA of the IMF (Figure 6.1).

Figure 6.1 Design of the structural reform conditions (Delphi, question 8)



6.1.2 EQ1.2: Relevance of the financial envelope

The second sub-question (EQ1.2) focuses on adequateness of the amounts and terms of the financial assistance. These questions aim to scope both initial and continued relevance.

Table 6.4 Sub-question on the relevance of the financial envelope of the MFA operation

EQ1.2 Were the amounts and terms of the financial assistance provided to Georgia adequate?
EQ1.2.1 Identify the main differences and reasons between the country's actual financing requirements and those foreseen at the inception of the programme (IMF & MFA)?
EQ1.2.2 Did the blend of loans and grants provide the appropriate mix in relation to the prevailing economic and financial conditions in the beneficiary country?

EQ1.2.1 Identify the main differences and reasons between the country's actual financing requirements and those foreseen at the inception of the programme (IMF & MFA)

The MFA 2 operation was part of a pledge of two possible MFA operations of the same amount made by the EC at the International Donors' Conference of October 2008. The EU completed the first MFA operation to Georgia in 2010. The approval of the second MFA was conditional on the continued existence of external financing gap above the part covered by the IMF arrangement.

In the Commission's SWD (2011) the external financing gap for the period (2009-2011) – based on the calculations of the IMF in the context of the SBA – was estimated at USD 2.4 billion. Taking the SBA and the WB DPL into account, the gap was still USD 0.85 billion. It was expected that the ADB, the US and other bilateral donors would cover USD 0.58 billion of the gap, while the EU under its budget support operation would provide USD 0.15 billion financing. The MFA 1 and 2 operations (around USD 0.11 billion) fully closed the gap, and accounted for 14 percent of the residual gap (i.e. the remaining gap above the IMF and WB financing). This was deemed an appropriate level of burden sharing for the EU, given the assistance pledged to Georgia by EU Member States, other bilateral donors and multilateral creditors. The MFA 2 Proposal stated that the amount of MFA complied with the proportionality principle: "it confines itself to the minimum required in order to achieve the objectives of short-term macroeconomic stability and does not go beyond what is necessary for that purpose."

Due to the long timeline of the operation (see section 2.2), the implementation period (2014-2017) did not even overlap with the period used for determining the amount of the assistance, i.e. 2009-2011. In 2014, at the time when the MoU negotiations were reactivated, an internal note of DG ECFIN with the subject "Report on mission to Georgia: Memorandum of Understanding negotiations for Macro-Financial Assistance to Georgia (Tbilisi, 10-14 June 2014)" included a detailed calculation on the budgetary financing gap in 2014. Based on the Georgian authorities' request, the total budgetary financing gap was estimated at USD 175 million. USD 120 million was planned to be covered by the first two tranches of the IMF programme (approved in 2014); USD 10 million and an additional USD 50-70 million by the budget support operations of WB and ADB. Finally, the note assumed that EUR 23 million would be disbursed already in 2014 by the EU. As the sum of the listed financing supports was higher than the gap, the note mentioned that in case all planned financing would realize in 2014, the second IMF tranche of USD 60 Million would be transferred to support FX reserves replenishment.

The IMF Staff report (2014) [78] related to the SBA estimated a temporary, USD 260 million external financing gap for 2014, mainly on account of a deteriorating trade balance and an USD 250 million scheduled debt repayment to the Fund. The IMF assumed that this gap would be fully covered by the IMF assistance and the planned WB and ADB financing amounting to USD 140 million together. The IMF Report presumed that USD 60 million MFA assistance would become available but the disbursements would not take place before 2015. Based on its estimations, the IMF forecasted "only insignificant external financing needs" as of 2015, as program policies were expected to contain external financing need while debt repayment schedule signalled a fall in roll over need.

First instalment

The first MFA 2 instalment was disbursed immediately in two tranches (in January and April 2015) after the signature of the MoU. External balances have deteriorated in 2015 compared to 2014: external financing need approached 12 percent of GDP, while FDI inflow remained at the 2014 level. External debt and liability ratios increased heavily on account of the lari depreciation. FX reserves were below the adequate level, which together with the high net external liability (132 percent of GDP) and gross external debt (above 86 percent of GDP) indicators represented a source of significant vulnerability. Fiscal deficit also increased mainly due to the deteriorating cyclical developments and increasing social spending. At the same time, the depreciation of the lari pushed the public debt-to-GDP ratio above 40 percent. Overall, the external financing situation and the balance sheet vulnerabilities of the country were worse than at the time of the design of the programme in 2011, as well as compared to the time of the design and signature of the MoU (2014). The fact that the NBG did not manage to increase the FX reserves in 2015 also suggested the presence of an external financing need.

Second instalment

Both tranches (loan and grant) of the second instalment of the MFA were disbursed in April 2017. The Commission's Information Note to the European Parliament and the Council (Brussels, ECFIN/D2 Ares (2017) on the disbursement of the second instalment did not assess directly the size of the external or public financing gap. However, it identified that in 2016 the current account deficit widened further partly on account of the short-term direct impact of the sharp lari depreciation. However, it was noted that the role of FDI financing increased. At the same time, the IMF Staff report accompanying the EFF agreement approved in 2017 identified a financing gap of USD 257 million of which USD 26 million was expected to be closed by the EU.

Actual data indicates a substantial improvement in current account deficit in 2017 and a marked increase in FDI financing. FX reserves increased, however it still did not reach a level providing adequate buffer for a BoP or exchange rate crisis. At the same time GDP growth regained momentum, helping to contain increase in the debt-to-GDP ratios. Fiscal deficit showed a mild decrease, mainly due to the improving cyclical position, but its level was close to 4 percent of GDP.

In summary, at the time of the release of the first instalment in 2015, the actual external financing need of Georgia was similar to the level estimated for 2011, when the operation was designed. As for 2017, i.e. the disbursement of the second instalment, most indicators suggest an improvement in the external and budgetary financing situation. However, the FX reserves was still below the adequate level. Reaching an adequate level of FX reserves was especially important in the context of the extremely high external debt

[78] IMF. (2014). Request for a Stand-by Arrangement; Press Release; and Statement by the Executive Director for Georgia. Country Report No. 14/250. https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2014/_cr14250.ashx.

and liability ratios, and balance sheet vulnerabilities in general. Therefore, the need for FX reserves replenishment well justified the need for MFA and EFF support.

EQ1.2.2 Did the blend of loans and grants provide the appropriate mix in relation to the prevailing economic and financial conditions in the beneficiary country?

Regarding the form of the assistance, half of the amount of EUR 46 million was disbursed in the form of grants, while the other half was provided in the form of a long-term loan.[79] This composition was consistent with the methodology for determining the use of grants and loans in the MFA operations as endorsed by the Economic and Financial Committee in January 2011 and the Joint Declaration by the European Parliament and the Council adopted together with the decision providing further macro-financial assistance to Georgia[80]. The decision to disburse half in grants and half in loans was taken on the basis of the followings:

- *Georgia's level of development as measured by its per capita GDP compared to the EaP countries*: Georgia's per capita GDP was below Armenia's level, but substantially above the level of the poorest EaP countries at that time. In addition, OECD listed Georgia as a lower middle-income country;
- *Georgia's public debt dynamics*: Public debt trends was a matter of concern, which supported the decision to give a part of the assistance in the form of grant;
- *Improvement in the country's economic situation.* A lower part of grant financing compared to the MFA 1 was warranted by the improvement in the economic developments. In addition, the SWD explained that the full use of grants in the MFA 1 operation was exceptional, justified by the very difficult circumstances Georgia faced in 2008;
- *Georgia's eligibility for concessional financing from the WB*. The combination of grants and loans was consistent with the fact that as of January 2009 Georgia was a "blend" country in terms of WB financing, as the country received a part of the WB assistance in the form of the International Development Association (IDA) lending, while the dominant part of the assistance was provided on International Bank for Reconstruction and Development (IBRD) terms.[81]

It is also important to mention that the MFA loan has been part of a broader package of EC support to Georgia in which the Directorate-General for Neighbourhood and Enlargement Negotiations (DG NEAR) provided all budget support operations in the form of grants.

Finally, the third MFA operation approved in April 2018 aims to provide EUR 45 million assistance of which EUR 35 million is available in the form of loan, and EUR 10 million in grants. Therefore, the subsequent MFA operations are consistent in terms of their form: the EU gradually decreases the grant component of the assistances in line with the economic convergence and the general improvement in the external financing situation.

In the Delphi questionnaire, the issue of grants or loans was raised in Question 9 for triangulation purposes. Regarding the composition of the financing of the MFA, we received diverse opinions (Figure 6.2). While 8 out of 16 experts agree or fully agree with the statement that "the value added to support Georgia's financing needs would have been larger if the MFA was provided in grants" (see sub-question 9.1), five respondents disagree with this statement. Furthermore, 8 out of 16 respondents believe that loans have a more disciplining effect compared to grants (see sub-question 9.2). A majority of the respondents do not support the statement that grants would have given a stronger incentive than loans to meet the structural reforms (see sub-question 9.3).

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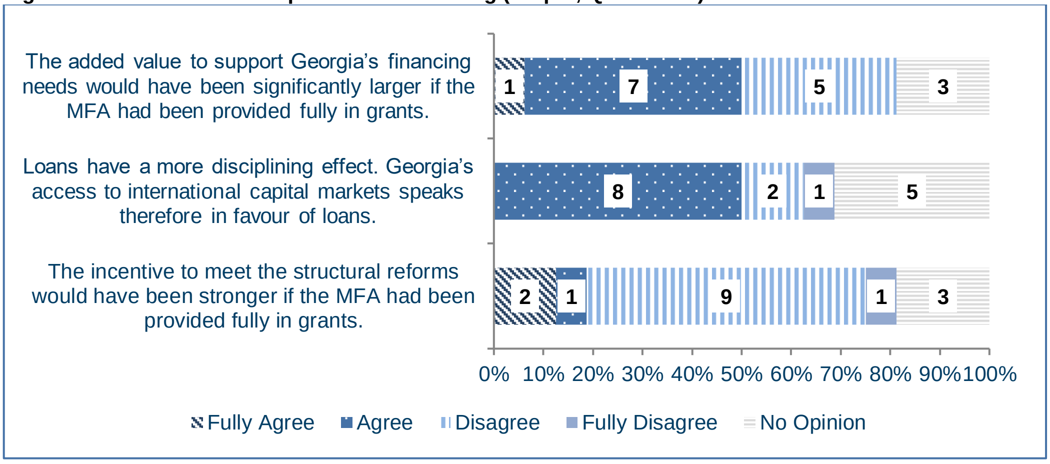
79 The detailed proposal for the composition of the assistance was part of the SWD accompanying the Proposal for MFA 2.

80 Decision No 778/2013/EU of the European Parliament and of the Council of 12 August 2013 providing further macro-financial assistance to Georgia, OJ L 218, 14.8.2013, p. 18.

81 Eligibility for IDA support depends on a country's relative poverty, defined as GNI per capita below an established threshold. IBRD provide loans to middle-income and creditworthy low-income countries. Some countries are IDA-eligible based on per capita income levels and are also creditworthy for some IBRD borrowing. They are referred to as "blend" countries. Georgia has been eligible to receive IDA resources until the fiscal year of 2014.

Figure 6.2 MFA and the composition of financing (Delphi, Question 9)



Overall, the blend of grant and loans of the MFA 2 operation was found appropriate and was coherent with the other MFA operations to Georgia. While the Delphi survey reflected some diversity in the opinions, the appropriateness of the blend was supported by the stakeholder interviews.

6.1.3 EQ1.3: Relevance of the programme conditionality

EQ1.3 specifically looks at the design of the programme conditions, to assess whether they were appropriate. The response to the question builds on the assessment on structural reforms. It also looks at the pace, timing and flexibility of the conditions.

Table 6.5 Evaluation sub-question on the relevance of the conditionality of the MFA operation

EQ1.3. Was the conditionality of the MFA operation appropriate in relation to the objectives to be achieved?
EQ1.3.1 Were the measures of the MFA operation relevant in relation to the economic challenges of Georgia? On reflection, were other relevant measures missing from the programme?
EQ1.3.2 To what extent were the measures of the programme well designed to address the objectives originally established? (pace, timing, flexibility)
EQ1.3.3 To what extent was the flexibility of conditionality both important and achievable in relation to exogenous factors and/or results falling short of goals?

EQ1.3.1 Were the measures of the MFA operation relevant in relation to the economic challenges of Georgia? On reflection, were other relevant measures missing from the programme?

The structural conditions of the MFA 2 covered four important reform areas: (i) PFM, (ii) social safety net, (iii) financial sector and (iv) trade and competition policy. These were consistent with the objectives of the MFA operation (see EQ1.1). In the interviews as well as in the first focus group meeting on structural reforms the perception was that most of the important reform areas were covered by the conditions.

From the 8 MFA conditions included in the MoU, 4 can be assessed as relevant or highly relevant in relation to the economic objectives, while all conditions are seen highly relevant or relevant in terms of the structural reform objectives. Table 6.6 summarizes the relevance of each of the conditions while this is further elaborated in the text below the table.

Table 6.6 Relevance of the conditions

No	Condition	Relevance
1	Improve awareness about public procurement	Relevant in terms of procurement practices, supporting structural reforms in the area of PFM. Less relevant in terms of economic challenges.
2	State Audit Office	Highly relevant in terms of external audit, supporting structural reforms in the area of PFM. Less relevant in terms of economic challenges.
3	Health care survey	Highly relevant in terms of structural reform process, not directly relevant in terms of the short-term economic challenges in Georgia.
4	Unit for Health Care Quality Improvement	Highly relevant in terms of structural reform process, relevant in terms of economic challenges.
5	Strengthening banks' capital adequacy (ICAAP)	Highly relevant in strengthening banks' risk management and the banking supervision. Highly relevant in terms of economic challenges.
6	Centralized Risk-Management Department (NBG)	Relevant in terms of improving risk management practices at NBG. Not relevant in terms of the economic and financial sector challenges. Scope of the action is limited compared to other MFA conditions.
7	Centralizing the management of EUR1 certificates	Relevant both in terms of economic challenges and the structural reform process. The action aimed at supporting the implementation of the DCFTA and boosting export performance and EU integration.
8	Secondary legislation - Law on Competition	This action aiming at strengthening competition policy was a very relevant structural measure, also relevant in terms of economic challenges. The action also supported the implementation of the DFCTA.

Public Financial Management

Condition 1: Improve awareness about public procurement

Despite the continuous improvement of the e-procurement system since 2010, there was a need to remove the major bottleneck for further improvement: the lack of qualified procurement professionals in both the public and private sector.[82] As a result, there was clearly a need for the SPA to improve the training by establishing a Training Centre. Therefore, this condition is assessed to be highly relevant in terms of the improvement of PFM and the structural reform process. However, it had less relevance in terms of the economic challenges at the time of the programme. These findings were confirmed by the stakeholder interviews in Tbilisi.

Condition 2: State Audit Office (SAO)

Parliamentary oversight of SAO was significantly broadened in 2012 by giving the Parliamentary Committee the power to check SAO's professional activities. Therefore, the independence of the SAO, the key institution of external auditing, was not ensured. This issue was raised and recommendations were formulated by the OECD[83], the International Organisation of Supreme Audit Institutions (INTOSAI) and the Swedish National Audit Office. Therefore, the condition aiming to restore full independence of the SAO was highly relevant and it aimed to improve efficiency, transparency and accountability of public finances and harmonise the legislation with the INTOSAI Mexico declaration[84]. This finding was supported by the stakeholder interviews as well as the first Focus Group discussions. The condition was also important as it gave incentives at a particular area, where the political support and will was not enough to take the

[82] According to the report "Analysis of the State Procurement System of Georgia" by the Georgian PMC Research Centre published in June 2014, capacity building in preparing technical requirements and improving the qualification of the members of tender commission of procuring entities were among the recommendations for the improvement of procurement results. See PMC Research Centre, 2014, Analysis of the State Procurement System of Georgia. Retrieved on 29 November 2018. http://csogeorgia.org/uploads/publications/121/PMCG__analysis_of_the_state_procurement_system_of_Georgia-eng.pdf.

[83] See OECD. (2013). Third Round of Monitoring Georgia, Monitoring Report, Anti-corruption Network for Eastern Europe and Central Asia, istanbul Anti-corruption Action Plan, https://www.oecd.org/corruption/acn/GEORGIAThirdRoundMonitoringReportENG.pdf.

[84] The International Organisation of Supreme Audit Institutions (INTOSAI)'s Mexico Declaration presents the core principles on Supreme Audit Institutions' Independence as an essential requirement for proper public sector auditing.

necessary measures. At the same time, this condition was not relevant in direct relation to the ongoing economic challenges in Georgia.

According to the stakeholders interviewed, other relevant areas of PFM, which could have been addressed by the MFA 2, were the issue of revenue auditing, i.e. due to existing legislation SAO cannot carry out a full audit of tax revenues. Furthermore, the poor quality of internal audits was also mentioned, as an issue which could have deserved more attention, as for the efficient functioning of auditing, both the external and internal audits need to work properly.

Social Safety Net

Condition 3: Health care survey

While the completion of the third round of the Health Utilization and Expenditure Survey was not directly related to the short-term economic challenges in Georgia, it was a fairly relevant step towards understanding the impact, strengths and weaknesses of the UHC program and therefore to improve the quality, coverage and efficiency of health care spending and thereby to facilitate inclusive growth. Relevance of the action was also supported by the fact that health care spending increased rapidly after the implementation of the UHC, also leading to overruns in budget expenditure. Therefore, a better understanding of the UHC and identification of sources of inefficiency was particularly important to ensure the sustainability of the system and to contain its negative budgetary impacts. This view was supported by the stakeholder interviews as well.

Condition 4: Unit for Health Care Quality Improvement

Establishment of a unit dedicated to health care quality improvement was a very relevant measure aiming to address the issues related to the improvement of the quality, efficiency and cost-effectiveness of the system and thereby to allow to further increase its coverage and ensure the sustainability of the health care services. The condition aimed at strengthening the capacities of the Ministry of Labour, Health and Social Affairs (MoLHSA) and establishing a unit dedicated to health care quality improvement. As the rapidly increasing costs of the UHC had a marked impact on the budget deficit as well, this condition was also relevant with respect to the short-term economic challenges.

Semi-structured interviews indicated that additional measures in this area could have targeted activities improving the capacities of Social Services Agency (SSA). As learnt from stakeholder interviews with IFIs, the lack of appropriate human capacity and infrastructure of the SSA is one of the most important factors explaining the inefficiency and low cost-effectiveness of the UHC (see EQ 6.2).

Financial Sector[85]

Condition 5: Internal Capital Adequacy Assessments (ICAAP) reports

While the Georgian banking sector proved to be relatively resilient in the crisis periods, the significant balance sheet mismatches pointed to the importance of the development of financial supervision. Prior to the MFA 2, the NBG had already made a considerable progress toward strengthening the banking supervision and the resilience of the financial sector. At the same time, the IMF-WB Financial System Stability Assessment (FSAP) identified some “pockets of weakness” in the functioning of the financial sector and supervision. One of the most important areas to be developed was the risk management by banks. Banks needed to raise their risk awareness and set their internal processes for assessing capital and liquidity adequacy in relation to their risk profile. The condition on the ICAAP report and on the recommendations to be formulated by the NBG addressed a dominant part of the shortcomings in banks risk’ management identified in 2014. The action supported to bring NBG’s practices closer in line with best international practices and to create an additional channel for improving NBG’s micro and macro prudential policies. Overall, the condition is assessed highly relevant both in terms of the structural reform process

85 For further details please consult our Case study 1 on the Financial Sector (Annex VII).

and the economic challenges. This view was strongly supported by the stakeholder interviews and the participants of the second focus group discussion in Tbilisi.

Condition 6: Establishment of the Centralized Risk-Management Department (CRMD) at NBG
Global financial crisis and highlighted the importance of central banks' financial risk management. IMF safeguard assessments also emphasized that the management of financial, operational, reputational, and strategic risks needs to be developed and central banks need to set up an independent risk control function, responsible for control of risk taking activities and risk management. Therefore, the establishment of the CRMD (prior a strategic priority of the NBG) was a relevant measure, supporting the harmonisation of the NBG's risk management with international best practices. This finding was supported by the stakeholder interviews as well. While addressing an important issue, this specific MFA condition did not relate to the relevant challenges of the financial sector, nor to the short-term economic challenges in Georgia. In addition, the scope of this action was limited compared to other conditions set in the MoU.

Regarding other potential measures in the area of the financial sector, an action supporting responsible lending practices, particularly in the non-banking financial sector (MFIs and private lending) would have been highly beneficial. Stakeholders from the financial sector were of the view that such a measure could have supported a more forward looking regulatory approach and might have helped to avoid the excessive retail credit growth and over-indebtedness of households (especially of the poor population), which became a pressing issue by 2018.[86]

Trade and competition policy

Condition 7: Centralizing the management of EUR1 certificates
Centralization of the issuance and the management of EUR1 certificates was an important step in harmonizing the legislation related to the rules of origin, an important element of the implementation of the DFCTA. As such, the condition has helped Georgia to be able to better exploit the opportunities offered by the DCFTA (see Case study on trade policy in Annex VII). Since Georgia needed to increase the competitiveness of its goods exports and diversify its export product portfolio, the condition was relevant both in terms of the economic challenges at the time of the design of the MFA programme as well as in terms of the structural reform process.

Condition 8: Secondary legislation - Law on Competition
Strengthening competition policy was of key importance, as the existing oligopolistic market structures were blocking economic progress and diminished the impact of structural reforms. Under the DCFTA, Georgia committed to having an effective competition legislation and an effective competition authority. The Competition Agency was formally established in March 2014. This action supported the adoption of the secondary legislation necessary to fully implement the Law on Competition adopted in 2014 and make the Competition Agency operational. Thus, besides addressing the issue of oligopolistic market structure, this condition aimed to support the implementation of the DFCTA. Therefore, the condition is assessed to be very relevant both in terms of economic challenges and the structural reform process.

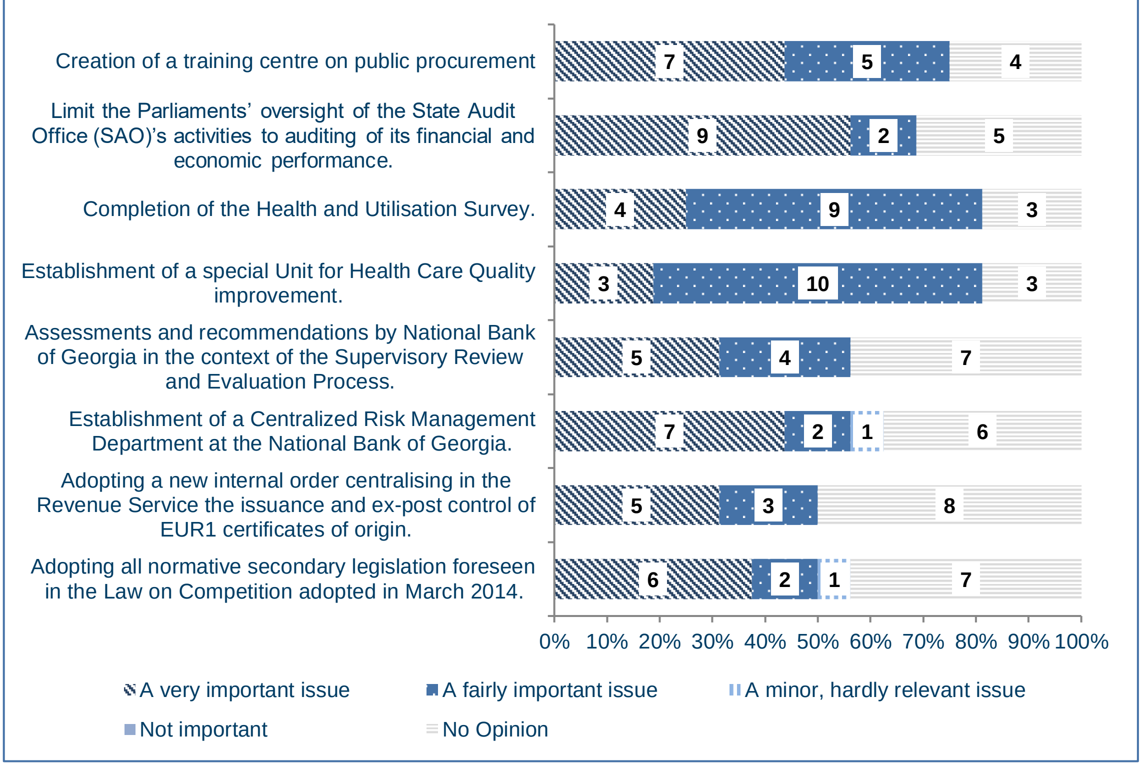
Stakeholders mentioned that other potential measures in the area could have targeted to support filling knowledge gap of companies related to the DFCTA. Many experts were of the view that companies cannot exploit the advantages of the DFCTA, as they do not have the necessary knowledge. Another issue raised at by the interviewees that EC could have included a condition concerning the proper functioning of the Competition Agency. As explained by experts in the field, the Agency lacks necessary power and competence for the implementation of the competition policy (see also EQ 2.3.2).

86 For further details please consult our Case study 1 on the Financial Sector (Annex VII).

For all the eight conditions, we cross-checked our findings from the desk research and interviews with the feedback received on question 5 from the Delphi questionnaire. On question 5, experts were asked for feedback on the relative importance of the reforms at the time the conditions were agreed and included in the MoU in 2014. Respondents ranked the reduction of the Parliament's oversight of the SAO activities (condition 2) the highest among all the structural conditions in terms of their importance (Figure 6.3). We can distinguish three different groups of conditions:

- Conditions seen as very important by the majority of respondents: condition 2;
- Conditions seen as very or fairly important by more than half of the respondents: conditions 1, 3, 4, 5, and 6;
- Conditions seen as fairly important or important by half of the respondents: conditions 7 and 8.

Figure 6.3 The importance of the reforms in 2014 (Delphi, Question 5)



EQ1.3.2 To what extent were the measures of the programme well-designed to address the objectives originally established? (pace, timing, flexibility),

The objectives mentioned in the SWD with respect to the MFA operation have been discussed in EQ1.1.1 above. In Table 6.1 below an assessment is made of the design of the conditions to address the relevant MFA objectives. In the assessment attention has been paid to the pace (e.g. achievable within the given time frame), timing (e.g. was there momentum and/or seen as a priority) and flexibility in the design phase of the conditions of the conditions.

In general, the MFA conditions were well-designed and discussed extensively with the authorities during the MFA preparation. The fact that the MFA 2 was planned to be implemented in a very short time, i.e. in less than one year from the MoU negotiations had a decisive impact on the design of the conditions. As emphasized by the MoU negotiation report[87], the actions had to be very well defined and supported by the authorities, in order to allow for a rapid implementation. Therefore, most of the measures were part of the government's reform agenda or were closely built on it. EC showed flexibility in the formulation of the conditions especially in the area of the Financial Sector. Stakeholders were of the view that while the

87 See EC. (2014). Report on mission to Georgia: Memorandum of Understanding, negotiations for Macro-Financial Assistance to Georgia. (Tbilisi, 10-14 June 2014).

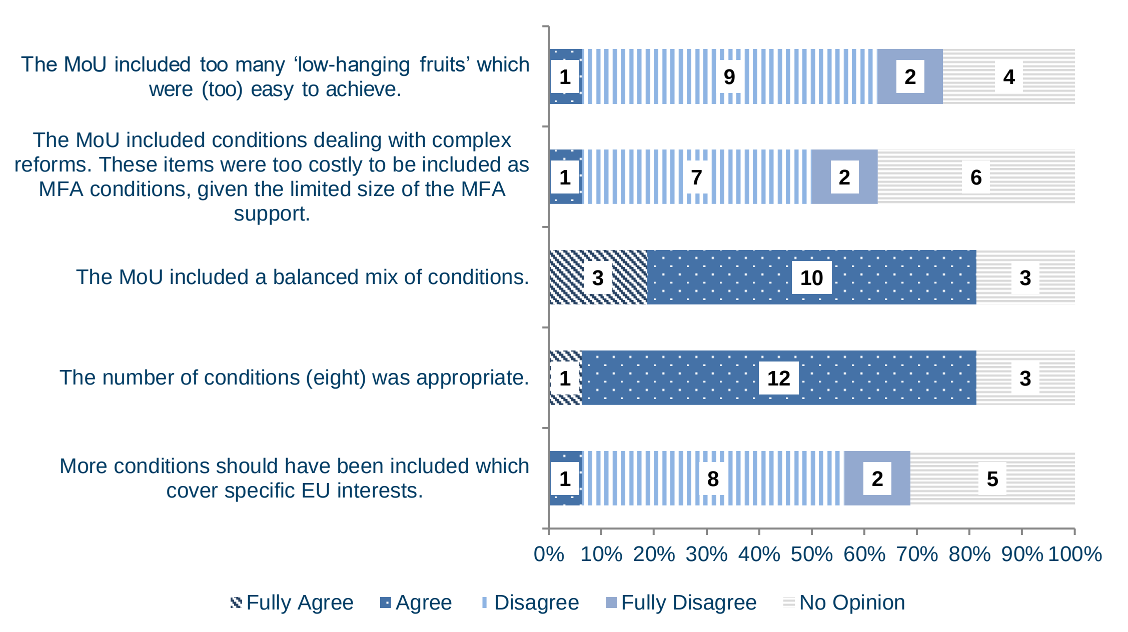
backbone of the reform agenda came from the Georgian authorities, in many cases the EC and other IFIs have contributed to the elaboration of the details of the actions, as the authorities lacked detailed implementation knowledge.

Table 6.1 Design of the conditions to address the MFA objectives

No	Condition	Contributing to MFA objective:	Quality of design
1	Improve awareness about public procurement	Support structural reform efforts aimed at raising sustainable growth and increasing the transparency and efficiency of PFM.	Condition was well designed. The action, as well as its pace and timing was consistent with the Strategic Plan of the SPA to improve awareness about public procurement legislation and procedures.
2	State Audit Office		Condition was well designed as it helped to bear down the political resistance of ensuring full independence of the SAO. The pace and the timing was appropriate.
3	Health care survey	Support the fiscal consolidation effort and external stabilisation in the context of an IMF programme; Support structural reform efforts aimed at raising sustainable growth and increasing the transparency and efficiency of PFM.	This design of the condition was sound. The support of the completion of the periodic survey was important as the political will was missing. The timing and pace was appropriate, as it provided valuable input for further refining the design and operation of the UHC shortly after its introduction.
4	Unit for Health Care Quality Improvement		While the condition was relevant, its design did not guarantee that the objectives would be met, as the condition was phrased in general terms that "a special Unit for Health Care Quality Improvement" would be established without defining its tasks and duties within the health care sector. The timing and the pace of the condition were appropriate.
5	Strengthening the process of ensuring banks' capital adequacy	Support structural reform efforts aimed at raising sustainable growth and increasing the transparency and efficiency of PFM.	The action was proposed by the NBG. Flexibility was provided in the formulation of the condition, as in its original proposal EC asked NBG to provide SREP assessment and recommendations for all banks. Timing and pace was appropriate and in line with NBG's regulation on capital adequacy adopted in 2013.
6	Centralized Risk-Management Department (NBG)		Substantial flexibility was provided in the formulation of the condition. The action was proposed by the NBG and replaced 2 other actions suggested by the EC (related to LCR regulation and the setting up of a Financial Stability Committee within the NBG). The condition as well as its pace were proposed by the NBG and it well suited in NBG's reform agenda.
7	Centralizing EUR1 certificates	Facilitate efforts to implement measures to promote closer economic and financial integration with the EU.	This action was well designed and it helped to speed up the implementation of the DFCTA.
8	Secondary legislation - Law on Competition		This action was well designed and supported the effective adoption of the secondary legislation related to competition policy.

The solid design of the conditions was confirmed in the feedback received on the Delphi questionnaire (Figure 6.4). In response to question 4, the majority of respondents assessed the mix of structural conditions as balanced and the number of conditions appropriate (see sub-questions 4.3 and 4.4). Only one respondent supported the claim that "the MoU included too many 'low-hanging fruits' which were (too) easy to achieve" (see sub-question 4.1). The majority of Delphi participants (10 out of 16 respondents) did not agree with the view that “more conditions should have been included which cover specific EU interests” (see sub-question 4.6).

Figure 6.4 Design of the structural reform conditions (Delphi, Question 4)



EQ1.3.3 To what extent was the flexibility of conditionality both important and achievable in relation to exogenous factors and/or results falling short of goals?

As described in EQ 1.3.1 and 1.3.2, the MFA 2 was designed to be implemented in a very short time frame (by the first half of 2015), as the EC assessed that there were pressing financing needs. Therefore, the conditions were set so as to allow rapid disbursements, targeted very specific and well defined areas, were kept simple and required actions seemed to be achievable in a short time. The conditionality considered the difficult economic, social and political situation in the country. Most of the conditions were met before the signature of the MoU and all conditions were fulfilled by the first half of 2015. As a result, there was very limited need for further flexibility. The flexibility with regard to the implementation of the conditions is shown in Table 6.2.

Table 6.2 Condition flexibility in relation to exogenous factors and results falling short of goals

No	Condition	Flexibility provided
1	Improve awareness about public procurement	No flexibility was needed as the Decree on Arrangements for the Functioning of the Training Centre of the SPA was adopted in September 2014.
2	State Audit Office	No flexibility was needed, as the law was amended in November 2014.
3	Health care survey	No flexibility was needed as field works were completed in December 2014 and survey results were presented in May 2015.
4	Unit for Health Care Quality Improvement	Some flexibility was provided: instead of creating a separate unit, the authorities assigned these responsibilities to the Executive Department of MoLHSA. The action was implemented by January 2015.
5	Strengthening the process of ensuring banks’ capital adequacy	After the flexibility provided in the formulation of the condition, no further flexibility was needed. Banks submitted ICAAP reports in September 2014 and NBG provided SREP assessment for BoG and TBC by May 2015.
6	Centralized Risk-Management Department	After the flexibility provided in the formulation of the condition, no further flexibility was needed and the CRMD was established in November 2014.
7	Centralizing EUR1 certificates	No flexibility needed, as the centralisation of EUR1 was accomplished in September 2014.
8	Secondary legislation - Law on Competition	No flexibility needed, as the secondary legislation was adopted by the authorities in September 2014.

6.1.4 EQ1.4: How did the long timeline of the MFA operation impact its relevance?

On account of the economic and social challenges Georgia faced in 2014, described in chapter 2 and 5, it can be concluded that the objectives of the MFA 2 operation mainly set in 2011 were very relevant in 2014. After a temporary improvement, Georgia has faced a deterioration in external balances due to the regional economic crisis, starting in 2014. While the fiscal position improved significantly by 2012, the budget deficit has started to increase gradually, due to the deteriorating cyclical position and the long awaited increase in social spending. While Georgia advanced with its structural reform agenda, the areas identified in the Decision and the SWD were still relevant. In addition, the development of social indicators – i.e. still high unemployment and inequality suggested that lack of inclusive growth was still a pressing problem of the Georgian economy (see section 2.1 and 5 for more details).

While it is difficult to prioritize, the most relevant objective was related to the support of the structural reform agenda. This impact was relevant both directly via the actions set in the MoU, by giving an international support to the reform objectives as well as indirectly, by smoothing the macroeconomic adjustment process and hence creating room for structural reforms. MFA 2 also had a prominent role in helping to alleviate external and in a lesser extent, public financing pressure, primarily by supporting the replenishment of FX reserves and helping to restore market confidence. These views were broadly supported by the stakeholder interviews and the results of the Delphi questionnaire (see 6.2.1 and Figure 6.7; as well as EQ2.2.1 and Figure 6.9).

6.2 EQ2: Effectiveness of the operation

This section deals with questions on the effectiveness of the MFA operation as far as the impact on macroeconomic stabilization is concerned, with a particular focus on the BoP, fiscal consolidation and structural reforms.

Table 6.7 Evaluation questions and sub-questions on the effectiveness of the MFA operation

Evaluation question and sub-questions	Evaluation criteria and themes
EQ2. To what extent have the objectives of the MFA operation been achieved?	**Effectiveness**
EQ2.1 To what extent has the MFA operation been effective in improving macroeconomic conditions (with focus on the Balance of Payments (BOP), and exchange rate)?	Effectiveness in improving macroeconomic conditions.
EQ2.2 To what extent has the MFA operation been effective in terms of fiscal consolidation?	Effectiveness in fiscal consolidation.
EQ2.3 To what extent have the short and medium-term expected structural effects of the assistance occurred as envisaged?	Effectiveness in promoting structural reforms.

6.2.1 EQ2.1: Effectiveness in improving macroeconomic conditions

Table 6.8 Evaluation sub-questions on the effectiveness of improving macroeconomic conditions (with a focus on the BOP)

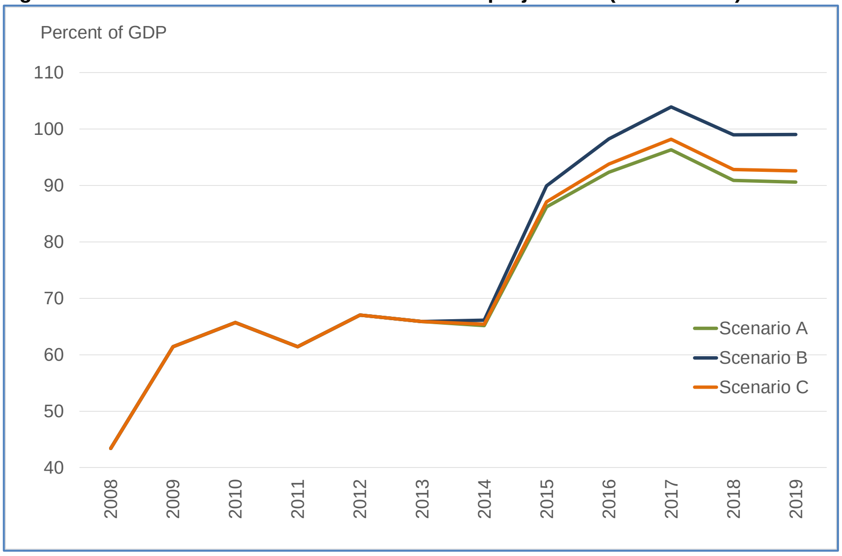
EQ2.1 To what extent has the MFA operation been effective in terms of improving macroeconomic conditions (with focus on the BOP and exchange rate)?
EQ2.1.1 To what extent has the MFA/IMF assistance contributed to returning the external financial situation of Georgia to a sustainable path over the medium to longer-term?
EQ2.1.2 Did the programme have a significant impact in alleviating market concerns about Georgia's solvency and restoring confidence in the economy, the exchange rate and the use of the local currency?
EQ2.1.3. What are the main internal and external factors on which the current trend in Georgia's external financial situation and its prolongation into the future are conditional?
EQ2.1.4. How is the country's external financial situation likely to evolve in the 5 years following the final disbursement given the likelihood of changes to current conditions?

EQ2.1.1 To what extent has the MFA/IMF assistance contributed to returning the external financial situation of Georgia to a sustainable path over the medium to longer-term?

In line with the methodological orientation from DG ECFIN, this section uses the DSA framework of the IMF[88] to quantify the effect of the SBA from the IMF and the MFA from the EC on external debt sustainability for the period of 2014-2019 (medium-term) and beyond (longer-term). To this end, different macroeconomic scenarios are constructed and compared within the framework. For a detailed presentation of the methodology, please refer to Annex VI.

Overall, we compute a baseline scenario (scenario A) and two alternative scenarios (Scenario B and C). The baseline scenario incorporates the effect of both the SBA of the IMF and the MFA of the EC. In this scenario, we present the factual realization for the path of the external debt for the past years (2014-2017), and we use the forecasted path consistent with the latest IMF projection for the future (2018-2023).[89] Two alternative scenarios are constructed to measure the impact of the financial support programmes. The first alternative scenario (scenario B) is calculated assuming that neither the IMF, nor the MFA is available. In the next scenario (scenario C), it is assumed that only the IMF loan was granted to Georgia without additional MFA assistance. In the alternative scenarios, we assume different paths for the country risk premium, interest rates and GDP growth. By comparing these alternative scenarios to the baseline, we can evaluate the aggregate effect of financial assistance (SBA and MFA) and the effects of the IMF SBA and EU MFA programmes can also be disentangled.

Figure 6.5 External debt-to-GDP – medium-term projections (2014 – 2019)



Source: IMF and own calculations.

The approval of the new IMF SBA and the consecutive launch of the MFA coincided with the Russian financial crisis in 2014. Georgia and other regional economies experienced sharp decline in remittances and export revenues. In light of the deterioration of the external environment, the NBG decided to allow the exchange rate to weaken by 40 percent cumulatively in 2015-2016. This contributed significantly to an increase in external debt-to-GDP ratio from 65 percent to 96 percent in the 2014-2017 period in the baseline scenario (Figure 6.5). The rise of the external debt-to-GDP ratio would have been even larger without the combined support from the IMF and the EU. In the absence of both sources (scenario B), the external debt-to-GDP ratio is estimated to have been peeked close to 104 percent in 2017, 8 percentage points above its actual realization, i.e. the baseline scenario. This difference between the baseline and

88 See IMF. (2013). Staff Guidance Note for Debt Sustainability Analysis for Market-Access Countries; https://www.imf.org/external/np/pp/eng/2013/050913.pdf.

89 See IMF. WEO October 2018 database https://www.imf.org/external/pubs/ft/weo/2018/02/weodata/weoselco.aspx?g=2200&sg=All+countries+%2f+Emerging+market+and+developing+economies.

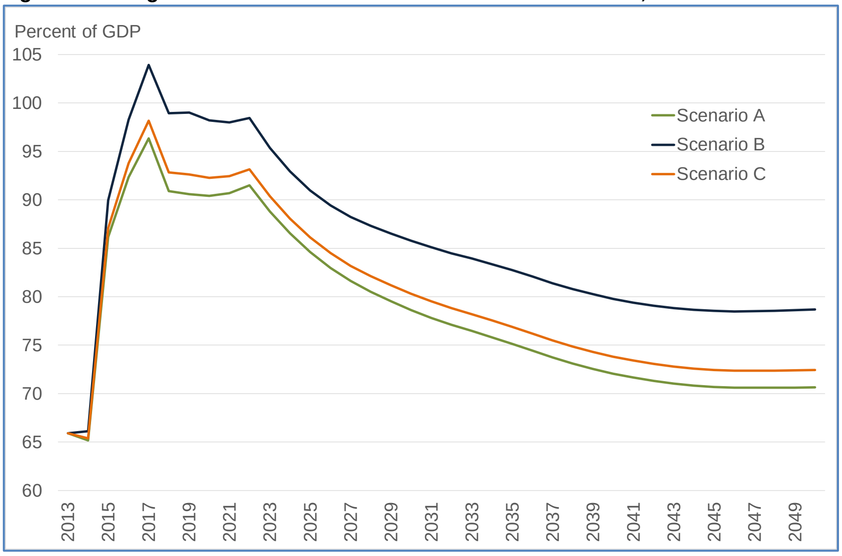
Scenario B persists throughout the remaining horizon as by 2019 the external debt-to-GDP ratio decline slightly below 91 percent in the baseline and to 99 percent in Scenario B. According to our simulations, the MFA contributed only marginally to stabilizing external debt-to-GDP, the beneficial effect comes mostly through the IMF assistance. This is not surprising given the relative amount of the MFA assistance compared to the IMF loan.

Table 6.9 Underlying assumptions for the long-term projection of the external debt

Real GDP growth (%)	Inflation (%)	Current account deficit (% of GDP)	Effective external interest rate%
4.0	3.0	6.5	5.5

We also analysed the key channels at work. Our investigation shows that a large share of the positive effect comes through the confidence channel: an agreement with the IFIs assumed to reduce risk premium and thus the marginal and the implicit financing costs of the outstanding debt. Furthermore, lower interest rates support investments and consumption and hence contributes to positive growth effect. The assumed direct positive impact on GDP growth rate affects external debt through several channels: on the one hand, higher GDP growth lowers the debt-to-GDP ratio directly through the denominator. On the other hand, the boost to domestic economic activity can have some negative effect on the trade balance through increased imports.

Figure 6.6 Long-term external debt-to-GDP under the scenarios, 2013 – 2050

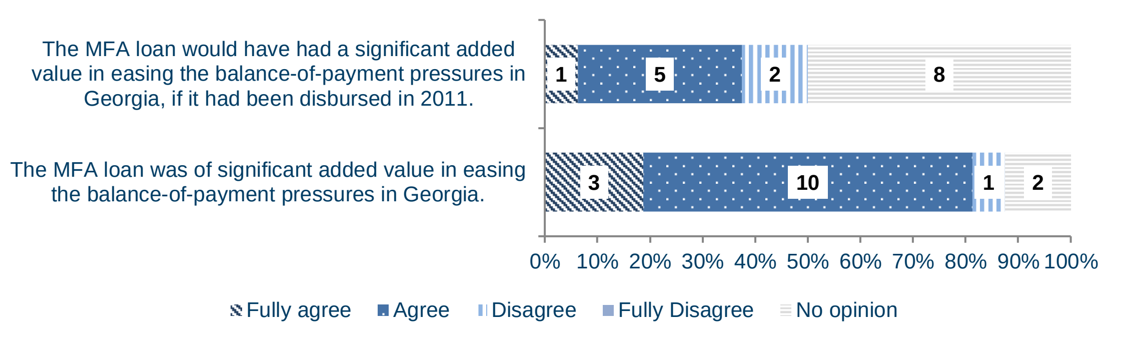


Source: IMF, own calculations.

By prolonging the projection horizon to 2050, we analysed the longer-term debt dynamics as well. We assumed that in the medium run, the current account deficit is fully covered by FDI inflow and it will gradually decrease to 6.5 percent of the GDP. Furthermore, we assume that with the increasing role of market financing, the effective external financing costs will reach 5.5 percent by 2050. Regarding the external debt asset accumulation, our assumption is consistent with the IMF forecast: on the short run, the need for FX reserves replenishment is reflected in external debt dynamics: debt decrease is contained by assumed reserve accumulation. Our results indicate that with relatively optimistic long-term assumptions (Table 6.9), Georgia's external debt-to-GDP ratio starts decreasing in the baseline scenario after 2022, and approaches 70 percent by the end of the forecast horizon. The positive effect of the combined SBA/MFA assistance remains significant over the projection horizon (Figure 6.6).

Our quantitative analysis is complemented by the responses from the Delphi questionnaire. Questions 1 and 2 of the Delphi questionnaire confirm that in the absence of either the SBA or the MFA, Georgia would have resorted to attracting additional external and domestic loans. However, this result is much stronger in the case of the absence of the SBA. Moreover, 6 respondents indicated that Georgia would have faced elevating financing costs in the absence of the SBA, while 'only' 4 respondents indicated this scenario in the absence of the MFA. No respondent supported the claim that Georgia may have defaulted without the IMF's SBA in 2014 or the MFA in 2014.

Figure 6.7 The Balance of Payments and Budget Effect of MFA (Delphi, Question 3)



Question 3 of the Delphi questionnaire indicates that most experts (13) saw a significant contribution from the MFA to easing the BoP pressures in Georgia (Figure 6.7). It is interesting to note that only 6 respondents support the view that the impact of the MFA on easing the BoP pressures in Georgia would have been larger if it had been disbursed in 2011. In fact, 2 respondents disagree with this statement, while 8 people expressed no opinion on this subject matter.

EQ2.1.2 Did the programme have a significant impact in alleviating market concerns about Georgia's solvency and restoring confidence in the economy, the exchange rate and the use of the local currency?

Changes in market concerns and confidence are revealed in the fluctuations of financing costs. In light of significant dollarization problems in Georgia, we also look at the changes in GEL/USD exchange rate and the rate of dollarization, which can also help us to identify episodes of market concern.

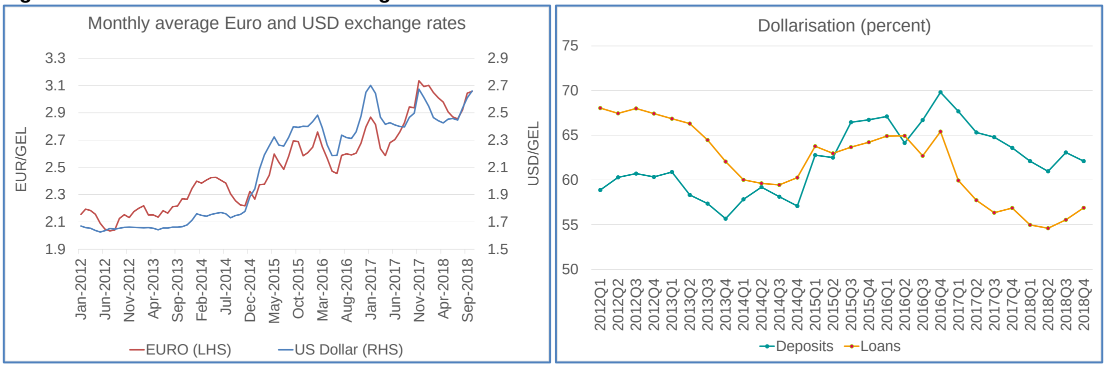
Changes in the market based financing costs are influenced by several factors, mainly by fluctuations in the global or regional risk appetite, changes in investors' assessment of the country's fundamentals (i.e. country specific risk), as well as the liquidity of the market of the given financial asset. Our objective is to analyse the country risk premium embedded in financing costs. Therefore, we examine the Georgian Eurobond spreads over the US benchmark yield and the JP Morgan Emerging Market Bond Index (EMBI). This approach allows us to control for the global as well as the emerging market related changes in risk perception.

Both indicators suggest a sizeable improvement in the country risk premium in the middle of 2014, i.e. at the time of the approval of the IMF SBA agreement. We assume that the risk premium impact of the MFA operation must have happened at the time of the approval of the IMF SBA, as it was a prerequisite of the activation of the MFA 2 operation, which was already approved by the EP and the Council of the EU in 2013. As among other affects, the two financial support operations impacted the market prices at the same time, we cannot disentangle the impact of the SBA and the IMF. Overall, the spread over the US government bond yield decreased by about 100 basis points compared to the end of 2013, while the decline over the EMBI was slightly lower (see Figure 5.6). Our assumption was also supported by the participants of the second focus group meeting in Tbilisi, as based on a short survey, the experts attributed a slightly higher, 110 basis points decrease of the risk premium to the IMF/EU programme[90].

The decrease in risk premium indicators proved to be temporary. By the end of 2014, Eurobond spreads increased sharply and the exchange rate started to depreciate due to the deteriorating regional economic outlook and the accommodative monetary policy. After some correction in the beginning of 2015, sovereign risk premium increased again, at the time when it became clear that the IMF SBA was going off-track. The increase of the spread over the US benchmark rates was well above 100 basis points, while the impact on the spread over EMBI was again less distinct, 70-80 basis points.

Exchange rate dynamics are also an important measure of the changes in the market confidence. Loss of confidence is usually coupled with the sell off and a parallel depreciation of the exchange rate. An improvement in market sentiments, i.e. a decrease in the perceived riskiness of the country, might result in an increased demand for the domestic currency resulting in the appreciation of the exchange rate. As Georgia is a heavily dollarized country, we examined the lari exchange rate against the US Dollar and the EURO. For both exchange rates, there is a marked appreciation at the time of the approval of the IMF SBA agreement. The appreciation of the USD/GEL exchange rate reached 2.2 percent from June to August 2014, while the GEL/EUR appreciated by more than 4 percent and the trend continued until the end of the year (see Figure 6.8).

Figure 6.8 Euro and US dollar exchange rates of lari and dollarization



Source: NBG.

Regarding the changes in the extent of dollarization, an improvement in market sentiment is expected to be accompanied by a decrease in the proportion of FX denominated assets, while in the case of loans we do not expect a sizeable change in the denomination structure in the short run. Looking at the data, in the second half of 2014 ratio of dollarization has decreased both in the case of the deposits and the loans. However, a significant part of this decrease is explained by the direct impact of the exchange rate appreciation. Controlling for this effect, our estimation suggest that in the period in question there was a slight 0.5 percentage point decrease in deposit dollarization.

EQ2.1.3 What are the main internal and external factors on which the current trend in Georgia's external financial situation and its prolongation into the future are conditional?

In the short run, the evolution of Georgia's external financial situation depends on the country's linkages to the rest of the world, changes in its trade potential, the evolution of remittances and FDI, as well as on the changes in financing costs. In the longer run, external position largely depends on the success to address structural issues, which are the major corner stone of sustainable growth.

[90] We obtained this information from the second Focus Group on economic and financial issues, Tbilisi, January 17, 2018.

Georgia is a small open economy, with export links with the EU, and the regional economies, such as Russia, Azerbaijan, Turkey, Armenia and Ukraine.[91] Partly due to the efforts to reach a geographically more diversified export structure, the importance of China has also increased. Overall, while the EU is the main trading partner of Georgia, the trade balance is strongly influenced by regional developments in non-EU countries. Due to its structure, trade is strongly exposed to commodity price developments. Export of services accounted for more than 50 percent of the total export in 2017 of which tourism is estimated to have accounted for two thirds of revenues.[92] Therefore, tourism has been a significant source of export revenues and, based on the data for the period of 2015-2017, played an increasing role in external developments. Tourists arrive mainly from the neighbouring countries (Russia, Turkey, etc.).

Besides trade and services, Georgia's external financial situation is influenced by the trends in the income balance. As discussed in detail in section 5.1, external financing situation as well as changes in global risk appetite affect the dynamics of the external financing costs. However, the implicit cost of financing of the outstanding debt has been well below the market rates and proved to be relatively resilient to the external premium shocks. This reflects the dominant role of long-term concessional financing, as well as the impact of international financial support programmes. Overall, the evolution of the income balance is largely dependent on the future role of the concessional financing. On the other hand, the credibility of the structural reform agenda, as well as the market expectations about the long-term sustainability impact country specific risk premium and hence the marginal financing cost as well.

Remittances are also an important factor in external dynamics: net inflow of remittances approached 10 percent of GDP by 2017. In 2017, a significant – but compared to the previous years decreasing – part (33 percent) of the remittances arrived from Russia (See section 5.1). In terms of external financing, the persistently high current account deficit has been to a large extent covered by FDI, coming mostly from Azerbaijan, the Netherlands, Turkey, the United Kingdom (UK) and the United States of America (USA).

Overall, as for the external factors, Georgia is still heavily exposed to regional developments (through trade exports, tourism, remittances as well as FDI financing) and fluctuating commodity prices. Our case study in Annex VII presents a detailed analysis of external trade dynamics.

As for the factors determining the longer-term development of the external position, Georgia needs to take substantial efforts to improve productivity and to increase its trade integration. To unlock the productivity potential, Georgia needs to develop its education system in order to improve skills (see section 5.4). Trade integration and diversification, as well as the accumulation of know-how could also be reinforced by participation in global value chains[93]. At the same time, Georgia has to face with the social economic challenges of the negative demographic trends and the duality of the economy. Shrinking and aging population will put pressure on social expenditures – dependency ratio is expected to increase significantly in the medium run. Georgia is characterised by a strong urban-rural dualism both in terms of economic development and of access to opportunities and social services. Structural policies need to support the catching up of rural areas both by ensuring equal opportunities and by creating local employment opportunities or supporting labour mobilization. Overall, investment in human capital and policies translating growth into job creation are essential in supporting potential growth and external sustainability.

EQ2.1.4 How is the country's external financial situation likely to evolve in the 5 years following the final disbursement given the likelihood of changes to current conditions?

Similar to answering the previous questions one needs various macroeconomic assumptions and an explicit analytical framework to forecast the external financial position of Georgia. In this regard, we rely on

91 See our case study on trade policy in Annex VII.

92 See Georgian tourism in figures (2017) https://gnta.ge/wp-content/uploads/2018/07/2017-ENG.pdf.

93 See WB. (2018). A Systemic Country Diagnostic. http://documents.worldbank.org/curated/en/496731525097717444/pdf/GEO-SCD-04-24-04272018.pdf.

the IMF's framework for external public DSA [94] in projecting a baseline projection for the country's external debt. The bottom line of our analysis is that Georgia's external financial situation is expected to remain on track, with external debt decreasing gradually from 96.3 percent of GDP in 2017 to below 89 percent in the next five years. The biggest threat to this projected baseline path lies in the external environment, especially in the regional developments and commodity prices (see EQ 2.1.3). If the country's current account deficit exceeds the level forecast by the IMF (See IMF WEO, October 2018) and/or the inflow of FDI falls significantly short of the external financing need, the improvement in the external debt can delay or will remain less pronounced.

6.2.2 EQ2.2: Effectiveness in fiscal policy

Table 6.10 Evaluation sub-questions on the effectiveness of fiscal consolidation

EQ2.2 To what extent has the MFA been effective in fiscal consolidation?
EQ2.2.1 How has the MFA impacted the fiscal position of Georgia?
EQ2.2.2 Was the envisaged pace, ambition and composition of fiscal consolidation appropriate in the context of the economic and financial conditions in the beneficiary country?

Below, we provide more detail on our approach to responding to these sub-questions.

EQ2.2.1 How has the MFA operation impacted on the fiscal position of Georgia?

The un-earmarked nature of the MFA assistance and the fact that half of the amount was provided in the form of grants could efficiently and flexibly help to alleviate fiscal pressures. The public deficit was close to 4 percent of GDP in the MFA implementation period and this level was higher than in 2012-2014. The deficit increase was partly due to the cyclical downturn and the related revenue losses. However, structural policy measures – like the long awaited increase in social spending, and the corporate tax reform preceding the elections also contributed to the change in the budget deficit. While the 4 percent public deficit was still in a moderate range, the fact that Georgia has limited access to market financing increased the importance of the EU and IMF financing (See section 5.2).

By providing financial assistance, the MFA operation has helped to smooth fiscal adjustment and thus created some fiscal space for structural reforms and for sustaining social spending. Besides, the grant component had an immediate deficit decreasing effect, while the loan part, through its concessional terms results in significant fiscal savings over the years (See Section 6.7 for calculations on the fiscal savings). Further positive fiscal impact can be attributed to the operation through its effect on GDP growth and hence on tax revenues. Finally, some of the structural measures also had a direct, although longer-term positive impact on public balances. Condition 1 targeted to improve public procurement; condition 2 addressed the issue of the independence of SAO, while condition 3 and 4 aimed at increasing efficiency and improving quality of health care services. These measures could contribute to contain expenditures and to improve the efficiency of public finances in general.

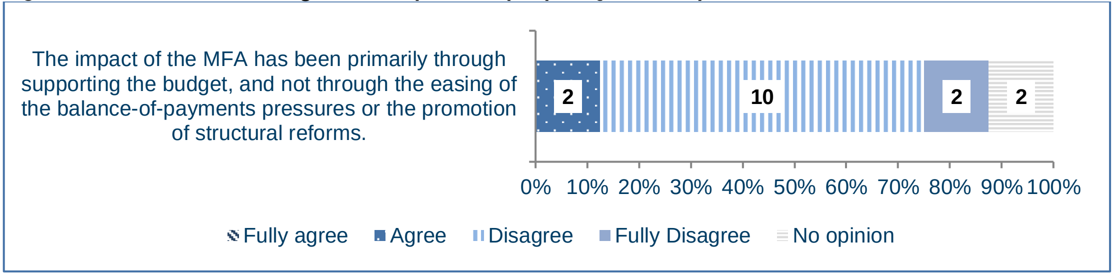
Our semi-structured interviews with the authorities and private sector representatives have indicated that the short-term impact on budget financing was a less important contribution of the MFA operation. While stakeholders have a common understanding that, the longer-term fiscal impacts of the reform conditions, i.e. conditions targeting PFM and the social safety net, were both highly relevant and important.

The results from question 3 of the Delphi questionnaire (sub-question 3) largely confirm the observations made by the Georgia authorities and private sector representatives (Figure 6.9). 12 respondents (fully)

[94] For an overview of this framework, see IMF. (2011). Modernizing the Framework for Fiscal Policy and Public Debt Sustainability Analysis. https://www.imf.org/external/np/pp/eng/2011/080511.pdf , and IMF. (2013). Staff Guidance note for Public Debt Sustainability Analysis in Market Access Countries. https://www.imf.org/external/np/pp/eng/2013/050913.pdf.

disagreed with the statement that the contribution of the MFA was rather through supporting the budget than through supporting the BoP or promoting structural reforms.

Figure 6.9 The MFA and Georgia's fiscal position (Delphi, Question 3)



EQ2.2.2 Was the envisaged pace, ambition and composition of fiscal consolidation appropriate in the context of the economic and financial conditions in the beneficiary country?

The IMF set the fiscal consolidation targets in its SBA (and the subsequent EEF), to which the MFA disbursements were linked. Therefore, in order to answer this question we need to evaluate the track record of the country in face of the IMF's requirements.

At the time of the approval of the IMF SBA in July 2014, the budget deficit was expected to increase to 4 percent of GDP from 2.6 percent in 2013. The substantial deterioration was mainly explained by the impact of the introduction of the UHC and the pension reform introduced in 2013. The authorities agreed to set a deficit target of 3.7 percent for 2014, 3 percent for 2015 and 2.7 percent for 2016. The consolidation was expected to materialize through the substantial decrease of current spending as the government planned to increase capital spending and the space for tax increases or revenue mobilisation was limited (see section 5.2). Despite of the agreed reduction of current expenditures, the IMF emphasized the need to maintain social spending (and to improve targeting to protect the poor).

Despite of the overrun of health care expenditures, Georgia recorded a budget deficit below 3 percent in 2014, mainly as a result of the better than expected revenue collection. However, in 2015 the deficit increased above 3.5 percent of GDP, i.e. well above the 3 percent target set by the IMF, mainly on account of the overruns in expenditures (partly due to the higher than planned health care spending). Despite the economic slowdown, revenues over-performed again, owing to improved tax administration and the lari depreciation, which increased inflation and import-related VAT revenues. In 2016, the corporate tax reform, a measure introduced preceding the elections, put further pressure on the budgetary performance, pushing the deficit close to 4 percent of GDP. The miss of the fiscal targets and the authority's unwillingness to take the necessary measures has contributed to the fact that the IMF SBA went off-track in 2015.

The new government elected in 2016 October started fiscal consolidation and committed itself to gradually decrease the budget deficit[95] close to 3 percent by 2020. The IMF accepted the budget deficit target set at 4.1 percent of GDP as it had already incorporated significant consolidation measures. The deficit decreased slightly below 4 percent in 2017.

Overall, the pace and the ambition of the fiscal consolidation plan set by the IMF was found reasonable. The fact that the targets were missed in 2015 and 2016 resulted from the recurrent overrun of the UHC related spending and the government intention to introduce an election budget. This view was also supported by the stakeholder interviews.

95 In terms of the so called GFSM 1986 budget deficit indicator used by the EC. IMF uses a different, so called augmented GFSM 2001 deficit concept.

6.2.3 EQ2.3: Effectiveness of structural reforms

Table 6.11 Evaluation sub-questions on the effectiveness of structural reforms

EQ2.3 To what extent have the short and medium-term expected structural effects of the assistance occurred as envisaged?
EQ2.3.1 What are the short and medium-term expected structural effects of the assistance (in the context of the Georgia's reform programme)?
EQ2.3.2 To what extent have the short and medium-term expected structural effects of the assistance (in the context of the Georgia's reform programme) occurred as envisaged?
EQ2.3.3. To what extent have the structural criteria of the MFA contributed to the desired structural outcomes / effects?
EQ2.3.4. To what extent have the structural effects been enhanced by complementarities between the MFA assistance, IMF programme conditions and other EU instruments?
EQ2.3.5 What has been the contribution of actions resulting from the respect of structural conditionality criteria to the achievement of the short- and medium-term macroeconomic objectives of the assistance (i.e. indirect effects of the structural conditionality criteria)?

This part of the MFA evaluation pertains to the structural conditions that were attached to the MFA operation.

EQ2.3.1 What are the short and medium-term expected structural effects of the assistance (in the context of Georgia's reform programme)?

The objectives of the reform programme of the authorities were presented above related to EQ1. The short and medium-term structural effects of the MFA conditions presented in Table 6.12 below are closely related to parts of the intervention logic of each of the conditions, as discussed in Chapter 5. As explained in section 5.3, no implementation deficit was encountered for any of the conditions.

Table 6.12 Expected short and medium-term structural effects of the assistance

No	Condition	Short-term effects	Medium-term effects
1	Improve awareness about public procurement	• Training of qualified procurement specialist; • Introduction of certification system that simplifies the process of recognition and identification of knowledge.	Improving the quality of procurement.
2	State Audit Office	Strengthen the independence of the SAO.	Strengthening external audit and PFM.
3	Health care survey	Documenting strengths and weaknesses of the UHC; Supporting reform initiative of the government.	Further refinement of the design and management – and therefore further improvement of the efficiency and quality – of the UHC programme.
4	Unit for Health Care Quality Improvement	• Establishment of a robust infrastructure for controlling; • Improving quality and efficiency of health care services.	Increasing the quality and efficiency of health services. Increasing the rate of utilisation of health services.
5	Strengthening the process of ensuring banks' capital adequacy	• Promote better risk management techniques in the banking sector; • Alignment with the international best practices; Harmonizing regulatory	• Strengthening banking regulation and supervision; • Improving capital adequacy of banks based on their risk profile; • Increasing resilience of the banking sector.

No	Condition	Short-term effects	Medium-term effects
		approaches with relevant Euro directives.	
6	Establishment of CRMD at NBG	Implementation of the NBG's CRM framework action plan.	• Improving the risk management processes at NBG; • Alignment with international best practices.
7	Centralizing EUR1 certificates	• Simplifying export procedures; • Implementation of DFCTA.	• Increasing trade with the EU; • Promoting export diversification.
8	Secondary legislation - Law on Competition	• Strengthening competition regulation; • Implementation of DFCTA.	• Strengthening anti-monopoly policies; • Promoting free trade; • Supporting economic growth.

EQ2.3.2 To what extent have the short and medium-term expected structural effects of the assistance (in the context of Georgia's reform programme) occurred as envisaged?

Table 6.12 above shows the expected short and medium-term effects of the actions. As explained before, we approached several stakeholders with specific knowledge of the field and we found no signs of implementation deficits. This finding was also supported by the Delphi results (see below). Below we give a short description on whether the expected short or medium-term effects have materialized.

Condition 1: Improve awareness about public procurement

The procurement-training centre was established and the certification system was put in place. In 2018, the SPA operated 5 different trading modules, four for the public and one for the private sector participants. Regarding the medium-term structural effects, the Public Expenditure and Financial Accountability (PEFA) performance assessment report on 2017 (published in 2018)[96] finds that "achievements in public procurement are impressive" compared to 2013. The assessment emphasizes the development and good use of IT in procurement and by PFM in general. The only area identified in the procurement system with weaknesses is the appeal and dispute process. At the same time, there was a widespread perception among IFIs, non-governmental organisations (NGOs) and the private stakeholders that shortcomings in the procurement processes remain significant. As was explained in the interviews, due to the high proportion of direct contracting and subcontracting the system is far from being transparent.

Condition 2: State Audit Office

The legal independence of the SAO is assured by the Constitution and the Law on State Audit Office. The PEFA report (2018) identifies the external audit processes as fully independent and as an area of significant strength, thus enhancing fiscal discipline. The report also stated that external auditing showed a significant improvement compared to 2013. The only area where the report pointed out room for further improvements is the follow-up of audit recommendations. The same view was expressed at our interviews conducted in Georgia: stakeholders stated that the follow-up on audit findings and recommendations by the SAO often lacks political will. Based on the 2017 compliance assessment note before the disbursement in 2017, the Parliament's attitude towards the SAO has improved. However, the Financial and Budgetary Committee of the Parliament keeps overstepping its legal authority and is asking the SAO to supply data that go beyond the annual financial audit.

96 The purpose of PEFA assessment is to provide an objective analysis of the PFM system against the PEFA indicators. See Public Expenditure and Financial Accountability (PEFA) Performance Assessment report, 2018. https://pefa.org/assessments/georgia-2018.

Condition 3: Health care survey

With technical and financial assistance from the WB, USAID, WHO, the MoLHSA has completed the Health Utilisation and Expenditure Survey. The field works were finished in December 2014 and the first results of the survey were presented in May 2015. As we learnt from the stakeholder interviews with the authorities and the IFIs, the survey results helped to identify the areas where further development was needed and served as an input to improve the quality and coverage of the UHC.[97] For example, as of 2018 the MoLHSA increased the coverage of outpatient medicines as the survey indicated that OOP spending on medicines was very high (See section 5.4). On the other hand, the survey provided valuable information on the decrease of OOP of poor households, giving feedback to the government on the positive impact of the reform. The survey information could also have been used to further improve the efficiency of the health care system, but on this field, only limited progress has been made (for further details see sections 6.6.2 and 6.6.3).

Condition 4: Unit for Health Care Quality Improvement

Instead of creating a separate unit, the authorities assigned these responsibilities to the Executive Department of MoLHSA. According to the Governmental Resolution №760, the Article 9 of the Statutes of the MoLHSA, the department was responsible for the "coordination of healthcare quality improvement activities for the enhancement of state health program efficiency". As for the expected medium-term effects, Georgia managed to improve the availability and the quality of public health care services to a significant extent. However, the cost-efficiency and financial sustainability of the health care system has not improved yet. We give a detailed analysis of the developments in these fields in section 6.6.

Condition 5: Strengthening the process of ensuring banks' capital adequacy

All Banks submitted their ICAAP reports in September 2014 and NBG completed the SREP for the two largest banks in 2015. Stakeholders were of the view that commercial banks' risk management practices improved since 2014. Data shows that banks are well capitalised (based on 2018 Q3 data the system wide CAR is above 17 percent) and their profitability has been steadily high. Asset quality proved to be resilient despite the sharp depreciation of the lari in 2014-2016. We give a detailed analysis of the developments in these fields in the Case study on the financial sector in Annex VII.

Condition 6: Improving the risk management processes at NBG

The Centralized Risk Management Department (CRMD) was established in November 2014. The department provided a core for risk management coordination between NBG departments, internal audit and international partners. The risk management practices of the NBG were harmonised with international best practices. Stakeholders confirmed that transparency and integrity of risk taking and risk management activities of NBG have improved considerably. For further details, see the Case study on the financial sector in Annex VII.

Condition 7: Centralizing the management of EUR1 certificates

The rules of origin now fall under the auspice of the MoF (Revenue Service Department), and companies complying with custom procedures face with a simplified procedure. Therefore, besides supporting the implementation of the DFCTA, the centralisation of EUR1 certificate helped to facilitate exports. Nearly 5,000 export certificates per year have been issued during 2014-2018 with a total value of more than USD 720 million – a relatively small figure. DCFTA apparently did not have yet much positive effect on Georgian exports to the EU so far. This is partly explained by the fact that companies do not understand the system, and the EU SPS and TBT requirements are very demanding. For further details, see the Case study on trade policy in Annex VII.

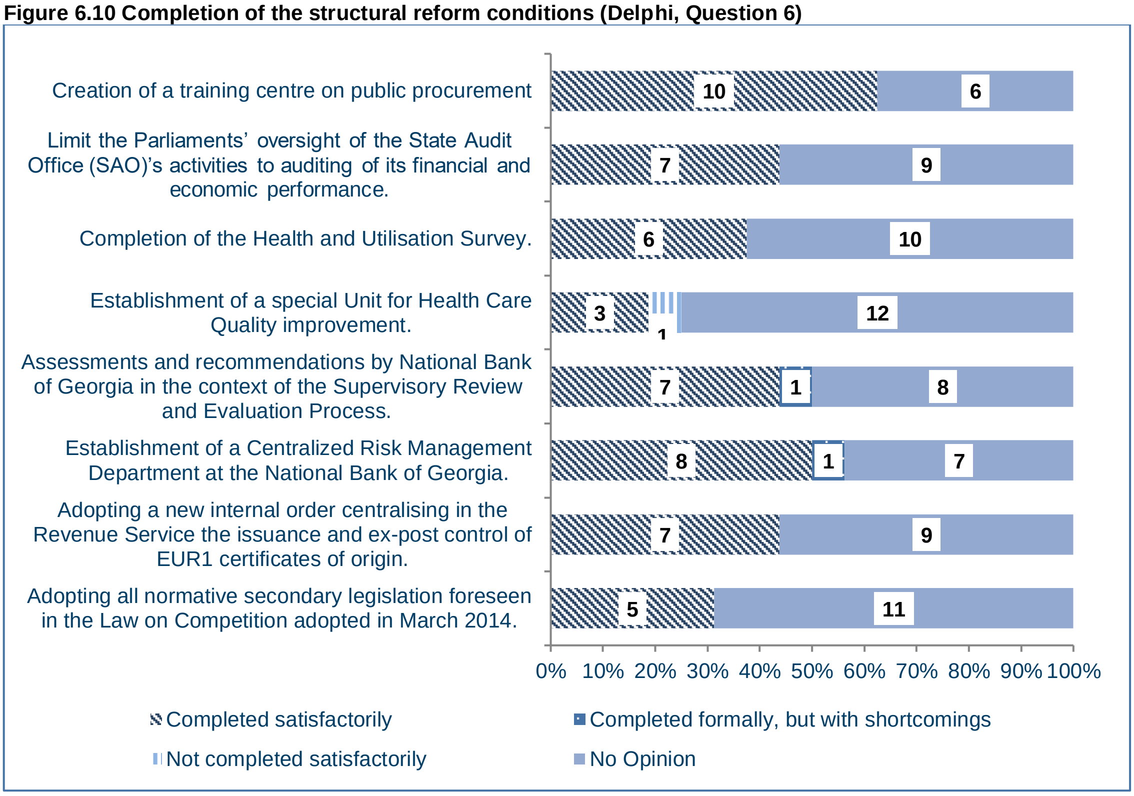
97 Survey results are presented in more detail in section 5.2.

Condition 8: Secondary legislation - Law on Competition

The secondary legislation related to the Law on Competition were adopted in 2014, which allowed for the effective functioning of the Competition Agency (formally established in March 2014). However many stakeholders expressed their concerns that competition policy is not implemented efficiently as the Agency does not have enough power and competence (lacks sufficient qualified staff). A new secondary legislation is under preparation and planned to be approved in 2019. Furthermore, the responsibilities of the different agencies covering various areas of competition are not determined, leading to inter-institutional disputes. Overall, high concentration and oligopolistic market structure is still a pressing problem signalling that competition policy does not work properly.

In the Delphi questionnaire, the assessments have been triangulated with experts' views about the implementation of the reforms. Majority of respondents agreed that the reforms had been completed satisfactorily (Figure 6.10). However, it must be emphasized that a significant amount of respondents had no opinion on the subject matter.

Figure 6.10 Completion of the structural reform conditions (Delphi, Question 6)



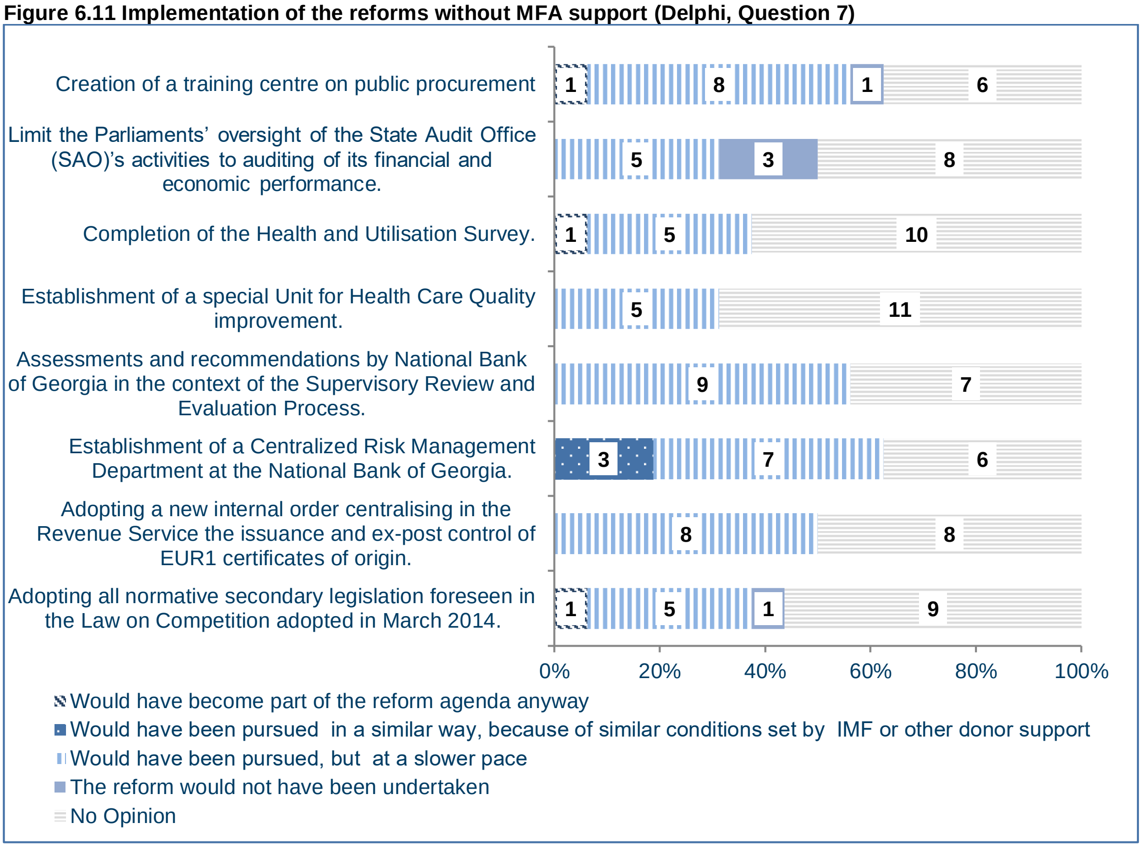
EQ2.3.3 To what extent have the structural criteria of the MFA contributed to the desired structural outcomes / effects?

The contribution of each structural conditions has been assessed in the interviews but also in a more structured manner in question 7 of the Delphi questionnaire by asking the respondents "what would have happened to the reforms agenda if the MFA support had not been taken place?". On the one hand, respondents may not assess any direct contribution of MFA to the implementation of the structural reforms if they agree with the statement that the reforms "would have become part of the reform agenda anyway" or "would have been pursued in a similar way because of similar conditions set by IMF or other donor support". On the other hand, respondents may see a clear impact of the MFA on the structural reforms if they agree with the statements that the reforms "would have been pursued, but at a slower pace" or the reforms "would not have been undertaken".

For all conditions, the majority of the respondents having opinion on the action in question do recognize a direct impact of the MFA conditions on reforms in Georgia. According to most of the respondents, this direct impact materialized through speeding up the reform processes, i.e. the reforms would have been pursued without the MFA conditionality, but at a slower pace. The direct impact is more pronounced in the case of the condition on SAO's independence, as 3 respondents were of the view that the action would not have been undertaken in the absence of the MFA condition.

For condition 6 (establishment of CRMD), however, there is less of a common agreement. Three respondents did not see any direct contribution of MFA (of which all of them saw a limited effect of MFA due to cross-conditionality), while 7 respondents saw an impact of MFA on the reform.

Figure 6.11 Implementation of the reforms without MFA support (Delphi, Question 7)



Nevertheless, to assess the full contribution of the MFA conditions indirect effects, for instance through strengthening the conditions of other interventions, need to be taken into considerations. This is discussed in EQ2.3.5 and further in EQ 4.1.

EQ2.3.4 To what extent have the structural effects been enhanced by complementarities between the MFA assistance, IMF and World Bank programme conditions and other EU instruments?

The main findings with regard to complementarities are summarized in Table 6.3.

Table 6.3 Complementarity between the MFA, other interventions or technical assistances

No.	Condition name	EU	IMF	WB
1	Improve awareness about public procurement	+	-	+
2	State Audit Office	+	-	-
3	Health care survey	-	-	+
4	Unit for Health Care Quality Improvement	-	-	+
5	Strengthening the process of ensuring banks' capital adequacy	-	+	+
6	Improving the risk management processes at NBG	-	+	-
7	Centralizing the management of EUR1 certificates	+	-	-
8	Secondary legislation - Law on Competition	+	-	+

The complementarities, cross conditionality and also other donor support linked to each of the conditions is discussed in further detail below. An overview of programmes and instruments is provided in Annex III.

Condition 1: Improve awareness about public procurement

The establishment of a training centre on public procurement was closely linked to the EU budget support operation. This condition, however, was neither linked to one of the structural benchmarks in the IMF SBA or EEF, the prior actions in the WB's 2012–14 Competitiveness and Growth DPOs - DPL I (2012), II (2013) and III (2014) – nor to the WB's 2015–17 Inclusive Growth DPOs. At the same time, WB as well as the USAID have an important role in giving technical assistance in this area.

Condition 2: State Audit Office

The operational independence of the SAO was also being supported by the EU through its budgetary support operations. In particular, the Support to Public Finance Policy Reform (PFPR) was also aimed at strengthening external audit through increased harmonization with the INTOSAI Lima and Mexico Declarations with specific attention on independence and objectivity. Strengthening the SAO's mandate, performance and communication was one out of six priority policy areas subject to performance criteria and indicators used for EU budget support disbursements. Conditions with regard to the operational independence of the SAO were neither included in the WB DPOs nor as a structural benchmark of the SBA or EEF by the IMF.

Condition 3: Health care survey

Similar to the area of PFM, there was no cross-conditionality in the DPLs and MFA in the health care sector. However, the conditions between DPLs and MFA were very similar in the area of health care. The WB has remained engaged in various areas of policy reform in health care through the 2012–14 Competitiveness and Growth DPOs and the 2015–17 Inclusive Growth DPOs, as well as in policy analysis through Public Expenditure Reviews (PERs) in 2012 and 2017 with a special focus on the health sector. Conditions with regard to improving the accessibility and quality of healthcare services were included as prior actions in the WB's DPL I (2012), II (2013) and III (2014). According to the World Bank this "engagement has, however, been based on a piecemeal approach to reform, without a broader vision on the key challenges of the sector and a coherent drive to address them".[98] The condition was not linked to one of the structural benchmarks in the IMF SBA.

Condition 4: Unit for Health Care Quality Improvement

This condition was aimed at supporting the government's efforts to improve the coverage and operation of the UHC system after the WB and the WHO, supported by the USAID, had finished the appraisal of Georgian health sector. This condition was complementary to the DPLs provided by the WB between 2012 and 2014. One out of three major pillars of the DPLs was to improve the accessibility and quality of

98 World Bank. (2018). Georgia: First, Second and Third Development Policy Operations. Project Performance Assessment Report. https://ieg.worldbankgroup.org/sites/default/files/Data/reports/ppar_georgia123dpo.pdf.

healthcare services and efficiency of targeted social programs. As mentioned in condition 3 already, the WB has remained engaged in various areas of policy reform in health care afterwards through the 2015–17 Inclusive Growth DPOs and the PERs in 2012 and 2017. Condition 4 can therefore be regarded as complementary to previous prior actions in the DPLs 1, 2 and 3. Similar to condition 3, the establishment of a special unit for health care quality improvement was not a structural benchmark of the SBA or the EEF of the IMF.

Condition 5: Strengthening the process of ensuring banks' capital adequacy

This condition was not included in conditionality of other international support programmes. At the same time, a joint IMF-WB Financial Sector Assessment Program (FSAP) carried out in 2014 stressed that efforts should be made to improve banks' risk management and that some vulnerable banks need to strengthen their capital buffers to mitigate funding risks. Therefore, this MFA condition was consistent with the suggestions made by the IMF and WB and meant a further step toward convergence to international best practices. Furthermore, the structural benchmark conditions attached to the IMF EEF targeted other areas of the financial supervision where the FSAP (2014) identified further development needs. Therefore, the programmes complemented each other in an efficient way. Finally, under the AA, Georgia has also committed itself to adopt the EU financial framework. For further details, see the Case study on the financial sector in Annex VII.

Condition 6: Improving the risk management processes at NBG

This condition was not included as part of the conditionality of other international support programmes. However, it was recommended by the IMF's safeguard assessment in 2011. For further details, see the Case study on the financial sector in Annex VII.

Condition 7: Centralizing the management of EUR.1 certificates

This condition was linked to the DFCTA commitments and the related EU budget support operation. In this respect, the MFA programme complemented the EUR 51 million DCFTA implementation and the Small and Medium-sized Enterprises (SME) Support Programme signed in 2014. During 2014-2018 period, nearly 20,000 certificates of origin were accepted by the Revenue Service Department.

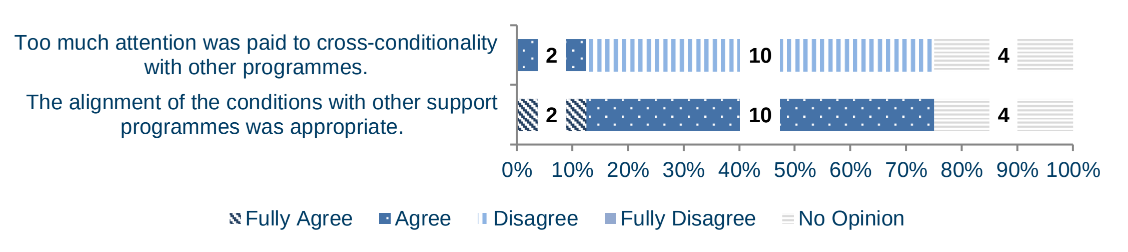
Condition 8: Secondary legislation - Law on Competition

This condition was linked to the DFCTA commitments and the related EU budget support operation. The Competition Agency adopted five orders in (on applications and complaints, on leniency programme, on methodological guidelines for market analysis, on notification on concentration and on procedure of investigation). The preparation of the orders was made by the Agency in close cooperation with the EU and the WB.

Overall, it can be concluded that the majority of the conditions were not cross conditional, as the IFIs did not aim to replicate conditions. However, the conditions were well aligned with the conditions of other interventions and support programmes (see EQ4.3). The different programmes and technical assistances built on the achievements of each other's. We learnt from our interviews that most of the stakeholders appreciated this alignment with the respective conditions.

The feedback on sub-question 4.5 and 4.7 of the Delphi questionnaire also supports this view. An ample majority of the respondents agree that the "alignment of the conditions with other support programmes was appropriate". Furthermore, 10 of the 16 respondents disagree with the statement that "too much attention was paid to cross-conditionality" while 2 other respondents agree with this statement. In both cases, the remaining four participants expressed "no opinion".

Figure 6.12 MFA conditions and the level of complementarities (Delphi, Question 4)



EQ2.3.5 What has been the contribution of actions resulting from the respect of structural conditionality criteria to the achievement of the short and medium-term macroeconomic objectives of the assistance (i.e. indirect effects of the structural conditionality criteria)?

In this question, we assess the indirect effects of the MFA conditions on the structural reforms and also to the achievement of the macroeconomic objectives.

Most of the MFA conditions seem to have contributed indirectly to some extent to the implementation of the requested reforms. These effects have primarily been generated by reinforcing the reform agenda set by the government and supported by the EU, other IFIs or donors. With regard to most conditions, the likely MFA contribution often results from joint leverage with an IFI in the lead. Condition 7 is an exception, as it was an EU specific condition related to the EU integration process. It needs to be mentioned that it is very difficult to disentangle the effects of the conditions of different interventions in the same policy area. The likely indirect effects of each of the MFA conditions and their related actions are assessed below.

Condition 1: Improve awareness about public procurement

The inclusion of this MFA condition was a logical next step considering that while Georgia had developed one of the most advanced e-procurement systems in the world, lack of qualified procurement professionals was considered one of the pressing problems in public procurement. As recorded by the PEFA (2018) report, the quality of procurement services improved in the period of 2013-2017, which contributed to the general objective of improving the transparency and efficiency of the PFM in Georgia. The condition reinforced the widespread procurement supporting activity of the WB and the USAID.

Condition 2: State Audit Office

By ensuring the independence of the SAO, the condition has contributed to the general objective of strengthening the efficiency, transparency and accountability of PFM in Georgia. Therefore, it also supported fiscal sustainability.

Condition 3: Health care survey

The Health care survey was an important first step for defining a strategy to improve the UHC reform introduced in 2013. The specific impact of this MFA condition is difficult to disentangle from the overall reforms in this area. The main contribution is created by joint leverage of the WHO, the World Bank and the Health System Strengthening Project of USAID, who provided both financial and technical assistance.

Condition 4: Unit for Health Care Quality Improvement

The condition reinforced the structural efforts aiming at improving the quality, efficiency and cost-effectiveness of the health care system. As in the case of the condition on health care survey, the contribution is created by joint leverage of the IFIs involved.[99]

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99 The World Bank also supported health care quality improvements. Word Bank Prior Action DPL3 in 2014 was "The Minister of Labour, Health and Social Affairs implemented upgraded standards for facilities providing primary healthcare." However, no evidence was found so far that the MFA condition strengthened the prior actions in the DPLs of the World Bank.

Condition 5: Strengthening the process of ensuring banks' capital adequacy
This MFA condition was a logical next step based on the challenges identified by the FSAP carried out by the IMF and the WB in 2014. By providing a credibility stamp, the action supported the NBG's reform agenda aiming at the introduction of bringing NBG's practice in line with Basel II and Basel III recommendations. As planned, after 2015 NBG extended the SREP for all banks. While the NBG had been committed to harmonize its banking supervision and regulation with the international best practices, the MFA ICAAP condition and the financial sector related structural benchmarks of the IMF EEF efficiently reinforced this process.

Condition 6: Improving the risk management processes at NBG
The Global financial crisis highlighted the importance of central banks' risk management.[100] The establishment of the CRMD was a logical step toward establishing a coherent risk management system at the NBG. The action was consistent with the recommendations of the IMF's safeguard assessment (IMF, 2011). At the same time, the scope of this condition was limited compared to the others and it has no expected impact on the achievement of the medium-term macroeconomic objectives of the assistance.

Condition 7: Centralizing the management of EUR1 certificates
This condition was closely related to DCFTA implementation. Although EUR1 certificates are necessary for exports to the EU, Georgia has just a few competitive export products and even those still face considerable hurdles on the EU market owing to poor quality standards and other compliance problems (non-tariff measures(NTM) such as non-tariff barriers (NTB) and sanitary and phytosanitary (SPS) regulations). DCFTA requires Georgia to adopt the whole body of EU standards, which consists of 25,000 EU standards, i.e. all the standards developed by the European Committee for Standardization (CEN), the European Committee for Electrotechnical Standardization (CENELEC) and the European Telecommunications Standards Institute (ETSI), including the 5,000 harmonised standards. During 2014-2018 period, nearly 20,000 certificates of origin were accepted by the Revenue Service Department.

Condition 8: Secondary legislation - Law on Competition
Besides supporting the implementation of the DFCTA, the condition was an important building block for the implementation of an efficient competition policy in Georgia. The EU had a prominent role in supporting the establishment of the Competition Agency and the approval of the secondary legislation was necessary to make the agency operational. Apart from the EU (DG Competition), the Agency receives technical assistance from several EU member states (Austria, France, Estonia, the Czech Republic, Germany, Sweden, Lithuania, etc.).

6.3 EQ3: Efficiency of the operation

To assess the efficiency of the operation, we respond to the following EQ.

Table 6.13 Evaluation questions on the efficiency of the operation

EQ3 To what extent did the MFA operation design and implementation allow to carry out the intervention efficiently?
EQ3.1 In what way has the design of the MFA assistance conditioned the performance of the operation in respect to its costs and its objectives?
EQ3.2 How did the long timeline of the MFA operation impact its efficiency?
EQ3.3 Was the disbursement of the financial assistance appropriate in the context of the prevailing economic and financial conditions in Georgia?

100 For further details see the Case study on the financial sector in Annex VII.

6.3.1 EQ3.1: In what way has the design of the MFA assistance conditioned the performance of the operation in respect to its costs and its objectives?

The design of the MFA operation did have substantial implications for its efficiency, both from the perspective of the EC as well as from the Georgian authorities.[101]

There was mutual leverage between the MFA and the SBA provided by the IMF and to a lesser extent the DPLs of the World Bank. The MFA operation was also closely coordinated with IMF. Therefore, impact was significant compared to its cost. Moreover, in negotiating specific policy conditions, the EC was able to draw on the expertise of those institutions, influence their conditionality and keeping the preparation cost of the MFA relatively low.

For the authorities, the number of conditions, focusing on different reform areas and the direct cost attached to certain reform areas were challenging. Nevertheless, most MFA conditions were part of the government's or the NBG's reform agenda and were also complementary, to some extent, to conditions set by other interventions (see EQ 2.3.4 on complementarities and Annex III on cross conditionality and complementarities).

To support the implementation by the beneficiary of the relevant measures, the EC aimed at achieving synergies with other EU policies and instruments. The main synergies were achieved through its budget support operations, notably in the area of PFM and measures defined by the AA promoting closer economic and financial integration with the EU.

Half of the MFA assistance was provided in the form of loans. As a result, the EU budgetary impact was smaller than in the case providing the full support in the form of grants. For the authorities of Georgia, it was the opposite. The savings originating from the MFA operation were less than if only grants had been provided. Nevertheless, the relatively soft conditions attached to the loan component of the MFA were attractive compared to most alternative funding sources. The highly concessional terms, i.e. low interest rates (see Section 6.7.3 for more details), long maturity (15 years) and long grace period, made the MFA attractive in comparison with other loan operations such as the SBA of IMF, and also compared to Eurobonds and T-bills. The benefits and savings associated with the soft conditions of the loan component, as well as the grant component are elaborated in detail Section 6.7.

The MFA was more cost-efficient than the provision of a similar amount of financial support by different EU Member States individually. It needs to be mentioned however that MFA was not replacing bilateral support of member states. Some member states, like Germany, France and Austria provided bilateral support to Georgia.

6.3.2 EQ3.2 How did the long timeline of the MFA operation impact its efficiency?

Georgia requested the activation of MFA 2 in May 2010. The EC proposed the MFA 2 operation in January 2011, and the European Parliament and the Council adopted it on 12 August 2013 (Decision 778/2013/EU). Delay in the adoption was caused by procedural disagreements between the co-legislators. The procedural disagreements within the EU resulted in a very lengthy procedure, taking more than 3 years from the official request to the approval of the operation. However, in the specific case of Georgia, this exceptionally long timeline of the approval did not result in efficiency losses. As of end 2010, Georgia decided to handle the IMF SBA as a precautionary agreement – primarily due to the improved financial circumstances. As the MFA operation is complementary to a *disbursing* IMF programme, the precautionary treatment of the IMF programmes prevented the activation of MFA 2. Georgia did not have a disbursing IMF support programme until July 2014, the approval of a new IMF SBA, which allowed the EC to

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101 The ex-ante evaluation statement put forward a number of reasons for a high degree of cost effectiveness of the MFA operation from the Commission's perspective. See https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52010SC1617&from=EN.

reactivate the MFA 2 operation and to start the negotiations on the MoU. Finally, the MoU was signed in December 2014 (See Section 2.2).

Overall, one can conclude that in the specific case of Georgia, the lengthy decision making process in relation to the approval of the MFA did not cause efficiency losses. However, the inception of the MFA operation is assessed to be slow by some stakeholders. Apart from the delay caused by the procedural disagreements, the 6 month time span from the request of the MFA (May 2010) to the submission of the EC proposal to the legislators (January 2011) is assessed to be relatively long. MFA is designed to support BoP crisis management, therefore rapid reaction, timely decision making and quick disbursement can be vital in crisis circumstances, when there is a pressing financing need.

6.3.3 EQ3.3: Was the disbursement of the financial assistance appropriate in the context of the prevailing economic and financial conditions in Georgia?

The first MFA 2 instalment was disbursed immediately after the signature of the MoU, in two tranches. Firstly, in January 2015 the EUR 13 million grant component of the first tranche was disbursed. Secondly, in April 2015, the EUR 10 million loan component was released (with a delay, which allowed the EU to obtain more favourable financing conditions for Georgia).

The disbursement of the second instalment, foreseen for 2015, was delayed because of the lack of Georgia's progress in the implementation of the IMF programme. Only after the approval of a new EFF loan to Georgia in April 2017 the EC decided on 28 April 2017 to proceed with the disbursement of the second MFA 2 instalment (EUR 10 million in grants and EUR 13 million in loans). For more information, see Section 2.1.

Overall, the implementation process in the context of the disbursements of the MFA 2 to Georgia is assessed to be efficient. The delay of the disbursement of the second instalment was due to factors outside the control of the Commission. Therefore, the disbursement of the MFA was appropriate in the context of the prevailing economic and financial conditions in Georgia. As explained in EQ 2.1.1, the combined effect of the MFA and the SBA contributed to a long-term improvement of the external financial position.

6.4 EQ4: EU value added of the operation

This EQ considers the extent to which EU assistance has provided additional benefits beyond what would have resulted from other interventions (in particular the IMF but also other donors).

Table 6.14 Evaluation sub-questions on the EU added-value the operation

EQ4 What was the rationale for an intervention at EU level? To what extent did the MFA operation add value compared to other interventions by other international donors?
EQ4.1 To what extent have the expected benefits of the EU intervention been attained?
EQ4.2 What is the value resulting from the EU assistance which is additional to the assistance obtained at other levels (IMF, other donors)?
EQ4.3 To what extent has the sharing of roles between the European Commission (DG ECFIN and other DG's), the IMF, Member States and others contributed to optimise the impact of the assistance?

EQ4.1 To what extent have the expected benefits from the EU intervention been attained?

The immediate benefits of the conditions and the related implementation deficits have been discussed in EQ 2.3.2. The evaluation has further identified added value of this MFA operation in several areas that are described below.

Stimulate structural reform process. The MFA 2 operation had a distinguished role in stimulating the structural reform process. By the conditionality set in the MoU, it helped the authorities to prioritize reforms and set up credible milestones. MFA has contributed to the promotion of reforms as it has created the necessary political will (e.g. SAO independence) and has helped to communicate unpopular reforms to the public. Furthermore, the government could capitalize on the conditionality to build further reforms. As was explained in the interviews, getting an external credibility stamp on policy reforms is a highly important factor in Georgia. In a similar vein, the MFA has helped the continuation of the policy dialogue with the EU in difficult periods, supporting the long lasting process of EU integration. MFA helped to anchor and support compliance with the demanding process of the convergence to EU regulation it.

Most of the conditions were part of the government's reform agenda and as such, most of them would have been accomplished even without the EU support. However, the MFA helped to provide additional momentum and credibility in a difficult period when there was a risk of losing commitment and of stagnating reforms. The progress in the areas covered by the conditionality – even if it can only partly be attributed to the MFA – opened the possibility of long-term benefits. In a broader context, the MFA signalled to the other countries in the region that in moments of economic difficulties, the EU is ready to support countries like Georgia embarking on a clear path towards economic reforms.

While the operation created important value added through the continuation of policy dialogue, its visibility was relatively low. Most of the stakeholders could not distinguish the MFA from other EU operations.

Help maintaining and building external financing buffers Georgia accumulated significant balance sheet vulnerabilities. The high level of and mostly FX denominated external and public debt, coupled with the long standing problem of dollarization increase the importance of accumulating adequate buffers for financing shocks. The MFA support contributed to the replenishment of FX reserves which has been below the adequate level since 2013 (see section 5.1).

Restore market confidence. By supporting the consolidation efforts and signalling that the EU is ready to give additional financial support to the country, the MFA operation – together with other international financial programmes - signalled that Georgia is on the right track in terms of structural reforms. This helped to restore market confidence and supported the decrease of risk premium, which was well reflected in the dynamics of market interest rates as well. According to our DSA, the confidence channel was responsible for a significant part of the positive impact of the operation on the external and fiscal sustainability.

Financial value added. The MFA contributed to alleviating the financing pressure in Georgia in 2015 and 2017. The size of the MFA operation (EUR 46 million) corresponded to 0.4 percent of Georgia's GDP in 2015. A main attractiveness of the MFA assistance versus alternative sources of financing (e.g. the SBA of the IMF, Eurobonds and T-bills) was that half of it was provided in the form of grants. Furthermore, the other half provided in loans had highly concessional terms, i.e. relatively low interest rates, long maturity and long grace period. This was confirmed by the authorities during the interviews. Our calculations points to significant savings resulting from the favourable form of the assistance (see section 6.7.3).

Alleviating fiscal pressure. Thanks to its un-earmarked nature, the MFA could help to smooth the budgetary consequences of the regional downturn and by that supported the structural reform process and helped to sustain social spending. The added value of the MFA in this respect was also confirmed by the

Delphi survey (Figure 6.15). In addition, the Commission presented the MFA as one of the instruments to support the Georgia authorities to deal with the implications of the armed conflict with Russia. By complementing the resources made available by the IFIs, bilateral donors and other EU financial institutions, it contributed to the overall effectiveness of the package of financial support agreed by the international donor community.

Indirect effects on the EU economy. The conditions related to the DFCTA and the EU integration of Georgia, such as the legislation related to the rule of origin and competition law might have some small positive indirect effects on the EU economy, also with respect to improved market entry of Georgian exports, (Georgia unilaterally liberalised its imports already since 2006). Furthermore, there are several other small potential EU gains, e.g. related costs of cross-border business, potential expansion of the Georgia market for FDI. The MFA contribution in these areas is rather limited and impossible to quantify given their long-term character and a very small size of Georgian economy.

In summary, the primary added value of the operation is related to its important role in promoting domestic structural reforms and restoring market confidence of investors in Georgia. This view was expressed by many stakeholders during the interviews. The MFA operation for Georgia provided added value for other actors involved in promoting socio-economic development of the country. The MFA has complemented other international support that Georgia received and contributed to the better macroeconomic outcomes, and political and economic stability at the Eastern neighbourhood.

EQ4.2 What is the value resulting from the EU assistance which is additional to the assistance obtained at other levels?

The MFA was provided on top of other substantial EU-funded programmes available to Georgia mainly through the ENPI (2007-2013) and its successor, the ENI (2014-2020). Given its un-earmarked character, MFA can be seen as a complement rather than as a duplication to other assistance programmes. Furthermore, by supporting the authorities' efforts to stabilize macroeconomic conditions, the MFA helped to improve the effectiveness of other EU financial assistance to the country, including the budgetary support operations and it contributed to the strengthening of the FX reserves.

EQ4.3 To what extent has the sharing of roles between the European Commission (DG ECFIN and other DG's) and other donors, and in particular the IMF, contributed to optimise the impact of the assistance?

MFA was closely linked to the SBA provided by the IMF and its added value should therefore not be assessed in isolation. Both IMF programmes in the period of the implementation of the MFA 2 (SBA approved in July 2014 as well as the EFF approved in April 2017) have counted with the MFA as a source of financing covering a part of the external financing gap identified for Georgia. As in the case of other international support operations, the financing gap was determined by the IMF and the EU, the IMF and the WB agreed on the amounts to be provided. Furthermore, IMF consulted with other donors on their possible involvement in filling the residual financing gap. Our semi-structured interviews with the representatives with other IFIs indicated that participation of the EU was important in motivating the catalytic role of the IMF programmes.

The cooperation between the Commission and the IMF was highly effective. While there was no structural exchange of information between the two institutions or a formal schedule, there were many discussions between IMF/EU, in an ad hoc, still efficient way. Regarding the analytical work done by IMF and the Commission, there was no redundant replication. In addition, the EC and IMF acted in a consistent manner throughout the operation. In the middle of 2015, i.e. when the IMF programme went off track the MFA was deactivated. Additionally, as a coordinated action, the IMF, the EC and other IFIs approached together the Georgia government to support maintaining the NBG's independence. Overall, the EC and the IMF had an efficient and complementary role in the programmes.

This complementarity was reflected in the design of the conditions as well. There were no cross-conditions as the IFIs aimed not to replicate conditions, but the different programmes and technical assistances built on the achievements of each other's. At the same time, IFIs have accumulated expertise in specific fields and therefore each IFI provided leadership in specific structural reform areas. As usually, IMF had the lead on macroeconomic issues, while the EC was an important partner especially in PFM (in particular public procurement), labour market reforms (training, skills improvement, matching programs) and trade related areas. The various stakeholders confirmed this efficient division of labour among IFIs during the interviews.

During the MFA 2 period, Georgia also received sizable bilateral financing from EU member states like Germany, France and Austria. According to OECD and government reports, bilateral loans and aid were primarily focused on infrastructural developments such as energy network development and road construction.[102] [103] In addition, in 2016, Germany pledged EUR 135 million in loans and EUR 5 million in grants to support financial sector development, electricity network management, development of rural areas.[104] Moreover, in 2018, the German Development Bank, KfW, and the French development agency, AFD, pledged EUR 74 million to finance energy sector reform in Georgia.[105] Due to the fact that bilateral financial assistance from EU member states was focused primary on infrastructure development, while MFA focused mainly on institutional development, these financings had a complementary role maximizing the value added of the operations.

6.5 EQ5: Coherence of the operation

EQ5: To what extent was the MFA operation in line with key principles, objectives and measures taken in other EU external actions towards Georgia?

As explained in Chapter 2, Georgia received substantial financial support from the EU and its related institutions after Georgia's military conflict with Russia in August 2008. The EU provided several forms of assistance and the MFA was part of this comprehensive package. In June 2014, the EU and Georgia signed the AA, which entered into force on July 1 2016. This, along DCFTA Agreement, builds a foundation for far-reaching Georgian political and economic integration with the EU. The EU provides over EUR 100 million in assistance to Georgia annually. Funding comes mostly from the European Neighbourhood Instrument (ENI), which supports Georgia in achieving the goals set out in the AA. Along with the EU, the EIB and the EBRD have also increased financial assistance to Georgia as of 2008. Since the start of EIB activities in Georgia in 2007, the value of EIB lending commitments in the country has reached more than EUR 1.5 billion.

The EU's key priorities for EU-Georgia cooperation (2014-2017)[106] were set out in the Single Support Framework, which identified three sectorial focus areas:

- Public Administration Reform;
- Agriculture and Rural Development;
- Justice Sector Reform.

With regard to the preparation of the MFA 2, there was close coordination within the EC. The EU Delegation to Georgia (EUD) also had a consultative role in the process, but the stakeholder consultations showed that its sense of ownership over the MFA assistance could be made stronger going forward.

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102 OECD. (2016). Financing Climate Action in Georgia. https://www.oecd.org/environment/outreach/Georgia_Financing_Climate_Action.Nov2016.pdf.

103 Government of Georgia (2017). External Aid in Georgia 2016 report. http://gov.ge/files/62365_62365_598584_anualReport.pdf.

104 See http://agenda.ge/en/news/2016/937.

105 See https://eeas.europa.eu/delegations/georgia/51495/german-kfw-and-french-afd-sign-74mln-eur-loan-agreements-support-georgia%E2%80%99s-energy-sector_en.

106 The Single Support Framework 2014-2017 was already replaced by a new Single Support Framework for the period 2017-2020 in 2017.

The following budget support contracts had similar conditions to the MFA 2 (refer to Annex 3):

- *Support to Public Finance Policy Reforms (PFPR)*, 2015-2017, N° ENPI/2013/024-705;
- *Support to EU-Georgia Deep and Comprehensive Free Trade Area (DCFTA) and Small and Medium sized Enterprises (SMEs)*, 2015-2018, N° ENI/2014/037-381;
- *Support to Public Administration Reform in Georgia (PAR)*, 2016-2019, N° ENI/2015/037-832.

The first 2 structural conditions of MFA 2 were aligned with the sectorial focus area of Public Administration Reform. At the same time, all conditions (except for action 6 on the establishment of the CRMD at the NBG) were closely related to Georgia's commitments under the AA/DCFTA and as such, had a very important role in supporting the implementation of these agreements. The MFA is a key instrument in facilitating the implementation of the agreements, as despite the commitment of the authorities, the timeline of the implementation is always a question. Furthermore, there is no real conditionality attached to the agreements, i.e. there is no "penalty" if there is no compliance with the commitments.

As discussed in Section 6.2.3., the conditions were well aligned with other EU interventions and support programmes. The feedback received from the experts participating in the Delphi questionnaire also supports this view (see EQ2.3.4.). Stakeholders (EC, IFIs and authorities) also underlined that the PFM, the health care sector, and the competition policy have been all key areas for the Commission and the MFA conditions fitted well into the EC's long-term agenda.

In summary, the MFA was part of a broader package of EU support to Georgia and the measures and conditions of the MFA were in line with key principles, objectives and measures taken in other EU external actions towards Georgia.

6.6 EQ6: Social impact

Assessing the social impact is an important aspect of this evaluation, as one of the rationales behind MFA is to ease the social impacts associated with severe BOP and budgetary pressures. In Georgia's situation in particular, social impact is an important element as the MFA operation was invoked in part as a direct response to the economic and social hardships the country endured as a result of the military conflict with Russia in August 2008 and the consequence of the global financial crisis.

A part of this evaluation therefore assesses how the MFA affected social development (i) as a result of the financial assistance provided; (ii) through the two structural conditions related to the strengthening of the social safety net in Georgia (on Health care reform), as well as (iii) indirectly through the other conditions. The analysis is structured around one main and three sub-questions, displayed in Table 6.15 below.

Table 6.15 Evaluation sub-questions on the effectiveness in terms of social impact

Q6 What was the social impact of the MFA operation?
EQ6.1 What are the expected short and medium-term social effects of the assistance?
EQ6.2 To what extent have the expected short and medium-term social effects of the assistance occurred as envisaged?
EQ6.3 What has been the contribution of the assistance to the occurrence of the expected social effects?

Identifying and analysing the social impact of the assistance is challenging due to data limitations. Time series data analysis alone does not provide enough evidence to answer these questions. Therefore, the analysis of social impact is more descriptive than the analysis of economic impact. While there are some obvious channels through which international financial support programmes affect social dynamics, it is almost impossible to disentangle their overall impact as a number of different factors, of which many had simultaneous and/or lagged effect, determines social developments.

6.6.1 EQ6.1: What were the expected short and medium-term social effects of the assistance?

Given that the main scope of the MFA is balance-of-payments support[107], the programme does not directly target social objectives. However, the MFA documentation includes references to implicit social objectives.

The Decision No. 778/2013/EU of the European Parliament and of the Council (Part A - Considerations) states that MFA should support the beneficiaries' commitment to common values shared with the Union, including – among others – sustainable development and poverty reduction. Social dimensions of the assistance are further elaborated in the SWD accompanying the legislative proposal, which refers to social needs indirectly. The SWD states that sustainable growth is among the objectives of MFA and that the operation should facilitate efforts by the authorities of Georgia to implement measures identified under the EU-Georgia ENP Action Plan[108]. This Action Plan in turn states that its priority area is to enhance poverty reduction efforts and social cohesion.[109]

Furthermore, the MoU specified two conditions with a direct impact on social developments in the field of health care, namely 'Action 3. Health Utilisation and Expenditure Survey' and Action 4. Unit for Health Care Quality Improvement''.

In addition, the IMF SBA (approved in 2014), to which the MFA instrument stated that it complements the authorities' reforms to strengthen the business environment, improve education and training, create jobs and reduce poverty and inequality.

Based on the legislative Decision, the MoU and other relevant MFA documentations, the stakeholder interviews and the analysis of the social developments in Georgia prior to the implementation of the MFA 2 operation, we have identified that the expected *short-term impacts* focused on:

- the improvement of the quality, efficiency and financial sustainability of health care services;
- by alleviating budgetary pressures and smoothing the macroeconomic adjustment process, helping to sustain the social spending.

In the *medium-term*, the MFA 2 aimed at addressing lingering social problems such as:

- persistent high unemployment;
- poverty;
- high inequality.

The first issue, high unemployment, is associated with skill mismatches, the poor quality of the educational system, and in significant regional disparities accompanied with low labour force mobility (see section 5.4). The latter two issues persist due to high unemployment, lack of inclusive economic growth, large share of agriculture in employment and the underdeveloped social safety net. These indicators are highly relevant, as we demonstrate in Chapter 5 in detail.

6.6.2 EQ6.2: To what extent have the expected short and medium-term social effects of the assistance occurred as envisaged?

In attempting to arrive at an objective conclusion, we identified a set of measurable short and medium-term indicators to track the achievements of the aforementioned actions, as well as the evolution in the relevant social development areas in Georgia. We complement our data analysis with the findings from the structured interviews, the Delphi Questionnaire and focus group discussions.

107 The Decision (No 778/2013/EU) states that MFA should not have as its primary aim the support of the economic and social development of the beneficiaries, (Decision No 778/2013/EU of the European Parliament and of the Council of 12 August 2013 providing further macro-financial assistance to Georgia, Part A – Considerations, p. 2018/19).

108 See https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52010SC1617&from=EN.

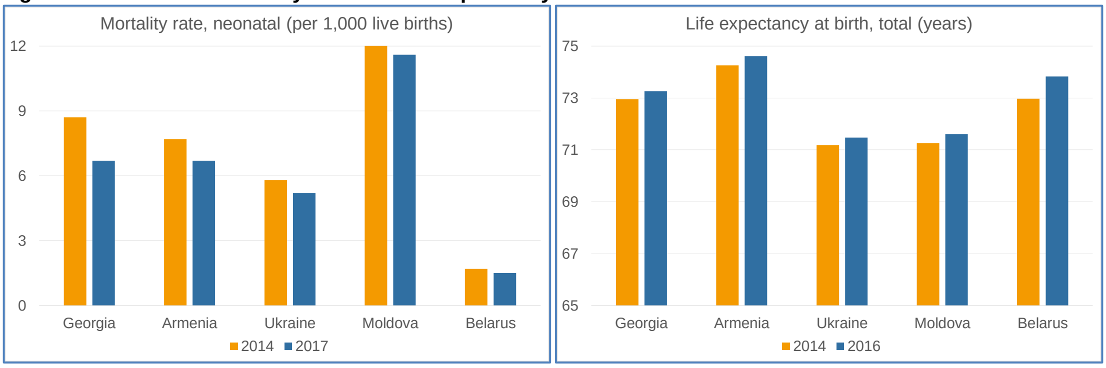
109 See EU/Georgia Action Plan at https://library.euneighbours.eu/content/eu-georgia-action-plan.

We found that reliable data allowing for tracking certain social developments in Georgia is scarce. It is especially the case for the indicators measuring the cost efficiency and quality of health care services. Therefore, in these fields we have to rely more on qualitative assessments, results of related researches and stakeholder consultations.

Short-term indicators

Our first set of short-term indicators are related to *health care quality and efficiency*. Due to data limitations, we examine neonatal mortality rate, life expectancy and OOP expenditures. It is important to note that one of the primary objective of the MFA conditions in the area of social safety net (Action 3 and 4), was to improve cost efficiency of the health system. Consequently, the impact of these conditions on the strengthening of the social safety net was partly indirect, working through the objective of ensuring financial sustainability of the public health care.

Figure 6.13 Neonatal mortality rate and life expectancy at birth



Source: World Bank Development Indicators.

Since 2014, all available indicators signal an improvement in the overall quality and availability of the health care system. Neonatal mortality rate decreased from 9 to close to 6 per 1000 birth. (Figure 6.13). This spectacular improvement – especially in comparison to regional peers – was partly related to the establishment of risk-appropriate perinatal care system. Life expectancy also increased in the period of 2014-2016, although the improvement was not outstanding in regional comparison (Figure 6.13). Besides the impact of the health care reforms introduced before 2014, the improvement was supported by additional measures. The MoLHSA updated its disease and infection practices; introduced new education programs of medical specialities in 2015[110] and adopted a program supporting medical education seekers from mountainous municipalities to improve health care services quality in problematic region. The government managed to sustain 2013 UHC reform achievements such as an increase in population ratio benefiting from publicly covered health care services[111] and decrease in OOP spending[112] on health care (Figure 6.14). Nonetheless, despite of the significant improvement, Georgian health care system remained heavily reliant on OOP payments, especially in terms of pharmaceuticals.

While elevated health expenditures had a positive effect on health services quality and availability, they also created a pressure on the government's fiscal position. After the implementation of UHC, health spending rose sharply and spending overshoot its budgeted amount in 2015 and 2016 before stabilizing in 2017.[113]

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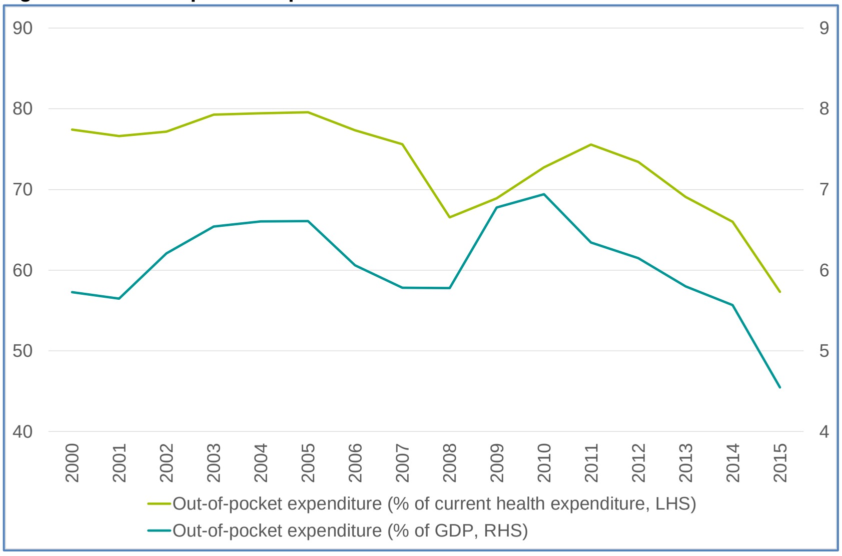
110 Such as "Pediatric emergency medicine", "Computer-tomography", MRI", "Professional pathology" "Oral surgery and surgical dentistry", "Angiology", "Cardiac electrophysiology and arrhythmia management".(Compliance Report on MFA 2 conditionality of the Georian Authorities. March, 2017).

111 Although in 2017, the MoLHSA limited the universality of the UHC by excluding or decreasing coverage of individuals with income levels above certain thresholds.

112 The expenses that the patient or the family pays directly to the health care provider, without a third-party (insurer, or State).

113 World Bank. (2018). Georgia Systematic Country Diagnostic (SCD) Concept Note. Washington, DC. http://documents.worldbank.org/curated/en/496731525097717444/pdf/GEO-SCD-04-24-04272018.pdf.

Figure 6.14 Out-of-pocket expenditure



Source: World Bank Development Indicators.
Memo: Latest data available for 2015.

As of 2014, the MoLHSA has pursued significant efforts to develop the human resource and institutional capacity for managing quality control and cost efficiency of health care services. [114] Despite the efforts, the analyses carried out by the WB (2017, 2018) [115][116] and the WHO (2017) [117] found that the overall efficiency of the system remained low.

As explained by IFI stakeholders, one of the main issues behind the low efficiency is that the Social Services Agency (SSA) does not have the capacity to act as active purchaser. There is a need to improve the infrastructure and human capacity of the agency. The lack of a monitoring system and the human capacity as well as the poor coordination among service providers are the most important impediments of taking proper decisions. Furthermore, due to the low quality of primary care, doctors and patients have more incentives to rely on the more expensive inpatient and emergency care. The complex payment scheme for hospitals makes difficult controlling costs. Utilization of primary care services as well as the doctors has remained relatively low. Finally, due to the under-use of generics and over-pricing, pharmaceutical retail prices in Georgia are among the highest in Europe, resulting in significant scope for efficiency gains in the pharmaceutical care as well. [118] A recent World Bank (2018) study concluded that sustainability of the UHC remained one of the major challenges in the public sector. [119] The structure of the financing system and incentives embedded in it are a major driver of costs. Budgetary constraints (i.e. lack of room for further revenue mobilisation) limit further expanding UHC coverage to provide the desired financial protection for the population. Therefore, the only way to further enhance the availability and quality of public health care is to improve its efficiency.

Regarding the second short-term indicator, *expenditures related to the social sector* (expenditures on social protection, health care and education) showed an increase in percent of GDP in the period of 2014-2017. Despite the regional downturn, the related slowdown in GDP growth and its negative budgetary

114 Compliance Report on MFA 2 conditionality of the Georian Authorities. March, 2017.
115 World Bank Group (2017). Georgia Public Expenditure Review Building a Sustainable Future, Report No: 114062-GE http://documents.worldbank.org/curated/en/630321497350151165/pdf/114062-PER-P156724-PUBLIC-PERFINAL.pdf.
116 World Bank. (2018). Georgia Systematic Country Diagnostic (SCD) Concept Note. Washington, DC. http://documents.worldbank.org/curated/en/496731525097717444/pdf/GEO-SCD-04-24-04272018.pdf.
117 Richardson E., & Berdzuli N. (2017). Georgia: Health system review. Health Systems in Transition, 2017; 19(4):1–90. http://www.euro.who.int/__data/assets/pdf_file/0008/374615/hit-georgia-eng.pdf?ua=1.
118 Richardson E., & Berdzuli N. (2017). Georgia: Health system review. Health Systems in Transition, 2017; 19(4):1–90. http://www.euro.who.int/__data/assets/pdf_file/0008/374615/hit-georgia-eng.pdf?ua=1.
119 World Bank. (2018). Georgia Systematic Country Diagnostic (SCD) Concept Note. Washington, DC. http://documents.worldbank.org/curated/en/496731525097717444/pdf/GEO-SCD-04-24-04272018.pdf.

consequences, total social spending increased from 13.8 percent of GDP in 2014 to 14.7 percent in 2016. In 2017, partly due to the changing priorities of the fiscal policy, expenditures related expenditures related to the social sector decreased to the 14.1 percent of GDP (see Figure 5.11). The overall increase of social related expenditures was largely driven by health care expenditures, having increased by 0.6 percent of GDP in the 2014-2017 period.

Summing-up, since 2014 Georgia managed to improve the availability and the quality of public health care services. However, the cost efficiency and financial sustainability of the health care system is not yet ensured. In spite of the cyclical downturn, expenditures on social protection, health care and education increased in the period of 2014-2017.

Medium-term indicators

Our medium-term social indicators of the assistance focus on reducing high unemployment; stimulating equality, and reducing the poverty rate. In evaluating whether these effects have taken place, we have to bear in mind that any policy response to these problems will only have a lagged effect, and thus the MFA's timeframe hardly allowed these to fully materialize during the analysed period. What we can verify is whether any favourable change has started to take hold in the latest available data.

Medium-term effects on the labour market

Georgia's total unemployment rate has remained virtually unchanged at around 12 percent since 2014 (See Chapter 5.4). Unemployment among young people, which has been the main contributor to the high overall unemployment rate historically, declined by 5 percentage points on average for 20-24 and 25-29 year age cohorts over the 2014-2017 period. Nonetheless, youth unemployment remains a major problem, affecting still around 20 and 30 percent of the 20-24 and 25-29 age cohorts, respectively. The decline in youth unemployment was accompanied by an increase in unemployment among older generations aged above 55 years (see section 5.4 for more details). Overall, the labour market's performance during the period of 2014-2017 did not improve. High unemployment, high youth unemployment and low participation rate of women continue to be major problems. Major fundamental bottlenecks such as skills mismatch, significant regional disparities coupled with low labour mobility remained unresolved. In order to alleviate skills mismatch, further improvement of the educational system is essential to achieve a significant reduction in unemployment and to support sustainable growth (see Section 5.4).

Medium-term effects on poverty and inequality

After an almost 10 percentage point decline in 2012-2014, the poverty ratio decreased only marginally, from 47 percent in 2014 to 45.5 percent in 2016 (Figure 5.16). Furthermore, the latest Welfare Monitoring Survey (WMS) shows an increase in the poverty rates in 2017 (UNICEF, 2018).[120]

The decrease of the poverty ratio was supported by the reduction of OOP health expenses while it was contained by the lack of improvement in unemployment. The recent increase in the poverty ratio can to some extent explained by the increase in consumer and especially food prices in 2017, partly driven by the heavy depreciation of the lari. Anaemic progress in poverty reduction resulted in only marginal improvements in inequality as gauged by the GINI coefficient (Figure 5.16). Over the 2014-2016 period, the GINI coefficient decreased only by 1 percentage point to 36. The 2018 introduction of the second pillar of the pension system in line with the IMF EFF can provide some additional help in reducing both poverty and inequality in Georgia.

Overall, economic growth in the period of 2014-2017 was not accompanied by robust job creation. Despite active steps taken by the authorities with the help of international donors to preserve social welfare standards, poverty and inequality have remained acute problems.

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[120] UNICEF. (2018), The Welfare Monitoring Survey, 2017. http://unicef.ge/uploads/WMS_brochure_unicef_eng_web.pdf.

6.6.3 EQ6.3: What has been the contribution of the MFA (financial assistance, conditions) to the occurrence of expected social effects?

The social safety net conditions of the MFA clearly contributed to the favourable developments in the public health care system. In line with action 3, the MoLHSA conducted the Health Utilization and Expenditure Survey in 2014 to learn about UHC impact on health care sector developments. The results served as a basis for further improving the quality and efficiency of the UHC.

Under Action 4, the responsibilities of the Executive Department of the MoLSHA were expanded to cover health care quality and efficiency improvement. MoLHSA has pursued efforts to develop the human resource and institutional capacity for managing quality control and efficiency of health care services[121]. MoLHSA introduced measures aiming at improving the quality of healthcare in Georgia, such as the improvement of post-natal health services to reduce the neonatal deaths rate, introduction of medical education specializations to prepare specialists that are targeted at specific problems of Georgian health care sector; establishment of a subsidized scheme for training of medical professionals for allocation to mountainous areas where the health care services have been especially poor.[122]

As pointed out in the answer to question 6.2, health care quality indicators signal improvements since 2014. However, we found no evidence for the improvement of the cost efficiency and financial sustainability of the health sector. When assessing the contribution of the MFA to the health care related developments, we need to emphasize that the implementation of MFA 2 started shortly after the introduction of the UHC programme in 2013. Therefore, it is impossible to disentangle the impact of the UHC and the MFA related actions on the quality and the availability of public health care services. Furthermore, the measures introduced in relation to the MFA conditions form a part of complex structural reforms. Some of these reforms impact the relevant processes with significant lags. Therefore, more time is needed for a more inclusive evaluation of these impacts.

Besides the direct impact of the MFA conditions targeting the social safety net, the MFA helped to ease pressure on the general public budget and hence supported sustaining social spending and financing of the social reform agenda. Furthermore, by closing the financing gap and supporting the structural reform agenda, the MFA together with other IFI support programmes helped to preserve macroeconomic sustainability as well as restoring market confidence. The smoothing of the economic adjustment process supported GDP growth and via this indirect channel had a positive impact on employment, disposable income and social developments in general.

Determining the exact contribution of the MFA in the aforementioned social aspects is not possible in the absence of a clear counterfactual scenario. The IMF did not engage in modelling and forecasting the labour market or health sector indicators, thus we cannot rely on any external assessment of what has been the expected and materialized impact of the financial assistance. However, the analysis is complemented by the results from the Delphi Questionnaire.

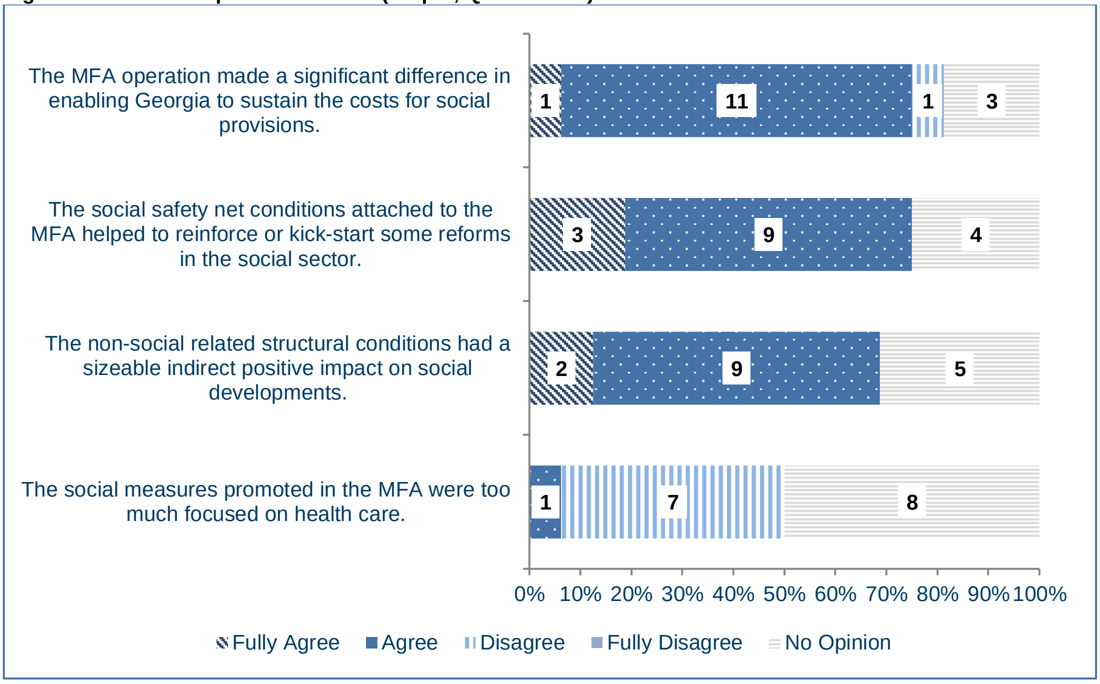
In Question 10 of the Delphi Questionnaire, 12 out of 16 participants (fully) agreed with the statement that "the MFA made a significant difference in enabling Georgia to sustain the cost for social provisions" (sub-question 10.1). Moreover, 11 out of 16 respondents also saw a strong positive connection between the non-social related structural conditions and recent social developments (sub-question 10.3). Based on the Delphi responses, there is little evidence that the social measures promoted in the MFA were focused too much on health care (see sub-question 10.4). In fact, 12 out of 16 participants believed that "the social safety net conditions attached to the MFA helped to reinforce or kick-start some reforms in the social

121 EC. (2017). Macro-financial Assistance to Georgia: Disbursement of the Second Tranche, Note to the European Parliament and the Council, ECFIN/D2 Ares(2017).

122 Compliance Report on MFA 2 conditionality of the Georian Authorities. March, 2017.

sector" (sub-question 10.2), such as education or social protection. The other four participants expressed "no opinion".

Figure 6.15 Social impact of the MFA (Delphi, Question 10)



When considering the effects of the combined SBA and MFA assistance, the desk research, the surveys and interviews show that the impact was diverging. We can conclude that the impact was positive for the quality and the coverage of the health care services both through the direct actions and indirectly, via the relaxation of fiscal burdens. However, we could not find evidence of improvement in the cost-effectiveness of the health care system. Progress in the medium-term social indicators was positive yet moderate, but the most promising MFA-relevant effects could come in the future owing to the lengthy process of trade integration of Georgia and the EU. Overall, the intended medium-term social effects of the assistance have not fully materialized yet. Once again, we must note that given the lags with which some of the policy measures work, more time is needed for a more inclusive evaluation of these medium-term indicators. We summarize our list of social indicators, their covered areas and our corresponding findings in the following table:

Table 6.16 Social actions and indicators and our corresponding findings

Actions and indicators	Term	Area/Specification	Verifiable indicators	Evaluation Statement (EQ 6.2)	MFA Contribution (EQ 6.3)
Improving the quality, efficiency and financial sustainability of health care services	Short-term	Health care	• Health care spending; • Population benefiting from health care coverage. • Life expectancy; • Neonatal mortality rate. • OOP health spending.	• Quality of health care improved as demonstrated by increase in life expectancy and decrease in natal mortality rate; • Health services became more available as demonstrated by decrease in OOP health care spending; • However, lack of improvement regarding the cost effectiveness and sustainability of health care sector.	Positive regarding the improvement in health care quality, in particularly, owing to: • analysis of the survey results on the impact of UHC; • establishment of health care unit; • establishment of perinatal care regionalization and referral system to improve maternal-infant health outcomes; • introduction of new programs of medical specialties and- program supporting medical education seekers from mountainous regions; • No tangible impact on efficiency.
Helping to sustain social spending		Fiscal sector	Social expenditures in percent of GDP.	The government managed to keep its social and health care expenditures elevated.	Positive, primarily through the relaxation of the overall budget constraint.
Reducing high unemployment	Medium-term	Labour market	Unemployment rate Participation rate.	Declining, yet still high unemployment rate.	Minor positive, primarily by restoring market confidence and smoothing the macroeconomic adjustment process.
Reducing poverty		General social cohesion	Poverty rate.	Declining, yet still high poverty rate.	Minor positive, mostly through impact on social spending and smoothing the macroeconomic adjustment process, and through the contribution to the improvement of health care quality and coverage (Condition 3 and 4).
Reducing inequality			GINI coefficient.	Declining, yet still high inequality rate.	

6.7 EQ7: Public debt sustainability

This EQ deals with the impact of the MFA 2 operation on Georgia's medium to longer term fiscal prospects. Sustainability of the fiscal position is one of the key areas of the evaluation therefore this section is dedicated to the public debt sustainability assessment.

Table 6.17 Evaluation sub-question on public debt sustainability

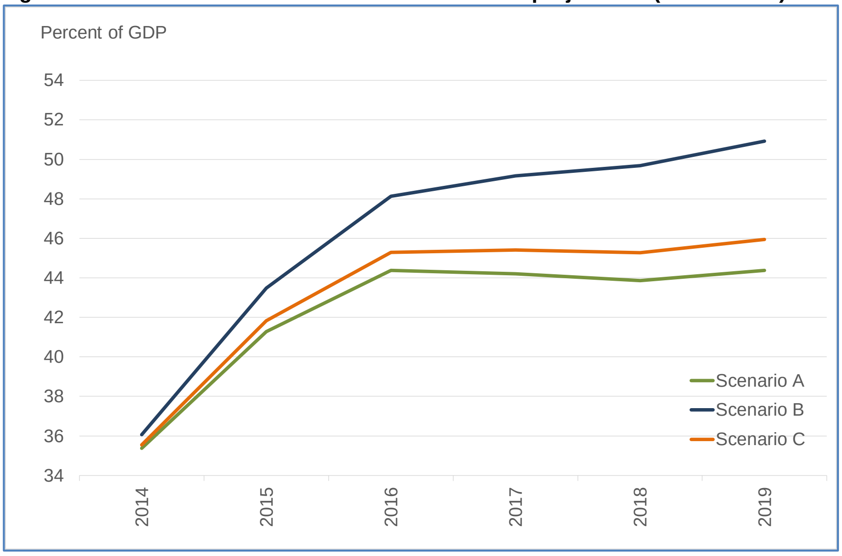
EQ7 What was the impact of the MFA operation on public debt sustainability?
EQ7.1 To what extent has the MFA/IMF assistance contributed to returning the fiscal situation of Georgia to a sustainable path over the medium to longer-term?

This section uses the DSA framework of the IMF to quantify the effect of the IMF and the EU assistance on public debt sustainability for the period of 2014-2019 (medium-term) and beyond (longer-term).[123] To this end, different macroeconomic scenarios are constructed and compared within the DSA framework. For a detailed presentation of the methodology and assumptions, please refer to Annex VI.

6.7.1 Debt sustainability in the medium-term

We compute one baseline scenario (scenario A) and two alternative scenarios (scenario B and C). The baseline scenario incorporates the effect of both the SBA/EEF of the IMF and the MFA of the EC. In this scenario, we present the factual realization for the path of the external debt for the past years (2014-2017), and we use the forecasted path consistent with the latest IMF projection for the future (2018-2023). [124] Two alternative scenarios are constructed to measure the impact of the financial support programmes. The first alternative scenario (Scenario B) is calculated assuming that neither the SBA, nor the MFA is available. In the next scenario (Scenario C), it is assumed that only the SBA loan was granted to Georgia without the MFA assistance.[125]

Figure 6.16 Public debt-to-GDP ratio – medium-term projections (2014 – 2019)



Source: MoF, IMF and own calculations.

[123] The IMF developed the DSA framework as a tool to better detect, prevent, and resolve potential payment crises. The framework consists of two complementary components: the analysis of the sustainability of total public debt and that of total external debt. For details see: https://www.imf.org/external/pubs/ft/dsa/.

[124] See IMF WEO October (2018) database. https://www.imf.org/external/pubs/ft/weo/2018/02/weodata/weoselco.aspx?g=2200&sg=All+countries+%2f+Emerging+market+and+developing+economies.

[125] For a detailed presentation of the methodology, please refer to Annex VI.

Figure 6.16 illustrates the effect of the different macroeconomic scenarios on the public debt-to-GDP ratio for the period 2014-2019. In the baseline scenario, Georgia's public debt increased close to 44.5 percent of GDP in 2016. Subsequently, the public debt-to-GDP ratio is projected to decrease slightly and remain around 44 percent. Without the joint financial assistance of the IMF and the EU, Georgia's public debt is projected to increase substantially, approaching 51 percent of GDP at the end of 2019. This is more than 6 percentage points higher than in the baseline. The results show that the joint assistance contributed significantly to return to a sustainable path over the medium-term. The financial assistance helped to ease macroeconomic pressure and generated higher growth. In the scenario only accounting for the IMF SBA (Scenario C), the debt path is very close to the baseline, which means that the MFA operation's contribution was less marked than the SBA to public debt stabilization given the smaller size of the envelope. Our analysis also reveals that the positive effects of the financial assistances works primarily through the confidence channel (risk premium shock) and the real growth channel (output growth shock).

6.7.2 Debt sustainability in the long term

A longer-term outlook requires a set of assumptions about the long-term equilibrium values of the main determinants of the public debt-to-GDP ratio (real GDP growth, inflation, primary balance to GDP, interest payments).[126] Table 6.18 presents our assumptions on the main variables and the medium-term forecasts of the IMF.[127].

Table 6.18 IMF medium-term forecasts and our long-term assumptions for the key variables

Assumption	Real GDP growth (YoY %)	Inflation (YoY %)	Primary Balance (GDP %)	Implicit Interest rate, %
Average of past 10 years	3.73	4.12	-1.16	2.90
IMF WEO (2016)	4.82	3.00	-2.43	4.23
IMF WEO (2017)	5.45	3.00	-0.37	3.37
IMF WEO (2018)	5.20	3.00	-0.41	2.63
Our long term assumptions	4.00	3.00	-0.30	4.81

Source: IMF, own calculations. Note: IMF WEO forecasts are represented for the last year of the given forecast round. I.e. IMF WEO (2018) presents the forecast for 2023.

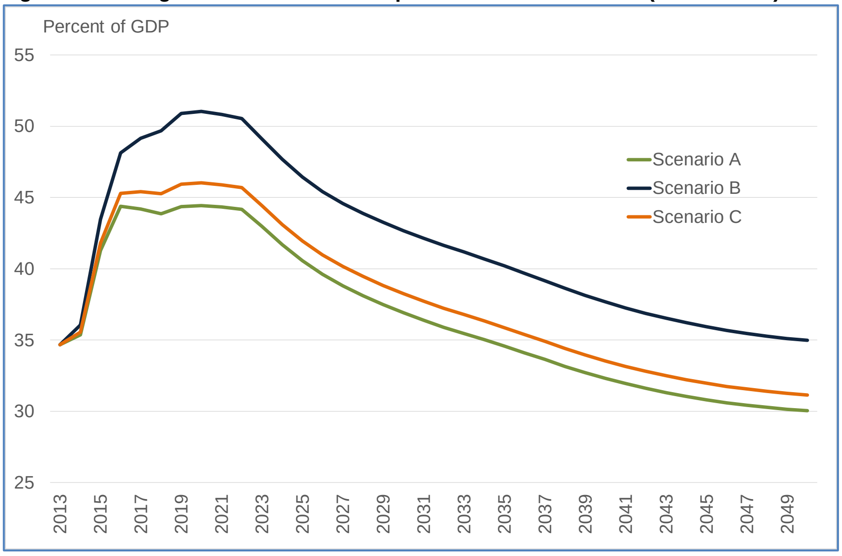
The analysis of public debt sustainability reveals that the combined SBA/MFA assistance allowed for more moderate debt accumulation (Figure 6.17). In particular, according to our baseline calculations, the public debt-to-GDP ratio is expected to peak at around 44.5 percent in 2017 – 2022 period while scenario B suggests that the debt would peak at 51 percent in the same period. As for the longer run, baseline scenario projects that the debt-to-GDP ratio will decline to pre-MFA levels already in 2035, while in scenario B, the ratio approaches its pre-MFA level by the end of the projection period.

In the long run, public debt is expected to follow a sustainable path supported by the real convergence and the assumed prudent fiscal policy. At the same time, the assumed increase in financing costs contains the debt reduction. Besides the risk related to the growth, financing cost and exchange rate developments, the public debt trajectory depends on the structural reforms alleviating the budgetary impact of the aging and shrinking population.

[126] We assume that GDP per capita (PPP, USD) will gradually converge to average GDP per capita (PPP, USD) of Bulgaria and Romania by 2050, thus, estimating a long term-growth at around 4 percent. As for the financing costs, we assume that the proportion of non-concessional financing of the public debt will gradually increase to 50 percent by the end of the projection horizon. Therefore, the implicit financing costs will be determined half by the favourable terms of the concessional financing and half by the market rates.

[127] Note that we apply the same long-term assumptions across all scenarios. This means that we believe that the structural determinants of the long-term fiscal sustainability are independent of the IMF/MFA assistance. It follows from this assumption that the initial differences across the scenarios persist, but slowly phase out over the longer-term.

Figure 6.17 Long-term evolution of the public debt-to-GDP ratio (2013 – 2050)



Source: Own calculations.

6.7.3 The fiscal savings related to the favourable MFA conditions

An important aspect of the MFA 2 is that it entails a grant element and a loan with a significantly lower interest rate burden compared to market alternatives. Furthermore, the 15 years maturity and the 10 years grace period of the loan component is also very favourable. Accordingly, it is worth exploring how much direct saving can be attributed to relying on the MFA as a source of financing other than conventional debt issuances.

In our calculations, we used the exact terms of the financial envelope provided by the EC (though these terms were not disclosed publicly). The different terms of the two loan tranches of the MFA 2 in amount of EUR 10 million and EUR 13 million, respectively, result in an effective weighted average interest rate of the whole loan equalling 0.88 percent. This assistance ranks the MFA 2 among the cheapest sources of financing at the time based on the collection of debt items by the MoF.[128]

Regarding the estimate of savings due to the MFA financing, we cannot make a simple comparison with market alternatives, as Georgia had no market financing with 15 years maturity and in terms of FX financing, it has a single Eurobond issued in 2011 with a maturity of 10-years.

To arrive at an estimate of how much saving can be attributed to the MFA's favourable conditions, we calculate a "fair price" for this debt item. In doing so, we sum up its associated discounted cash flows to arrive at the present value of this item in the market circumstances of the time of the disbursement of the first tranche, in 2015. The challenge in this respect is estimating the corresponding interest rate that would prevail on the market, were the country able to issue a bond with the same maturity. As mentioned above, we can only observe a Eurobond interest rate. In 2015, i.e. at the time of the disbursement of the first tranche of MFA 2, the Eurobond yield to maturity amounted to 5.25 percent on average with a remaining maturity of 6 years. In order to estimate a 15 years interest rate we need to make an assumption on the term premium over 6 to 15 years prevailing in 2015. Our approach is to look at the term structure in Georgia's GEL yield curve for the longer tenors (between 5 and 10 years, the longest tenor). Based on the data available for the period between 2012 and 2015 the average term premium is 210 basis points for 10-year maturities over 5-year maturities.

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[128] See the outstanding debt items in the publication of the Ministry of Finance. (2018). Public Debt of Georgia Statistical Bulletin No.10. https://mof.ge/images/File/Public-Sector-Debt-Statistical-Bulletin-N10-ENG.pdf.

Based on this information we can produce two conservative estimates of savings. In our first estimate, we do not count with the term premium and assume a 5.25 interest rate for market financing. Second, we assume a 210 basis points term premium. Based on these assumptions, we estimate a saving ranging between EUR 31.3 million and EUR 33.8 million in 2015, corresponding to 0.26 and 0.28 percent of GDP, respectively.

The results of our calculations are presented below in nominal terms and as a ratio to 2015 GDP. For an easier understanding, the MFA's fair value and the associated savings can be interpreted in the following way as well: assuming that the prevailing market rate is 7.35 percent, the favourable conditions of the MFA made it financially equivalent to providing a market-based loan of around EUR 12 million combined with a grant of EUR 34 million in 2015.

Table 6.19 The savings related to the MFA at the prevailing market-based rate

Assumed market interest rate	Estimated net present value of the loan component in 2015 (in EUR million)	Estimated present value of the grant component in 2015 (in EUR million)	"Savings" due to the favourable MFA conditions (in EUR million)	"Savings" due to favourable MFA conditions (in GDP %)
5.25%	9.3	22.0	31.3	0.26%
7.35%	12.27	21.7	33.9	0.28%

Source: Own calculations.

6.7.4 Conclusion

The analysis of public debt sustainability reveals that the combined EU and IMF assistance contributed significantly to returning the fiscal indebtedness to a manageable level. In particular, according to our calculations, in the absence of the joint financial support, the public debt to GDP would approach the initial level only by the end of our projection horizon. Our calculations revealed that the grant and loan blend and the financing terms of the MFA were very favourable at the time of disbursement, and have contributed to significant, around 0.3 percent of GDP savings when compared to market based alternatives. This MFA support, combined with the IMF's SBA/EEF, helped to contain the sharp increase of the public debt and to stabilize the debt at a significantly lower level at the medium-term.

Chapter 7 Conclusions

This chapter builds on the evidence presented in the report and sums up the evaluation team's conclusions on the performance of the MFA 2 operation to Georgia along the seven evaluation criteria (relevance, effectiveness, efficiency, EU value added, coherence, social impact and public debt sustainability).

The conclusions presented below are built on an analysis using multiple evaluation approaches. However, we need to emphasize that data limitation in certain areas (e.g. social and specifically health sector related indicators), as well as the short time span since the full implementation of the MFA provided challenges in terms of impact measurement. Furthermore, the rapidly changing external environment and the fact that the MFA was provided in parallel with the IMF SBA and EEF programmes and other international financing instruments as well as the implementation of the Association Agreement encumbered the disentangling of the different factors behind the developments. Despite these difficulties, we believe that the conclusions are well founded.

SUMMARY

The EU's second MFA has enabled Georgia to progress with its ambitious structural reform agenda in a period when regional developments put significant pressure on the economy concomitant with the inherent risk of a loss of commitment and the stagnation of reforms. By supporting the structural reforms and providing financing, the operation – together with the ongoing IMF programmes – helped to restore market confidence and thus decreased substantially the debt financing costs the country was facing. The operation thus helped to alleviate external and budgetary financing pressure and improved Georgia's external and public debt trajectory.

RELEVANCE

Relevance of the objectives: The economic and social challenges in Georgia in 2014 made the objectives of the MFA operation very relevant, even if the design of the operation dated back to the period 2011-2013. In 2014, Georgia faced a sudden deterioration in external balances due to the regional economic crisis, and foreign exchange reserves dropped below the adequate level. While the budget deficit was moderate, it has increased gradually since 2014. Furthermore, a high and mostly foreign exchange denominated private and public debt signalled significant balance sheet vulnerabilities. Besides, the development of social indicators, persistently high unemployment, poverty ratio and inequality – all exceptionally high even compared to the regional peers – highlighted that the lack of inclusive growth was a pressing problem of the Georgian economy. Therefore, the evaluation team assesses that both the direct financial support and the structural reform objectives were highly relevant.

Relevance of the financing envelope and the form of the assistance: The amount of the assistance was determined in line with the principles of the Joint Declaration by the European Parliament and the Council. We found that both the form and the terms of the financing were relevant and appropriate. The MFA was provided half in the form of grant, half in the form of a long-term loan. The blend of a grant and a loan was consistent with the lower middle-income status of the country as well as the risk associated with its public debt sustainability. Furthermore, the composition was consistent with the other MFA operations provided to Georgia. Importantly, the financial terms of the loan were very favourable compared to other alternatives both in terms of the pricing, the maturity and the extensive grace period.

Relevance of the structural conditions: The structural conditions addressed very specific reform areas. The MFA 2 operation was designed to be implemented in a very short time frame. Therefore, the conditions were set so as to allow rapid disbursements by targeting very specific and well-defined areas, which were mostly based on the government's own reform agenda and which required actions achievable in a short period of time.

The eight structural conditions attached to the MFA covered four policy areas: public financial management, social safety net, financial sector, and trade and competition policy. There was a broad agreement among the local stakeholders that most of the important reform priority areas were covered by the conditions. While only half of the conditions are seen as relevant in terms of the economic objectives, all of them are assessed to be relevant in terms of the structural reform objectives.

At the same time, we must note that the action on the establishment of the risk management department at the NBG had a limited scope compared to the other actions set by the MoU. While stakeholders were of the view that the conditions were all relevant, there was a broad agreement among experts from the financial sector that an action supporting responsible lending practices, particularly in the non-banking financial sector would have been highly beneficial at the time.

EFFECTIVENESS

Effectiveness in improving the external financial conditions: We have found that the financial assistance from the IMF and the EU contributed substantially to the stabilization of Georgia's external financial position. In the absence of the IMF/EU supports, the external debt-to-GDP ratio is estimated to have been about 8 percentage points higher in the medium-term. The MFA also helped with stabilizing the external debt dynamics.

A large share of the positive effect came through the confidence channel: the agreement with the IMF and EU had a substantial positive impact on market sentiments, reducing the risk premium by about 100 basis points, also decreasing the financing costs of the outstanding debt. Also thanks to the assistance Georgia's external financing situation is expected to remain on a sustainable path. The current account deficit is expected to decrease, while the FDI is assumed to be a stable source of financing in the long run supporting the decline of the debt-to-GDP ratio. In line with the relatively small amount of the MFA assistance compared to the IMF loan, the MFA contributed to a lesser extent to these effects than the IMF loan.

Effectiveness in supporting fiscal consolidation: The un-earmarked nature of the MFA assistance and the fact that half of the amount was provided in the form of grants helped to alleviate fiscal pressure and support the fiscal consolidation path set by the IMF. The evaluation team assessed the pace and the ambition of the fiscal consolidation plan set by the IMF reasonable. The fact that the targets were missed in 2015 and 2016 were attributed to the lack of the government's commitment to follow prudent fiscal policy. The new government elected in 2016 started a fiscal consolidation and committed itself to gradually decreasing the budget deficit to close to 3 percent by 2020.

Effectiveness in structural reforms: The Georgian authorities were effective in the implementation of the conditionality: most of the actions had been met before the signature of the MoU and all of them had been fulfilled without any implementation deficit by the first half of 2015. The direct effect of the MFA conditions materialized through speeding up the reform processes: most stakeholders shared the view that the reforms would have been pursued without the MFA conditionality, but at a slower pace. Besides the direct impact of the measures, the conditionality has contributed to the implementation of the structural reforms indirectly, by reinforcing the reforms efforts of the IFIs and other donors.

Regarding cross-conditionality, the first two actions in the area of public financial management appeared in a similar form in EU Budget Support operations. While there has been no cross-conditionality with other IMF and World Bank operations, the conditions were well aligned with the support programmes and technical assistances provided by other IFIs. Stakeholders from IFIs confirmed that the different programmes and assistances built on the achievements of each other's and had a complementary role, which was appreciated by the stakeholders.

As for their medium-term impact, the actions contributed to a significant progress in the area of public financial management and the banking regulation. At the same time, progress is uneven in the areas of the health care sector, and trade and competition policy. In both cases, one of the most important impediments named by the stakeholders is the lack of sufficient human and infrastructural capacity.

EFFICIENCY

Efficiency of the design of the MFA operation: The Commission closely coordinated with the IMF, the WB and other international institutions, both in the design and the implementation phase of the operation. This cooperation and the mutual leverage of expertise of IFIs increased the impact of the MFA compared to its cost.

For the Georgian authorities, the implementation of the conditions, and the direct cost attached to certain reform areas were challenging. Nevertheless, most MFA conditions were part of their reform agenda and to some extent were also complementary to the conditions set by other IFIs.

Furthermore, the EC aimed at achieving synergies with other EU policies and instruments, especially with its budget support operations and the Association Agreement. The MFA was provided half in the form of grants, therefore the EU budgetary impact was smaller than in the case providing the full support in the form of grants. Nevertheless, the relatively soft conditions attached to the loan component of the MFA were attractive compared to alternative funding sources.

Efficiency of the implementation of the MFA operation: Georgia requested the activation of MFA 2 in May 2010. The EC submitted its proposal in January 2011, and the European Parliament and the Council adopted it on 12 August 2013 (Decision 778/2013/EU). Delay in the adoption was caused by procedural disagreements between the co-legislators. In the specific case of Georgia this exceptionally long timeline of the approval (more than 3 years compared the official request) did not result in efficiency losses, because from the second half of 2010 until July 2014, i.e. the approval of a new IMF SBA, Georgia did not have a disbursing IMF programme, which had prevented in itself the activation of the MFA 2.

The first MFA 2 instalment was disbursed shortly after the signature of the Memorandum of Understanding in December 2014. The disbursement of the second instalment, foreseen for 2015, was delayed because of the lack of Georgia's progress in the implementation of the IMF programme. Only after the approval of a new IMF loan in April 2017, the EC could proceed with the disbursement.

Overall, we conclude that the lengthy decision-making process in relation to the approval of the MFA did not cause efficiency losses, but we assess the inception process of the MFA operation (six months from the official request to the submission of the EC proposal) to be relatively slow. The MFA is designed to support crisis management, therefore rapid reaction is essential for the efficiency of the operation. At the same time, we found the implementation process to be efficient, as the delay of the disbursement of the second instalment was due to factors outside the control of the EC.

EU ADDED-VALUE

Stimulate structural reform process. The MFA 2 operation had a distinguished role in stimulating the structural reform process. The conditionality set in the MoU helped the authorities to prioritize reforms and set up credible milestones. MFA facilitated the communication of unpopular measures to the public and sometimes provided a stimulus for the necessary political reform will. The operation also helped to anchor and support compliance with the demanding process of the convergence to the EU regulation.

Most of the conditions were part of the government's reform agenda and as such, most of them would have been accomplished even without the EU support. However, the MFA helped to provide additional momentum and credibility in a difficult period with the inherent risk of a loss of commitment and stagnation of reforms. The progress in the areas covered by the conditionality – even if it can only partly be attributed to the MFA – opened the possibility of long-term benefits.

In a broader context, the MFA signalled that the EU is ready to support countries like Georgia, embarking on a clear path towards economic reforms, in moments of economic difficulties.

Financial value added. The MFA contributed to alleviating the external and budgetary financing pressure in Georgia. The size of the MFA operation (EUR 46 million) corresponded to 0.4 percent of Georgia's GDP in 2015. A main attractiveness of the MFA assistance versus alternative sources of financing was that half of it was provided in the form of grants. Furthermore, the other half provided in loans had highly concessional terms.

Help maintaining and building external financing buffers. Georgia has overtime accumulated significant balance sheet vulnerabilities. The high level and mostly foreign exchange denominated external and public debt increases the importance of building adequate buffers for financing shocks. The MFA support contributed to the replenishment of foreign exchange reserves, which has been below the adequate level since 2013.

Restore market confidence. By supporting the consolidation efforts and signalling that, the EU is ready to give additional financial support to the country the MFA operation – together with other international financial programmes – signalled that Georgia was on the right track. This helped to restore market confidence and supported a decrease of risk premium, which was reflected in lower borrowing costs for the country. According to our DSA, the confidence channel was responsible for a significant part of the positive impact of the operation on the external and fiscal sustainability.

Alleviating fiscal pressure. Thanks to its un-earmarked nature, the MFA could effectively help to smooth the budgetary consequences of the regional downturn, by that supported the structural reform process, and helped to sustain social spending. In addition, the MFA 2 was part of the Commission's pledge made at the International Donors' Conference in 2008. The EU pledge aimed at supporting the Georgian authorities to deal with the implications of the armed conflict with Russia and the regional political tensions. By complementing the resources made available by the IFIs, bilateral donors and other EU financial institutions, it contributed to the overall effectiveness of the financial support agreed by the international donor community.

COHERENCE

Coherence of the operation: Georgia received substantial financial support from the EU after Georgia's military conflict with Russia in August 2008. The EU provided several forms of assistance and the MFA was part of this comprehensive package. The MFA was prepared in close coordination within the Commission and with the European External Action Service and the conditions were closely aligned with other EU operations in Georgia. Seven of the eight conditions were part of or closely related to Georgia's commitments under the Association Agreement and DCFTA. Overall, the conditionality had a very important role in supporting the implementation of the reform agenda agreed under these arrangements, also by setting an exact timeline for the measures.

SOCIAL IMPACT

Social impact of the operation: the MFA instrument was designed to help the Georgian authorities in their efforts to address some of the social challenges via three different channels. First, the MFA helped to ease pressure on the budget and hence supported sustaining social spending and financing of the social reform agenda, which was particularly acute at the time, as Georgia was well behind its peers in terms of socially oriented spending. Second, the MoU conditionality was put in place so as to help the authorities in prioritizing the reforms in the area of health care. Finally, by smoothing the economic adjustment process, the MFA together with other IFI programmes supported GDP growth and via this indirect channel had a positive impact on employment, disposable income and social developments in general.

Short-term social impact: Regarding the short-term effect, we found that the MFA has contributed to the improvement of the quality and the coverage of the health care services. This impact was achieved both directly, through the related actions and indirectly, via the relaxation of fiscal burdens. However, we could not find evidence of improvement in the cost-effectiveness of the health care system. The lack of improvement in this field was mainly due to the human and infrastructural capacity limitations and the inefficient incentive structure in the health care system. As for the second short-term social objective of the MFA, we found that expenditures related to the social sector (expenditure on social protection, health care and education) have increased over the implementation period (2014-2017). The MFA operation could support this development both by providing a direct and un-earmarked financing to the budget as well as indirectly, by smoothing the economic adjustment process.

Medium-term social impact: Progress in the medium-term social indicators was positive yet moderate. Unemployment remained virtually unchanged, poverty ratio and the GINI index measuring inequality decreased marginally. These minor positive developments materialized mostly through the MFA impact on social spending and indirectly, by restoring market confidence and smoothing the macroeconomic adjustment process. However, we must note that given the lags with which some of the policy measures work, more time is needed for a more inclusive evaluation of these impacts.

PUBLIC DEBT SUSTAINABILITY

Public debt sustainability: The MFA support, combined with the IMF programmes, helped to contain the sharp increase of the public debt and to stabilize it at a manageable level. Our analysis of public debt sustainability reveals that in the absence of the joint financial support, the public debt-to-GDP ratio would culminate at above 50 percent in the period of 2019-2020, i.e. about 6 percentage points higher than signalled by the latest IMF forecast (October 2018).

Our investigation shows that a large share of the positive effect comes through the confidence channel, followed by the pro-growth effect of the structural reforms. Besides lower interest rates, the implementation of the structural reform agenda and the impact of the direct financing supported growth prospects. Based on our calculations the grant and loan blend and the financing terms of the MFA were very favourable at the time of the disbursement, and have contributed to significant, around 0.3 percent of GDP savings when compared to market-based alternatives.

In the long run, the public debt is expected to follow a sustainable path supported by the convergence of real GDP per capita and the anticipated prudent fiscal policy. Besides the GDP growth, financing cost and exchange rate, the public debt trajectory depends heavily on the success of structural reforms alleviating the budgetary impact of the aging and shrinking population.

Annex I Stakeholder consultation strategy

Introduction

Stakeholder consultation was a key element to successfully carry out this ex-post evaluation of EU macro-financial assistance (MFA) 2 to Georgia. The planning of the MFA 2 operation started already in October 2008, at the International Donors' Conference, when the EU pledged to provide two possible MFAs to Georgia. The first MFA operation was implemented in 2009-2010, and already in 2010, the Georgian authorities asked for the activation of the second MFA. The design of MFA 2 started in January 2011, when the EC adopted a proposal to provide a second MFA to Georgia. However, the adoption was delayed until August 2013 (see Section 2.2). The MoU, the Loan Facility Agreement and the Grant Agreement were officially signed 2014 December. Disbursement of the first instalment took place in 2015 January (grant component) and April (loan component); the second and last instalment was disbursed in April 2017 (see detailed timeline in Annex VIII).

Table A.1.1 Timelines: general timeline of MFA 2 operation

TIMELINE OF MFA 2								
2011	2012	2013	2014	2015	2016	Jan-Apr. 2017	May-Dec 2017	2018
MFA design				**MFA implementation**			**Post-MFA era**	

This stakeholder consultation strategy was developed with the overall objective to capture as much information as possible with regard to the MFA 2 operation in addition to information collected through review of key documentation and communication, consultation of EC officials, and data analysis. The consultation focused on extracting recollections from the time period in which the operation was designed (2011–2014) and implemented (2015–April 2017), but also on collecting views on the period after the MFA 2 was ended (May 2017– 2018) to assess its impact and sustainability.

This consultation strategy:
- sets out the objectives of the consultation;
- maps key stakeholders;
- presents the consultation methods and tools which are used; and
- demonstrates how the stakeholder consultation fits in the evaluation framework.

Table A.1.2 presents a detailed timeframe for the implementation of this consultation. The items listed in this timeframe are elaborated in the following sections.

Table A.1.2 Time schedule of the implementation of the stakeholder consultation

<table>
<tr><th colspan="12">CONSULTATION TIME SCHEDULE</th></tr>
<tr><th colspan="2">OCTOBER 2018</th><th colspan="6">NOVEMBER 2018</th><th colspan="4">JANUARY 2019</th></tr>
<tr><th colspan="2">Brussels
9; 17/19 October</th><th colspan="2">Home based
20 November</th><th colspan="2">Tbilisi, Georgia
12-16 November</th><th colspan="2">Home-based
22-27 November</th><th colspan="2">Tbilisi, Georgia
15-18 January</th><th colspan="2">Home-based
Week of January 21</th></tr>
<tr><td colspan="4" rowspan="2"></td><td>Georgia authorities</td><td rowspan="2">Semi-structured interviews</td><td colspan="2"></td><td>Georgia authorities</td><td rowspan="2">Semi-structured interviews</td><td colspan="2"></td></tr>
<tr><td>IFIs, Other donors</td><td>IFIs</td><td rowspan="2">Delphi survey (online survey + follow up)</td><td>Other donors</td><td>IFIs</td><td rowspan="2">Delphi survey (online survey + follow up)</td></tr>
<tr><td>EC representatives</td><td>Semi-structured interviews</td><td>IMF</td><td>Semi-structured interviews</td><td>External experts</td><td>Focus group structural and social reforms</td><td>Georgia authorities</td><td>External experts</td><td>Focus group macroeconomic and fiscal reforms</td><td>Georgia authorities</td></tr>
</table>

Objective setting

The objective of stakeholder consultation was to collect as much valuable and relevant information as possible from various groups and people involved to construct an ex-post assessment of the design, implementation and impact of the MFA 2 operation. We consulted stakeholders on the following key aspects:

- Relevance of the MFA 2 operation: we assessed the relevance of the objectives, the financial envelop and the conditionality, both at the time of designing the MFA 2 operation (2011 –2014) and with the benefit of hindsight;
- Effectiveness of the MFA 2 operation: the direct results of the operation, i.e. its results on macroeconomic level and in the area of the structural reforms;
- Efficiency of the MFA 2 operation: the design and process of the MFA 2 in terms of value-for-money;
- EU-added value of the MFA 2 operation: the added value of the operation when considering other possible scenarios and alternatives;
- Coherence of the MFA 2 operation: alignment with other support initiatives implemented at the time of the MFA 2;
- Social impact: the more indirect impact of the MFA 2 operation in the context of social development in Georgia;
- Debt sustainability: the longer-term result of the MFA 2 in terms of implications to Georgia's government and external debt dynamics and the fiscal and external sustainability.

Consultation was thus partly related to recalling past events, but also to collect current opinions, which can be made with the benefit of hindsight. We thus aimed to gain an understanding of the decision-making at the time of the design and implementation of the MFA operation, but we also wanted to identify the actual relevance and impact of the operation.

While stakeholders were asked to make (subjective) assessments and express their personal opinions, we encouraged them to refer to written sources wherever possible. Eventually, the results of the stakeholder consultation were triangulated with data and documentation to provide well-evidenced responses to Evaluation Questions (as demonstrated in the last section of this annex).

Stakeholder mapping

Since MFA entails balance-of-payment support and does not lead to tangible and visible outputs for the public, no consultation from the general public and citizens was sought. Instead, consultation was targeted to specialists – either people who have either been closely involved in the development and/or the implementation of the MFA operation or people with expert knowledge in the areas related to the objectives of the MFA operation (i.e. macroeconomic and fiscal policy, and structural reforms in the areas of PFM, social policy, financial sector, trade and competition policy).

Below we present the four groups of stakeholders that had a central role in this consultation strategy:

1. Georgia public Institutions

Obviously, the recipient was an important stakeholder to consult on the key aspects, in order to incorporate the beneficiary's view on the MFA2 operation.

After having gone through all documentation provided and collected on the MFA 2, we have identified the following key institutions within the Government of Georgia for a discussion on the design and the implementation MFA 2 operation, and its macroeconomic and fiscal effects:

- Ministry of Finance (MOF): implementing Ministry of the MFA loan;

- National Bank of Georgia (NBG): implementing financial institution;
- Parliamentary Budget Office (PBO).

Within these organisations, a distinction should be made between high-level policy makers and the technical staff working on actual implementation. The latter group is able to specifically comment on the efficiency of the implementation of the MFA 2 operation.

Furthermore, we have identified a number of other key stakeholders within the government to consult specifically on the relevance, effectiveness, and impact of the conditions for structural reforms:
- State Audit Office (SAO): on PFM reforms (action 1 and 2);
- State Procurement Agency (SPA) on action 1;
- Ministry of Labour, Health and Social Affairs (MoLHSA) on social reforms (action 3 and 4);
- National Bank of Georgia (NBG) on financial sector reforms (action 5 and 6);
- Ministry of Economy and Sustainable Development (MoESD) on trade and competition policy (action 7 and 8).

2. International Financial Institutions

As major international financial institutions (IFIs), the IMF and World Bank were key stakeholders for consultation as they were to some extent involved in the preparation and implementation of the MFA 2. In addition, they provided similar support to Georgia (the IMF via a SBA and an EFF, the World Bank via DPLs). Both organisations could thus provide input to all key aspects of the evaluation. They are probably not the group with the largest interest in this MFA evaluation, but they do have a significant influence.

3. Georgia external (i.e. non-governmental) experts

There is a variety of actors, who were not directly involved in the MFA operation itself, but are very knowledgeable on the topic of macroeconomic and fiscal developments, and on structural and social reforms in Georgia. It was important to consult these actors as well in order to determine the actual relevance, effectiveness and impact of the MFA 2, as they possess the knowledge to place the MFA 2 in the wider context of Georgia's economic and social situation. We have identified the following groups:
- Ex-government officials and (ex-) Parliamentarians: They might have been part in the decision making with regard to the structural conditions, but due to their (current) position, they might give a more external view on these issues;
- NGO, academics and other interest groups: they might be able to provide an outsider's view on the economic and social developments that have taken place in Georgia in the period of 2011-2018 and on the structural reforms which have taken place in Georgia since the MFA;
- Banks and financial institutions: Officials from private banks in Georgia might be able to provide an external view on the economic and financial developments in Georgia and on the current macroeconomic and fiscal situation.

4. Other donors

A selection of other donors was consulted, to provide a more outsider's' opinion on the MFA operation in the context of wider aid provisions and to gain further insight in the coherence of the MFA operation. They do not have a strong interest or influence, but are interesting to get a better understanding of the context in which the MFA was provided, and possibly can put the relevance and impact into context. A shortlist of donors was put together by the team taking into account the suggestions of DG ECFIN. We consulted with:
- US Agency for International Development (USAID);
- German Development Agency, GIZ;
- World Health Organisation (WHO).

The list of completed interviews is presented in Annex 2.

Two focus group sessions were organized with a distinct focus. The first session covered structural and social reforms in Georgia, and focused on the relevance of the MFA conditions. For this focus group, we invited (former) Parliamentarians, academics and non-governmental organisations. (See the detailed list of the participants below).

Table A.1.3 Participants of the first focus group discussion in Georgia

	Name	Position	Reason for inviting
1.	Giorgi Papava	Lecturer in Macroeconomics, Ilia State University	Excellent Expertise in macroeconomic policy/developments and financial stability.
2.	Vakhtang Charaia	Lecturer in Macroeconomics, Tbilisi State University	Expertise in macroeconomic policy/developments and financial stability.
3.	Beso Namchavadze	Senior Analyst, Transparency International Georgia	Expertise in macroeconomic policy/developments and financial stability.
4.	Paata Bairakhtari	Vice President, The Association of Young Financiers and Businessmen	Expertise in business environment aspects, macroeconomic developments and financial stability.
5.	Emzar Jgerenaia	Editor- in-Chief, Expert on Economics, *The Georgian Economics*, a monthly journal	Expertise in macroeconomic policy/developments and reforms, business environment aspects, trade policy-related issues.
6.	Nodar Ebanoidze	Expert on Economics, Parliamentary Committee on Budget and Finance, Deputy Head in 2012-2016	Expertise in macroeconomic policy/developments and fiscal policy.
7.	Gigla Mikautadze	Chair, Georgian Taxpayers Union	Expertise in business environment and fiscal policy.
8.	Davit Gamkrelidze	Lecturer, Ilia State University	Expertise in fiscal policy.
9.	David Keshelava	Lecturer, ISET	Expertise in macroeconomic policy/developments.
10.	Ana Burduli	Researcher, PMC Research	Expertise in macroeconomic policy/developments.
11.	Giorgi Mzhavanadze	Lecturer, ISET	Expertise in macroeconomic policy/developments.

The second focus group session focused on the macroeconomic and fiscal developments, including topics like Georgia's financing needs, debt sustainability as well as the financial sector reforms. Participants were experts from the financial sector. Our focus was on senior economists residing in special economic research or analysis departments of the banks and other financial institutions. (See the detailed list of the participants below).

Table A.1.4 Participants of the second focus group discussion in Georgia

	Name	Position	Reason for invitation
1.	Davit Demetradze	Head of treasury and cash management, Procredit Bank Georgia	Expertise in macroeconomic developments and financial stability.
2.	Eva Bochorishvili	Investment Officer, Galt&Taggart, Investment Arm of Bank of Georgia	Expertise in macroeconomic developments and financial stability, business environment aspects.
3.	Lasha Kavtaradze	Investment Officer, Galt&Taggart, Investment Arm of Bank of Georgia,	Expertise in macroeconomic developments and financial stability, business environment aspects.

	Name	Position	Reason for invitation
4.	Nino Vakhvakhishvili	Georgia Capital PLC, investment company	Expertise in business environment aspects.
5.	Giorgi Makatsaria	Economist, Basis Bank	Expertise in macroeconomic developments and financial stability.
6.	Tamar Kumsiashvili	Head of Treasury Department, FINCA Bank Georgia,	Expertise in financial stability.
7.	Gigi Eloshvili	Economist, VTB Bank	Expertise in macroeconomic developments and financial stability.
8.	Givi Kupatadze	Senior Economist, MFO Crystal	Expertise in business environment aspects.
9.	Revaz Makalatia	Economist, Terabank	Expertise in macroeconomic developments and financial stability.
10.	Akaki Sarjveladze	Economist, Pasha Bank	Expertise in macroeconomic developments and financial stability.
11.	Givi Adeishvili	Economic Analyst, TBC Capital	Expertise in financial stability and macroeconomic developments (balance of payments, GDP and exchange rate).

Consultation methods

Related to the four groups of key stakeholders above, the evaluators used a targeted consultation approach. We made use of three key tools:

1. Semi-structured interviews

The objective of the interviews was to extract detailed information on the following:

- MFA design and implementation;
- results of MFA on the macroeconomic and fiscal situation;
- results in the fields of the structural reform conditions;
- social impact;
- debt sustainability.

Interviews were thus carried out particularly with the first two stakeholders, who are well aware of the MFA instrument and its implementation. We also conducted interviews with the fourth group (other donors), but these interviews were focused on the coherence of MFA with other donor initiatives and were less in-depth.

The format of semi-structured interviews was chosen on purpose: on the one hand, this format offers the possibility to discuss a few set topics with the interviewees. Details were asked on events which happened in the past, therefore we sent out pre-interview questionnaires. These questionnaires contained a brief overview of key bullet points that the evaluators would like to discuss, to enable the interviewee to prepare him/herself by collecting information in advance. On the other hand, semi-structured interviews leave room for the interviewer to raise other relevant issues, also in feedback to answers of the interviewee.

The most important findings of the semi-structured interviews are listed in the following table:

No.	Most important findings of the semi-structured interviews
1.	The blend of grant and medium-term concessional loan of the assistance was appropriate.
2.	The most important reform areas were covered by the conditions and the actions set by the MoU were all relevant or highly relevant.
3.	Additional measures could have targeted (i) ensuring the conditions for SAO's revenue auditing; (ii) improvement of internal auditing; (iii) improving the human and infrastructural capacities of Social Services Agency (iv) supporting responsible lending practices; (v) support filling the knowledge gap of companies related to the DFCTA; and (vi) improving the human and infrastructural capacities of the Competition Agency.
4.	Public procurement needs to be further developed. Lack of sufficient progress in the area of the health care (cost effectiveness) and the competition policy was mainly due to the lack of sufficient human and infrastructural capacities. Implementation of the DFCTA is very costly and the beneficial impact on trade performance is not yet tangible.
5.	The primary added value of the operation is its important role in promoting structural reforms. Getting an external credibility stamp on policy reforms is a highly important factor in Georgia.
6.	MFA 2 also had a prominent role in helping to alleviate external pressure, primarily by supporting the replenishment of FX reserves and in helping to restore market confidence.
7.	The short-term impact on budget financing was a less important contribution of the MFA operation.
8.	The conditions were coherent with and well complemented the operations of other IFIs, which was well appreciated by non-IFI stakeholders as well. There was an efficient division of labour among IFIs.
9.	The pace and the ambition of the fiscal consolidation plan set by the IMF was reasonable. Deficit targets were missed due to the lack of the government's commitment.

2. Expert focus group

The objective of the focus groups is to gain information of the MFA in a wider context: what has been its relevance and its impact if the operation is put in a broader perspective. The focus groups are also particularly useful to the questions on effectiveness, which discuss the current trends in Georgia's macroeconomic and fiscal policy, and ongoing social reforms.

Focus groups are ideal for exploring people's experiences, opinions, wishes and concerns and have been identified as especially useful for studying the success or failure of particular policies and programmes. Organising these focus groups helps us to understand the current paradigm of reforms and get a better understanding on how MFA has been tailored to the local situation in Georgia.

We used this instrument particularly for the third stakeholder group: these experts have been or are too far away from the MFA operation to conduct detailed one-on-one interviews, but their participation in a group discussion would be very useful to gain deeper understanding of the macro/fiscal developments and the structural/social reforms in Georgia. We restricted the discussion to two hours, to encourage participation of people and ensured participants that Chatham House rules were to be applied. These rules elicit the maximum amount of input from the participants and therefore provide the best opportunity to contribute to addressing the evaluation questions with valuable stakeholder insights that may not be possible in a more open forum.

We organised two group sessions, each with a specific focus:

a. *Structural and social reforms in Georgia*

- Relevance of the MFA conditions in light of Georgia's developments;
- Reforms in: PFM, social safety net, trade and competition policy;
- Development of social indicators regarding employment and poverty and inequality.

b. *Macroeconomic, fiscal and financial sector developments in Georgia*

- Georgia's financing requirements;
- Internal and external factors of Georgia's external financial situation;
- Pace, ambition and composition of appropriate financial consolidation;
- Debt sustainability;
- Financial sector reforms.

The first focus group took place during the first mission to Georgia in November 2018. For this focus group, we invited (former) Parliamentarians, academics and non-governmental organisations (see list of participants above). The second focus group took place during the second mission in January 2019 and involved officials from banks and financial institutions (see list of participants above).

The most important findings of the Focus Group discussions are listed in the following table:

No.	Most important findings of the Focus Group discussions
First Focus Group on structural and social reforms	
1.	Most of the important reform areas were covered by the conditions.
2.	Conditions et in the MoU were relevant.
3.	One of the most relevant action was the one supporting the independence of SAO. Independence of SAO strengthened and the office produces great reports, but the recommendations are not always implemented due to the lack of political will.
4.	Low cost effectiveness of the UHC is a major problem of the health care system.
5.	Level of social expenditure is high, there is a need to improve its efficiency.
6.	High unemployment and skill mismatches are lingering problems of the Georgian economy.
Second Focus Group on macroeconomic, fiscal and financial sector developments	
1.	The IMF/EU programme caused a 110 basis points decrease in the country risk premium.
2.	Group discussions gave important inputs for the long term assumptions to the debts sustainability analysis.
3.	ICAAP condition (Action 5) was highly relevant both in terms of the structural reform process and the economic challenges.
4.	Additional measures could have support the introduction of responsible lending practices. Lack of appropriate regulation in the past and over indebtedness of low income households is a pressing problem for the economy.
5.	External debt sustainability, high dollarization (both in the public and private balance sheets) are still relevant problems of the economy.

3. Delphi method

The Delphi method is an evaluation methodology that relies on judgmental estimates of experts based on their insights and collective knowledge. We applied a light version of the Delphi method as an additional consultation tool. The objective of using this tool was to gain further insight into the added value of the MFA operation. In November, after the first field mission, we identified a few possible scenarios related to the Georgia's macroeconomic and fiscal developments and structural reforms. The main question to the participants in the Delphi survey was to what extent the MFA operation has contributed to certain macroeconomic and fiscal developments, and in the field of structural reform, by considering what would have happened if the MFA would not have been granted. (See the questions of the Delphi questionnaire in Annex IV).

In operational terms, the Delphi method involved two rounds of consultations. We sent the panel members a link to an electronic questionnaire powered by the CheckMarket Survey Tool. We also provide them the opportunity to re-assess their position. The panel included 16 experts. It is a balanced mix of Georgian officials, EU officials, either based in Brussels or in-country, and representatives of other IFIs. This allowed us to receive a sufficient amount of valid responses. It should be emphasised that the quality of result is not so much related to the number of respondents, but rather to the level of knowledge of the expert panel. Regarding the survey instrument, the experience with previous MFA evaluations strongly suggested the use of a simplified questionnaire, focusing on a limited set of key variables. This increases the response rate and favour the emergence of a consensus opinion.

The most important findings of the Delphi survey are listed in the following table:

No.	Most important findings of the Delphi survey
1.	The impact of MFA has been primarily through the promotion of structural reforms and the easing the balance-of-payment pressure in Georgia.
2.	The general design of the operation (i.e. with the first instalment linked to the IMF SBA progress in general and the second instalment linked to the structural conditions) was optimal.
3.	The design of the conditionality was appropriate. The MoU included a balanced mix of conditions, the complexity and the number of the actions were proper.
4.	The conditions set by the MoU were important or fairly important.
5.	All conditions were completed satisfactorily.
6.	The main value added of the conditionality was through the speeding up the implementation of the reforms.
7.	The alignment of the conditions with other support programmes was appropriate.
8.	The MFA operation made a significant difference in enabling Georgia to sustain the costs for social provisions. The non-social related structural conditions had a sizeable indirect positive impact on social developments.
9.	The social safety net conditions attached to the MFA helped to reinforce or kick-start some reforms in the social sector.

The consultation strategy and the evaluation framework

Table A.1.5 combines the different groups of stakeholders and the consultation methods, and shows how they contributed to answering the evaluation questions. We also mention other sources, which provided information that could be triangulated with the information collected from stakeholder consultation.

Table A.1.5 Stakeholder consultation in the evaluation framework

EQ criteria	Sub-criteria	Stakeholders	Consultation method	Other sources
RELEVANCE	Relevance of objectives	Georgia Authorities: MOF, NBG	Semi-structured interviews	• Consultation of EC staff; • Study of documentation.
		IFIs		
		Other donors		
		Georgia authorities, IFIs	Delphi survey	
		External experts (officials from banks and financial institutions)	Focus group on macroeconomic and fiscal/financial topics	
	Relevance of the financial envelope	Georgia Authorities: MOF, NBG	Semi-structured interviews	• Consultation of EC staff; • Economic/financial background papers.
		IFIs	Delphi survey	
		External experts (officials from banks and financial institutions)	Focus group on macroeconomic and fiscal/financial topics	
	Relevance of conditions	Georgia Authorities: selected organisations/ ministries for structural reforms	Semi-structured interviews Delphi survey	• Consultation of EC staff; • Case studies on financial sector and trade policy; • Reports on socio-economic situation in Georgia.
		IFIs		
		External experts (Parliamentarians and NGO/academics)	Focus group on structural reforms	
EFFECTIVENESS	Effectiveness in terms of macroeconomic stabilisation	Georgia Authorities: MOF, NBG	Semi-structured interviews	• Consultation of EC staff; • Debt sustainability analysis; • Data analysis; • Document review of macroeconomic reports.
		IFIs		
		External experts (officials from banks and financial institutions)		
		External experts (officials from banks and financial institutions)	Focus group on macroeconomic and fiscal/financial topics	
	Effectiveness in terms of fiscal policy	Georgia Authorities: MOF, NBG	Semi-structured interviews	• Consultation of EC staff; • Descriptive quantitative analysis; • Document review of fiscal reports.
		IFIs		
		External experts (officials from banks and financial institutions)	Focus group on macroeconomic and fiscal/financial topics	
	Effectiveness in terms of structural reforms	Georgia Authorities: selected organisations/ ministries for structural reforms	Semi-structured interviews	• Consultation of EC staff; • Data analysis; • Document review of Georgia reforms; • Case studies on financial sector and trade policy.
		IFIs	Semi-structured interviews	
		External experts (Parliamentarians and NGO/academics)	Focus group on structural reforms	

EQ criteria	Sub-criteria	Stakeholders	Consultation method	Other sources
EFFICIENCY	NA	Georgia Authorities: MOF, NBG (more technical staff)	Semi-structured interviews	• Consultation of EC staff; • Desk research, review of documentation/communication.
EU ADDED VALUE	NA	Georgia Authorities: MOF, NBG IFIs	Semi-structured interviews Delphi survey	• Delphi survey to key EC staff; • Documentation review and interviews with EC staff on the rationale.
COHERENCE	NA	Georgia Authorities: MOF, NBG	Semi-structured interviews	• Consultation of EC staff; • Review of programme documentation and EU / other donor programmes; • Case studies.
		Other donors	Semi-structured interviews	
SOCIAL IMPACT	NA	Georgia Authorities: selected organisations/ ministries for structural reforms IFIs Other donors	Semi-structured interviews; Delphi survey	• Consultation of EC staff; • Document and data analysis of social variables.
		External experts (Parliamentarians and NGO/academics)	Focus group on structural reforms	
DEBT SUSTAINABILITY	NA	Georgia Authorities: MOF, NBG IFIs	Semi-structured interviews	• Consultation of EC staff; • Debt sustainability analysis; • Document review of fiscal reports.
		External experts (officials from banks and financial institutions)	Focus group on macroeconomic and fiscal topics	

List of key MFA 2 documents reviewed

European Commission DG ECFIN (2010). Proposal for Further Macro-Financial Assistance to Georgia for 2010-11, Note for the Economic and Financial Committee. ECFIN/D2/AJ/ic Ares(2010)SN680365.

European Commission DG ECFIN (2011a). Proposal for a Decision of the European Parliament and of the Council providing further macro-financial assistance to Georgia. 13.1.2011, COM(2010) 804 final.

European Commission DG ECFIN (2011b). Ex-ante evaluation statement on further macro-financial assistance to Georgia, Accompanying document to the Proposal for a Decision of the European Parliament and of the Council providing further macro-financial assistance to Georgia. 13.1.2011, SEC(2010) 1617 final.

Decisions No 778/2013/EU of the European Parliament and of the Council of 12 August 2013 providing further macro-financial assistance to Georgia, Joint Declaration by the European Parliament and the Council adopted together with the decision providing further macro-financial assistance to Georgia, Official Journal of the European Union, 14.8.2013 L218/15-23.

European Commission DG ECFIN (2014a). Report on mission to Georgia: Memorandum of Understanding negotiations for Macro-Financial Assistance to Georgia, (Tbilisi, 10-14 June 2014). Ref. Ares(2014)2331983 - 14/07/2014.

European Commission DG ECFIN (2014b). Report on mission to Georgia: Memorandum of Understanding negotiations for Macro-Financial Assistance to Georgia, (Tbilisi, 28 July -1 August 2014). Ref. Ares(2014)2620777 - 07/08/2014.

Association Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and Georgia, of the other part, Official Journal of the European Union, 30.8.2014 L261/4-743.

Memorandum of Understanding between the European Union as Donor and Georgia as Beneficiary and the National Bank of Georgia as Beneficiary's Financial Agent, 11.12.2014.

Macro-Financial Assistance for Georgia Loan Facility Agreement, 11.12.2014.

Macro-Financial Assistance for Georgia Grant Agreement, 17.12.2014.

European Commission DG ECFIN (2015a).European Union Macro-Financial Assistance: Disbursement of the 1st Instalment of EUR 10,000,000 Confirmation Notice. Ref. Ares(2015)1648792 - 17/04/2015.

European Commission DG ECFIN (2015b). Macro-Financial Assistance to Georgia Disbursement of the First Tranche, Information Note to the European Parliament and the Economic and Financial Committee, ECFIN.D2/JCZ/lg Ares(2015).

Compliance Statement of the Government of Georgia, 03/04/2017.

European Commission DG ECFIN (2017a). Macro-Financial Assistance to Georgia Disbursement of the Second Tranche, Information Note to the European Parliament and the Council. Ref. Ares(2017)2209157 - 28/04/2017.

European Commission DG ECFIN (2017b). European Union macro-financial assistance (MFA): Disbursement of the 2nd Instalment of EUR 13,000,000, Confirmation Notice. Ref. Ares(2017)2617571 - 23/05/2017.

BDO (Project funded by the European Union), Operational Assessment of the financial circuits and procedures in Georgia, November 2017. Specific Contract No. No.ECFIN-139-2017/SI2.761024.

Annex II The list of completed interviews

Table A.2.1 List of completed interviews with key stakeholders during the first field visit to Georgia

	Name	Position	Institution
		Georgia Authorities	
1	Giorgi Kakauridze	Deputy Minister	Ministry of Finance (MoF)
2.	Nikoloz Gagua	Deputy Minister	
3.	Eka Guntsadze	Head of Budget Department	
4.	Mirza Gelashvili	Head of the Department for Macroeconomic Forecasting and Fiscal Policy	
5.	Ioseb Skhirtladze	Head of Department for State Debt and External Financing	
6.	Mamuka Baratashvili	Head of Department for Tax Policy	
7.	Archil Imnaishvili	Head of Department for Macroeconomics and Statistics	National Bank of Georgia (NBG)
8.	Zviad Zedginidze	Head of Department for Financial Stability	
9.	Tata Khetaguri	Head of PBO	Parliamentary Budget Office (PBO)
10.	Vakhtang Chalapeikrishvili	Head of the Unit for Macroeconomic Analysis and Tax Policy	
11.	Natia Tsikvadze	Unit for Government Budget Analysis	
12.	Tsotne Karkashadze	Head of the Department for Examining Government Budget and Strategic Planning	State Audit Office (SAO)
13.	Giorgi Chakvetadze	Chief Budget Analyst	
14.	Ekaterine Ghazadze	Deputy Auditor General	
15.	Marta Karumidze	Head of Public Relations Service	State Procurement Agency (SPA)
16.	Natia Bedenashvili	Acting Head of the Training Centre	
17.	Ana Chania	Head of the Analytic Service	
18.	Mariam Gabunia	Head of Department for Foreign Trade Policy	Ministry of Economy and Sustainable Development
19.	Vakhtang Tsintsadze	Head of Economic Analysis and Reforms Department	
		IFIs and other donors	
1.	Nia Sharashidze	Economist	IMF
2.	Francois Painchaud	Resident Representative	
3.	Irakli Khmaladze	Project Manager	EC delegation (EUD)
4.	Nino Samvelidze	Project Manager	
5.	Sirje Poder	Attache, Program Officer	
6.	Vincent Rey	Head of Cooperation	
7.	Nino Kochishvili	Programme Officer	
8.	Mariam Dolidze	Senior Economist	World Bank (WB)
9.	Gia Amzashvili	Access to Finance Policy Advisor	USAID, G4G
		Georgia externals	
1.	Giorgi Papava	Lecturer in Macroeconomics	Ilia State University
2.	Otar Nadaraia	Head of Unit for Macro-financial Analysis, former Vice President at NBG	TBC Bank
3.	Aleksandre Bluashvili	Expert, Unit for Macro-financial Analysis	
4.	Davit Demetradze	Head of Treasury and Cash Management Finance Department Head Office	Procredit Bank Georgia
5.	Irakli Partsvania	Head of Treasury	Halyk Bank
6.	Eva Bochorishvili	Investment Officer	Galt&Taggart, Investment Arm of Bank of Georgia
7.	Lasha Kavtaradze	Investment Officer	
8.	Nino Vakhvakhishvili	Investment Officer	Georgia Capital PLC
9.	Giorgi Makatsaria	Economist	Basis Bank

Table A.2.2 List of completed interviews with additional key stakeholders during the 2nd field visit to Georgia

	Name	Position	Institution
		Georgia Authorities	
1.	Elza Jgerenaia	Head of Department for Labour Market and Employment Policy	Ministry of Labour, Health and Social Affairs (MoLHSA)
2.	Nutsi Odisharia	Head of the Department for Social Protection	
3.	Avtandil Ghoghoberidze	Program manager of enterprise development department	Enterprise Georgia (Georgia state agency)
4.	Teo Babunashvili	Program Manager	
5.	Nodar Khaduri	Chairman, Former Minister of Finance (2012-2016)	Competition Agency of Georgia
6.	Samson Uridia	Head of Department for International Relations	Revenue Service
		IFIs and other donors	
1	Marijan Ivanusa	Head of Country Office	World Health Organisation
2	Christian Doering	Team Leader for PFM	GIZ, German development agency
3.	Elene Tskhakaia	PFM Consultant	
		Georgia externals	
1.	Vakhtang Charaia	Lecturer in Macroeconomics	Tbilisi State University
2.	Beso Namchavadze	Senior Analyst	Transparency International Georgia
3.	Chingiz Abdullayev	CFO	Pasha Bank
4.	Tamar Kumsiashvili	Head of Treasury Department	FINCA Bank Georgia,
5.	Archil Bakuradze	Chair (Board)	MFO Crystal
6.	Givi Kupatadze	Senior Economist	MFO Crystal
7.	Givi Adeishvili	Economic Analyst	TBC Capital

Table A.2.3 List of completed interviews with key stakeholders by Skype

	Name	Position	Institution
1	Mercedes Vera Martin	Mission chief of Georgia	IMF
2.	Sergio Rodriguez	Senior Economist	
3.	Lire Ersado	Program Leader	WB
4.	Kakha Demetrashvili	Deputy Chairman	SPA

Table A.2.4 List of completed interviews with key stakeholders in Brussels

	Name	Position	Institution
1	Dirk Lenaerts	Head of Sector Macro-Financial Assistance, D2	DG Economic and Financial Affairs, European Commission (EC)
2.	Joern Griesse	Deputy Head of Unit, D2	
3.	Nicolas Lilienthal	Legal Officer	
4.	Martynas Baciulis	Georgia Desk, D2	
5.	Judita Cuculic Zupa	Economist, D2	
6.	Heliodoro Temprano Arroyo	Advisor	
7.	Nicoletta Pusterla	Bilateral Division, Team Leader Georgia	EEAS
8.	Sofie Van Bergen	Georgia-Moldova desk	EEAS
9.	Michaela Hauf	Team Leader for Georgia	DG NEAR, EC

Annex III Cross conditionality and complementarities

Development Policy Loans of the World Bank

The DPLs of 2012, 2013, and 2014 focused on three pillars:

- Pillar I: Strengthen legislation to promote market access to the European Union and improve customs efficiency, power sector reliability, and the quality of general education;
- Pillar II: Improve the coverage and transparency of the budget;
- Pillar III: Improve the accessibility and quality of healthcare services and efficiency of targeted social programs.

While the development policy loans (DPLs) addressed the same areas (Trade policy, PFM and Health Care), there was no cross-conditionality in the DPLs and MFA. The most similar conditions between DPLs and MFA could be found under Pillar III (health care) for two policy areas.

Policy Area III.1: Improve the accessibility and quality of healthcare services

- Prior Action DPL1 (2012):
  - The MoLHSA of Georgia implemented upgraded standards in all hospitals by issuing permits to improve the safety and quality of healthcare services;
  - The Government of Georgia issued a decree expanding medical insurance to children below the age of six (6) and pensioners.
- Prior Action DPL2 (2013):
  - The Government of Georgia introduced universal health coverage for primary and emergency care.
- Prior Action DPL3 (2014):
  - The MoLHSA implemented upgraded standards for facilities providing primary healthcare.
- Status: Completed.

Policy Area III.2 Improve the efficiency of targeted programs

- Prior Action DPL2 (2013):
  - The MoLHSA adopted three pilot modules in the districts of Tbilisi, Rustavi and Mtskheta for social information management systems on: (a) state pensions; (b) state compensation; and (c) state social packages.
- Prior Action DPL3 (2014):
  - The MoLHSA adopted the pension module of the Social Information Management System throughout the country.
- Status: Completed.

Annex IV Results of Delphi Questionnaire

Start date:	22-11-2018
End date:	29-01-2019
Live:	69 days
Questions:	10
Panelist count:	28
Total responded:	16 (57.1%)
Reached end:	16 (57.1%)

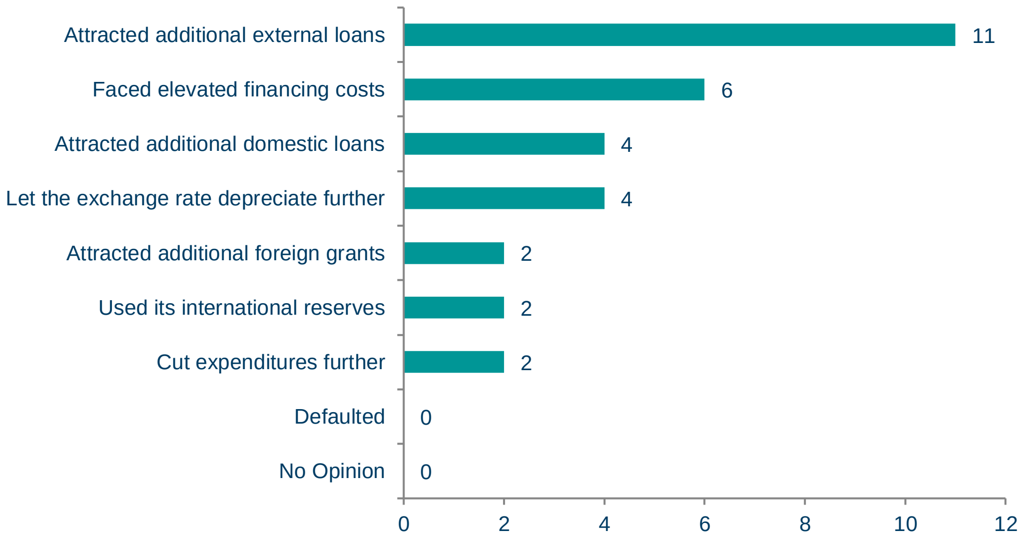
The Delphi questionnaire contained ten questions, related to the MFA operation in Georgia:

- Three questions on the macro-economic and fiscal situation, the added value of the financial support provided by the IMF SBA and EU MFA, and the specific added value of the MFA operation (questions 1-3);
- Four questions on the relevance and progress in the areas of structural reform, and the added value of the MFA in this respect (questions 4-7);
- Two questions on the MFA design (questions 8 and 9);
- One question on MFA's added value to social impact (question 10).

Macro-economic/ Fiscal Situation

1. If the IMF Stand By Agreement (SBA) had not been provided in 2014, what would have happened?

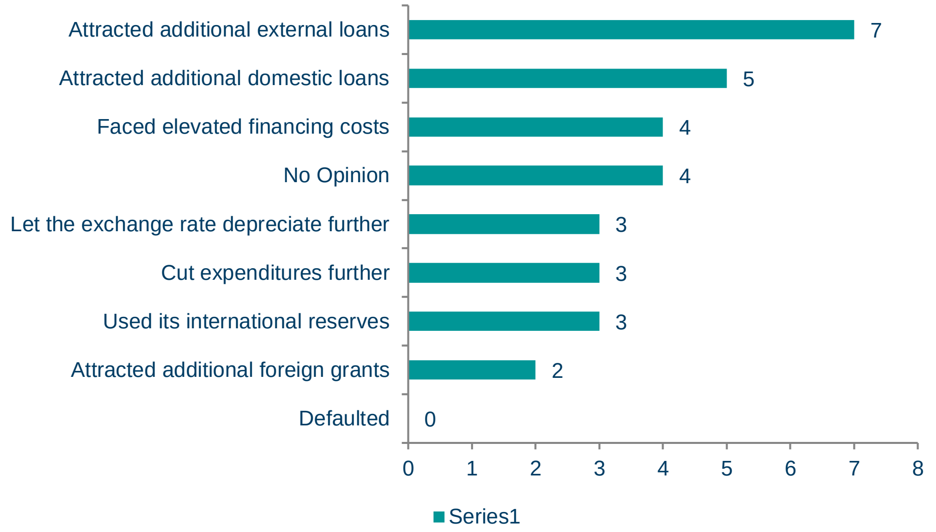
Georgia would have:



Respondents: 16 (multiple choices possible).

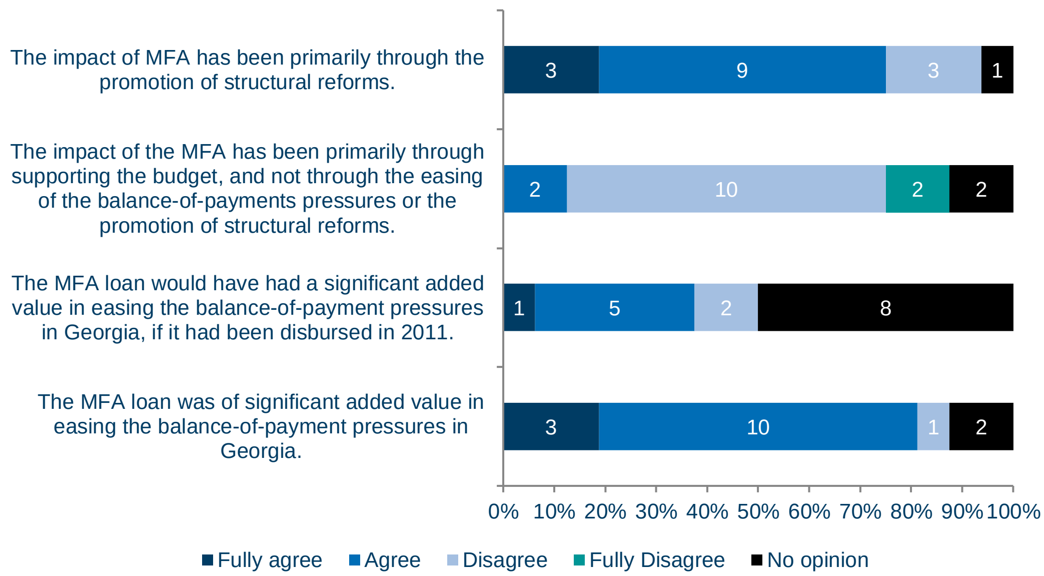
2. If the EU Macro-Financial Assistance (MFA) had not been provided in 2014, what would have happened?

Georgia would have:



Respondents: 16 (multiple choices possible).

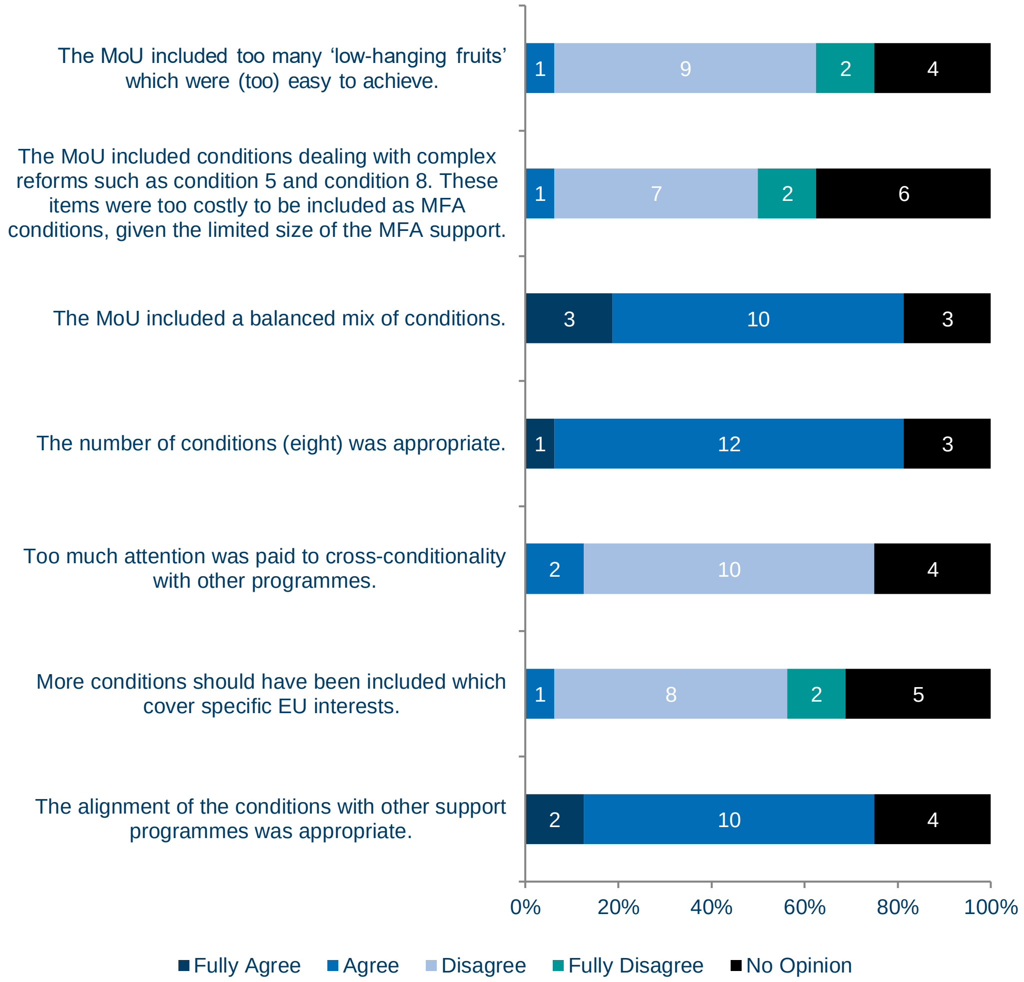
3. To what extent do you agree with the following statements?



Respondents: 16.

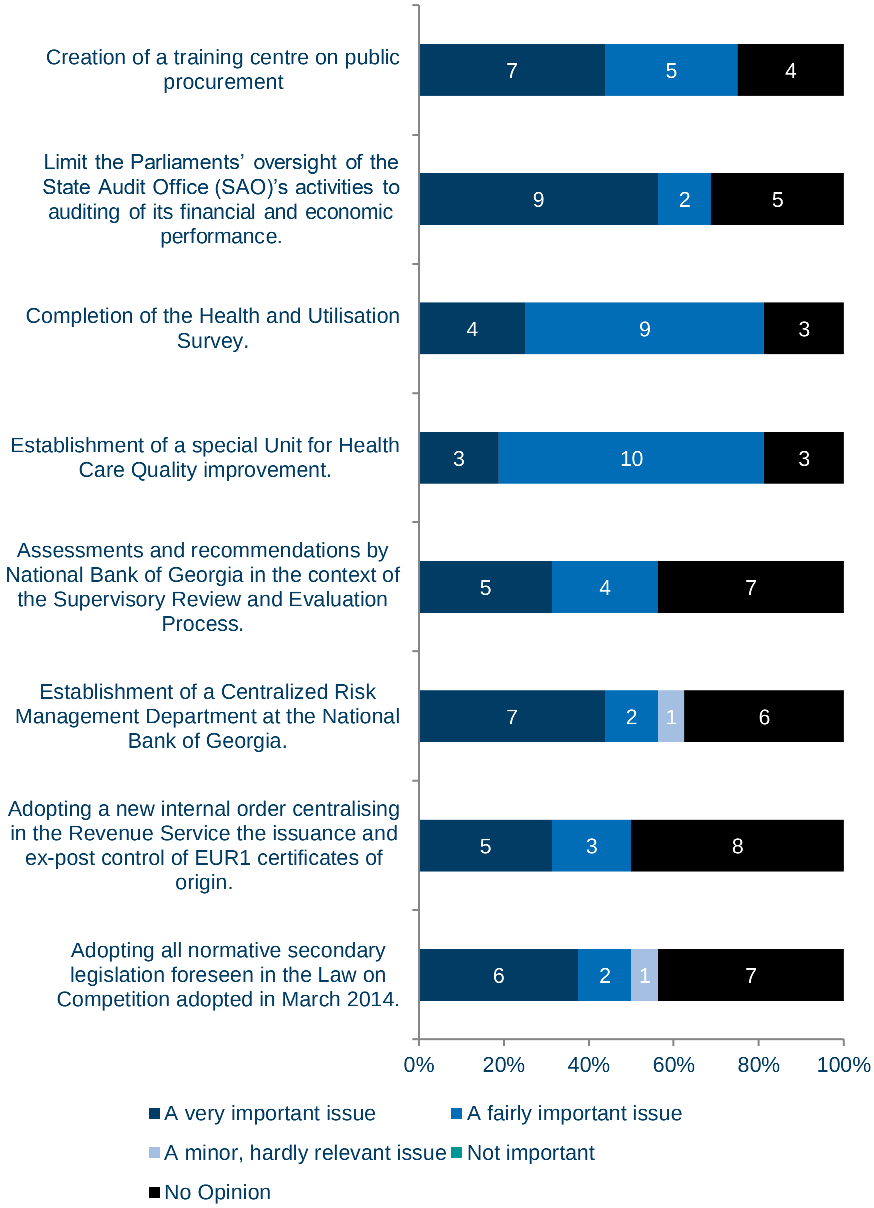
Structural Reforms

4. To what extent do you agree with the following statements?



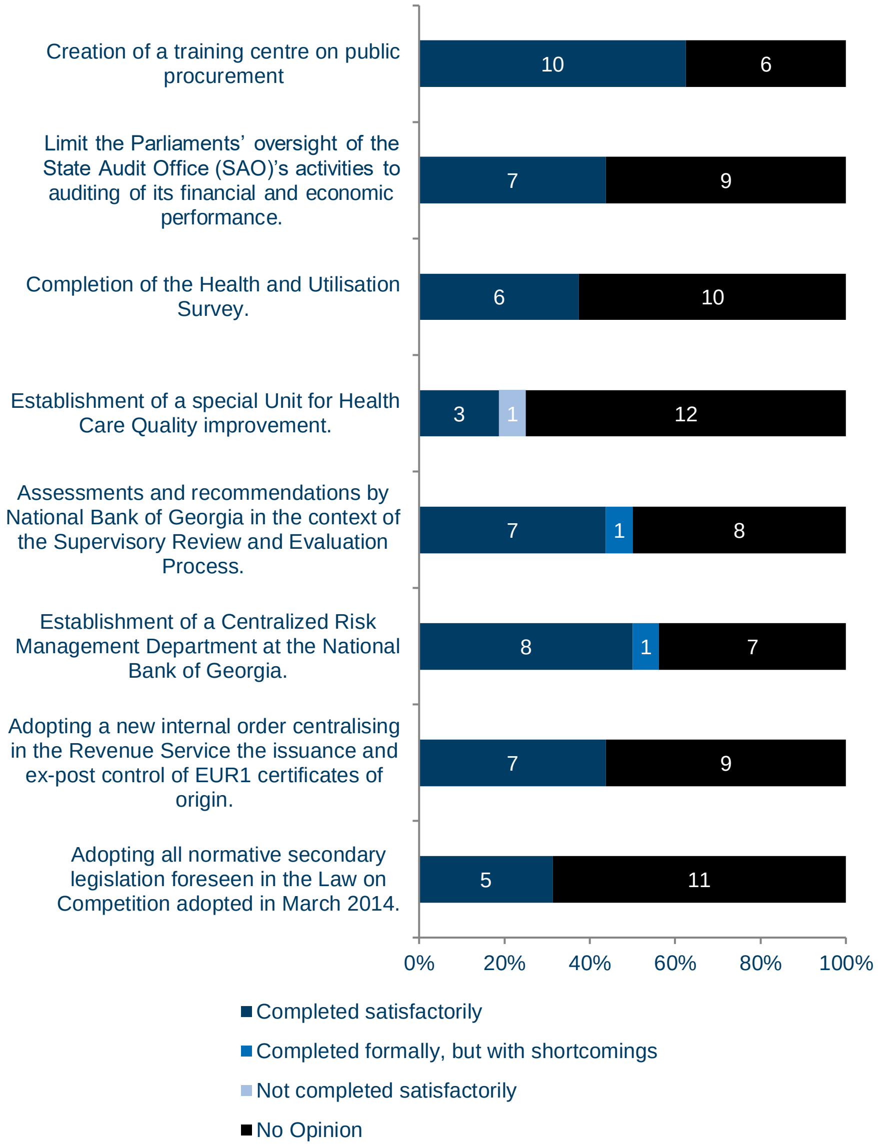
Respondents: 16.

5. How do you assess the relative importance of these reforms at the time they were included in the Memorandum of Understanding (2014)?



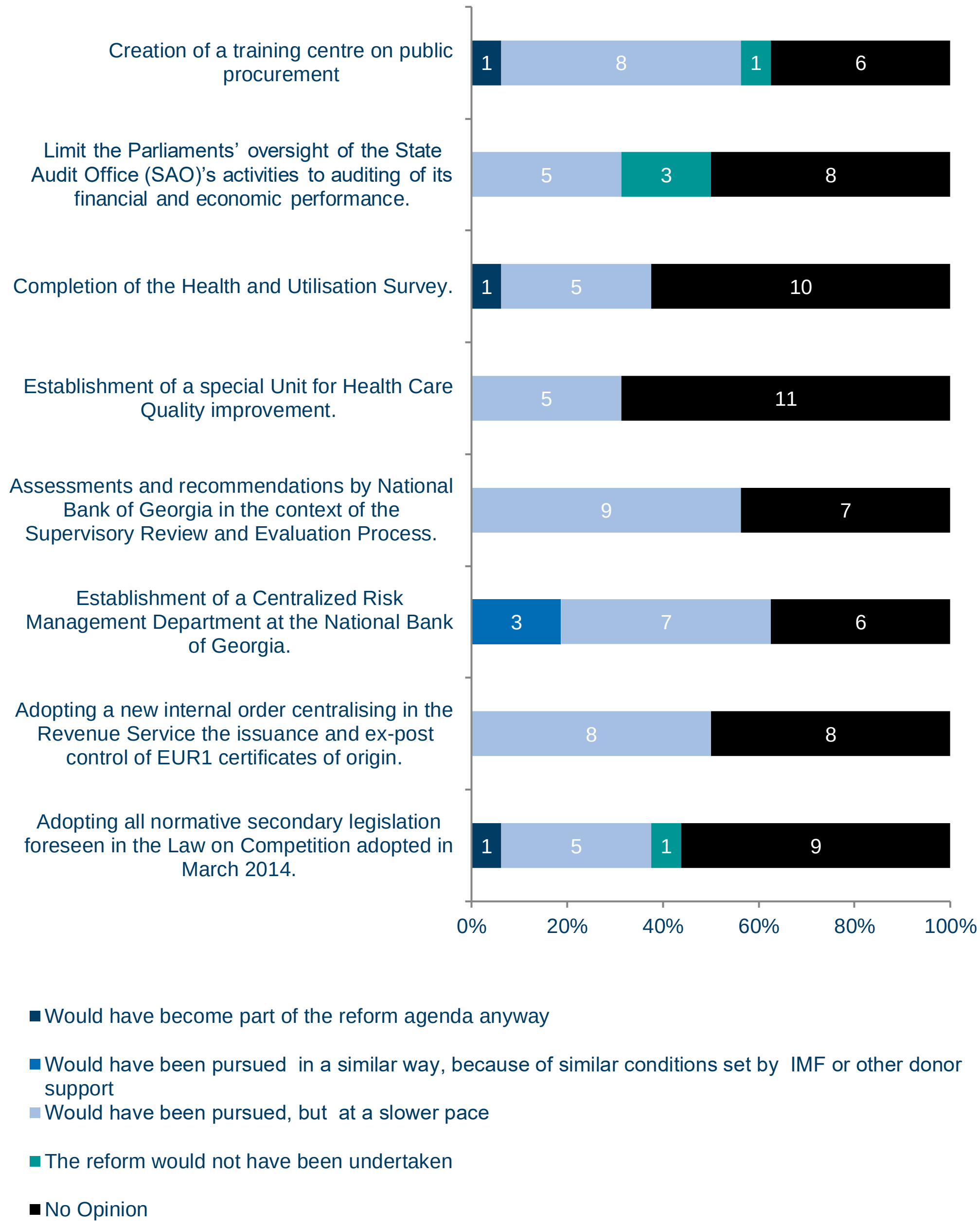
Respondents: 16.

6. In 2017, the eight conditions were formally completed. In your opinion, were these reforms completed satisfactorily or merely formally with some shortcomings?



Respondents: 16.

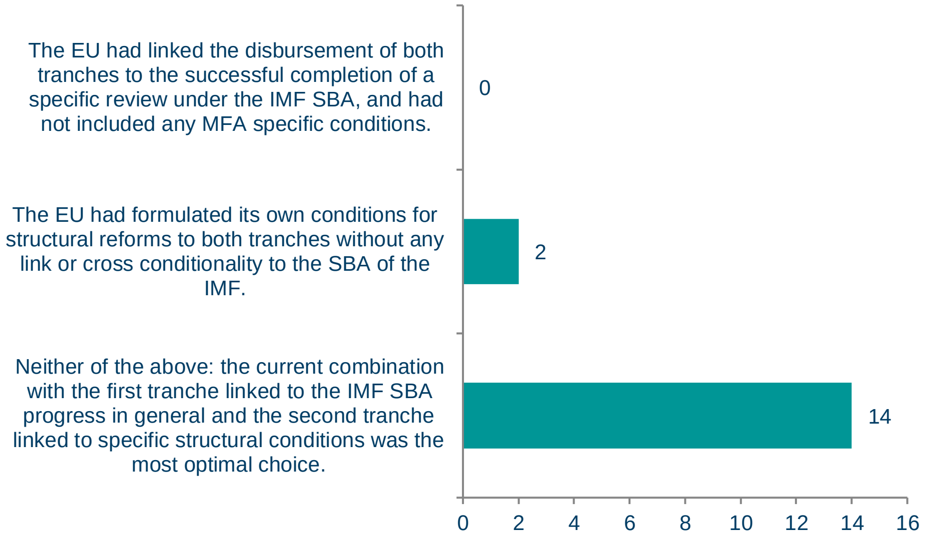
7. What would have happened to the following reform conditions if the MFA support had not taken place?



Respondents: 16.

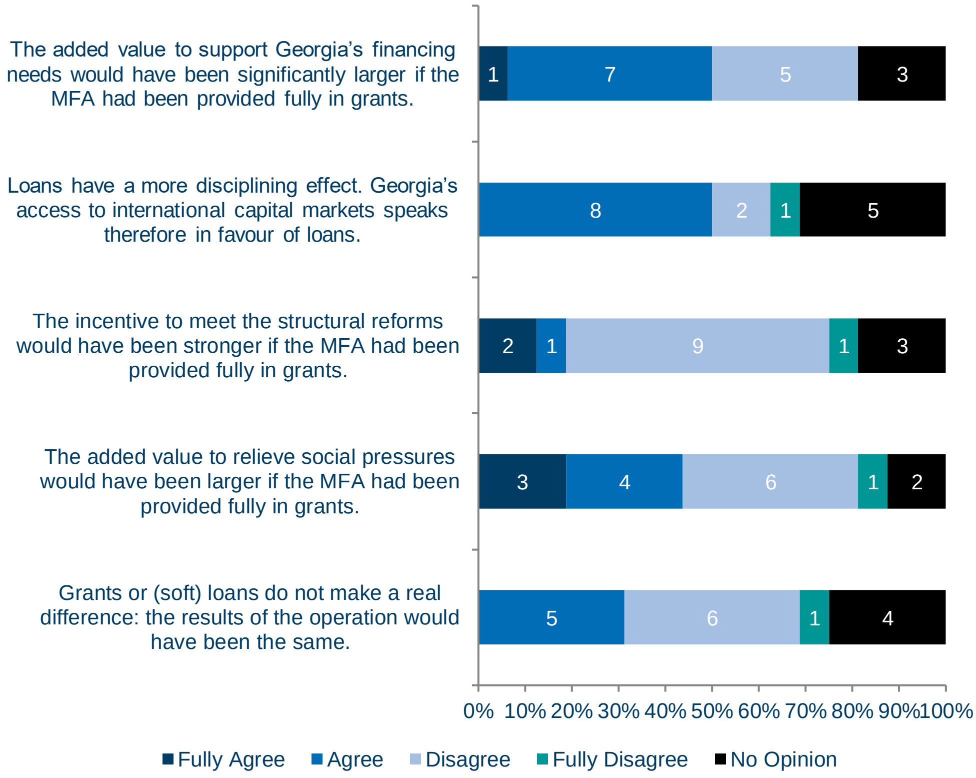
Design of MFA

8. The condition for disbursement of the first tranche of the MFA was a satisfactory track record in the implementation of the SBA between Georgia and the IMF. For the second tranche, eight specific conditions were introduced. In your view, the impact / added value of the MFA would have been increased if:



Respondents: 16.

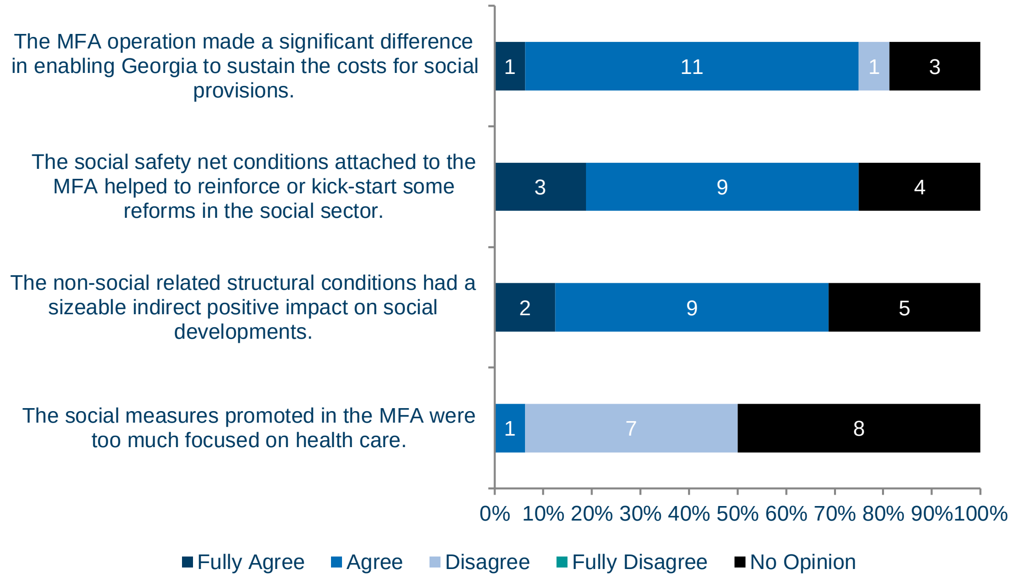
9. The MFA was provided half in grants and half in loans. What do you think about the composition of the financing? Please indicate to what extent you agree with the following statements.



Respondents: 16.

Social Impact of the MFA

10. To what extent has the EU added value in alleviating social pressures in Georgia? Please indicate to what extent you agree with the following statements:



Respondents: 16.

Annex V Delphi Questionnaire invitees

Table A.5.1 Delphi Questionnaire invitees

	Name	Institution	Responded?
		European Commission	
1	Martynas Baciulis	EC, DG ECFIN	Yes
2	Luca Oriani Vieyra	EC, DG NEAR	No
3	Irakli Khmaladze	EC, EU Delegation	Yes
4	Vincent Rey	EC, EU Delegation	No
5	Nino Samvelidze	EC, EU Delegation	Yes
6	Sofie van Bergen	EC, EEAS	Yes
		Government/Authorities of Georgia	
7	Archil Imnaishvili	National Bank of Georgia	Yes
8	Otar Nadaraia	(National Bank of Georgia)	Yes
9	Giorgi Kadagidze	(National Bank of Georgia)	No
10	Nikoloz Gagua	Ministry of Finance	No
11	Fridon Aslanikashvili	Ministry of Finance	No
12	Vakhtang Tsintsadze	Ministry of Economy/Sustainable Development	Yes
13	Tata Khetaguri	Parliamentary Budget Office	No
14	Kakha Demetrashvili	State Procurement Agency	Yes
15	Dmitri Gulisashvili	State Procurement Agency	No
16	Salome Chakvetadze	Ministry of Finance	Yes
17	Tsotne Karkashadze	State Audit Office	Yes
18	Eva Bochorishvili	Galt&Taggard	Yes
19	Lasha Inauri	Ministry of Environmental Protection	No
		IMF and World Bank	
20	Mercedes Vera Martin	IMF	Yes
21	Nia Sharashidze	IMF representation	Yes
22	Francois Painchaud	IMF representation	Yes
23	Lire Ersado	World Bank	Yes
24	Mariam Dolidze	World Bank	Yes
25	Genevieve Boyreau	World Bank	No
		Other donors	
26	Philipp Steinheim	GIZ	No
27	Giorgi Amzashvili	USAID	No
28	Tamar Buadze	USAID	No

Annex VI Methodology of the DSA calculations

Assessing the impact of financial assistance on the sustainability of the external (EQ2.1.1) and public debt (EQ 7.1) requires a set of realistic and consistent assumptions to create the different scenarios. The baseline scenario (Scenario A) incorporates the financial programme both from the SBA of the IMF and the MFA provided by the EC. For the past, the baseline scenario thus consists of the factual realization of the relevant variables. For the projection horizon, the baseline scenario is primarily constructed on the basis of the October 2018 IMF World Economic Outlook, and the IMF forecast for Georgia presented there. For the longer term[129], we use assumptions on the long-term equilibrium values of the main driving forces, consistently with the latest DSA, calculations published by the IMF (see Table A.6.1 and Table A.6.2).

We construct the following two alternative scenarios:

- Scenario B assumes that neither the IMF SBA, nor the MFA was granted to Georgia;
- Scenario C assumes that Georgia received the SBA from the IMF, but no MFA was granted.

A summary of the scenarios and their underlying assumptions are presented in Figure A.6.1 below.

Figure A.6.1 The analysed scenarios in the DSA calculations

Scenario A - Baseline scenario:
- Includes SBA and MFA assistance
- Most likely scenario based on observed data for the past, and the IMF forecasts for the future

Scenario B:
- No financial assistance scenario (No SBA and no MFA assumed)
- Assumes higher risk premium (based on observed data) and lower GDP growth (based on regional forecast comparison)

Scenario C:
- No EU MFA assistance (Includes SBA, but no MFA assumed)
- Assumes higher risk premium and lower GDP growth (both effects scaled down based on the relative size of the EU MFA to the combined programme)

As for the quantification of the alternative scenarios (B-C), we proceed with the following steps:

1. First, we assume that the confidence impact of combined MFA and SBA programmes started in 2014. This assumption is based on the fact that the IMF SBA agreement was approved in July 2014. Prior to

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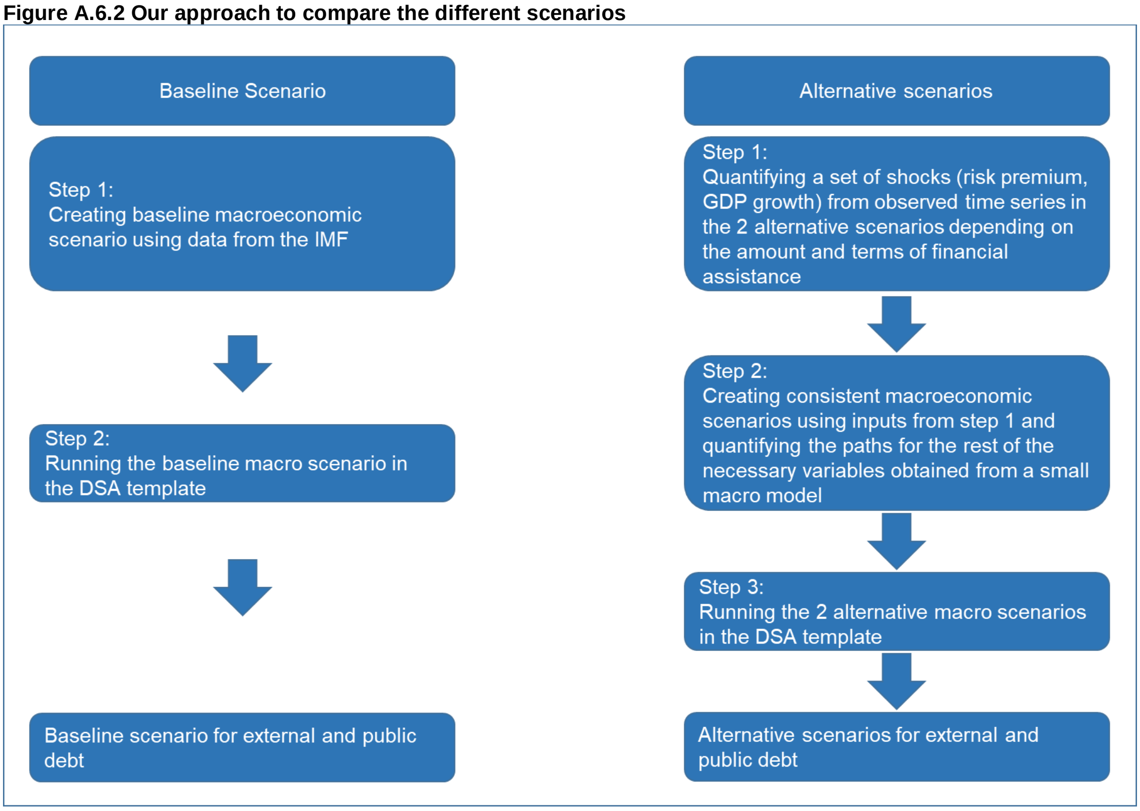
129 The IMF's standard projection horizon is 5 years, and we deviate from that in our long-term forecast, which is an arbitrary decision. It is, however, approved by the IMF methodology to use a longer timeframe, which may be more appropriate for capturing the relevant risks for debt sustainability. For more on this, see: http://www.imf.org/external/np/pp/eng/2013/050913.pdf.

that Georgia did not have a disbursing IMF support programme as the authorities treated the SBA/SCF programme approved in April 2012 as precautionary and did not borrow from it which prevented the activation of MFA 2 (See Section 2.2). Hence, a cut off period for the beginning of scenario projections is 2014;

Based on the observed dynamics in Georgia's financing conditions and the IMF's growth forecasts shortly before and immediately after the approval of the SBA programme, we quantify the underlying shocks to the risk premium and GDP growth attributable to the financial assistances from the IMF and the EU. In doing so we implicitly assume that *all* the change on the risk premium and on the growth outlook is attributed to the IMF SBA agreement and the launch of MFA 2 operation. In order to divide the effects between MFA 2 and SBA, we assume that the underlying shocks related to the EU assistance and the IMF loan are proportional to their amount of the total (MFA and SBA combined) package;[130]

2. Third, consistent paths for some additional macroeconomic variables that are necessary inputs to the IMF's DSA templates (interest rates, inflation, current account and the primary fiscal balance) are derived using a small macroeconomic model131 across the different alternative scenarios;
3. Finally, the consistent macro scenarios are used as inputs in the DSA framework to derive the dynamics for the debt variables in all three alternative scenarios.

Figure A.6.2 Our approach to compare the different scenarios



Regarding the second step of creating the alternative scenarios, when quantifying the shocks for the risk premium and the real growth, we proceeded as explained below:

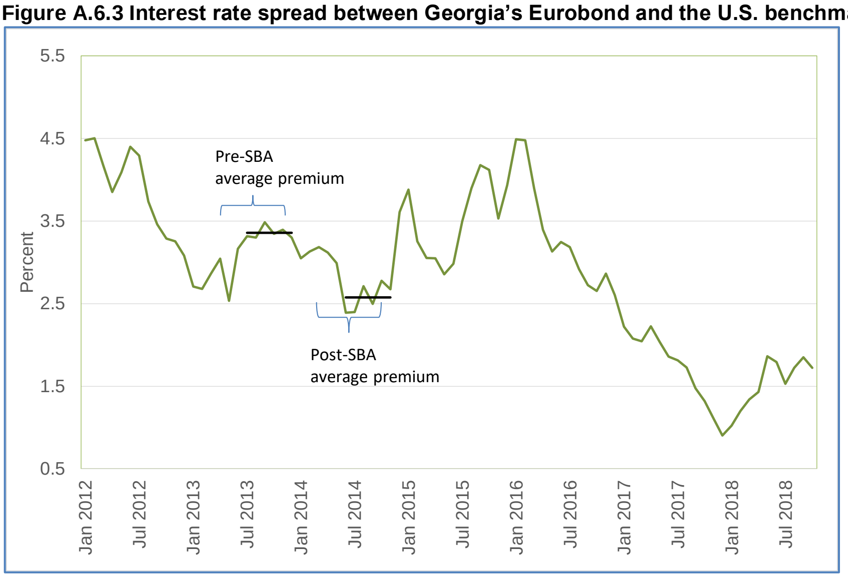
1. The risk premium for Georgia (as approximated by the interest rate spread between the 10-year Eurobond issued by Georgia and the corresponding U.S. benchmark) decreased substantially, by about 180 basis points to 2.7 percent throughout 2012 and first months of 2013. This explicit improvement in the risk perception of investors might contributed to the authorities' decision of handling

130 These two assumptions imply that our results for the impact of both the IMF and the joint IMF-EU assistance is an upper estimate. This is especially true for the EU contribution.

131 It is a standard stock-flow consistent small macro framework developed by OGResearch, which can be used to model the changes in the stock of public and external debt to various macroeconomic shocks and has been successfully applied in assessing issues with long-term external and fiscal sustainability in several countries.

the IMF agreement as precautionary. In the middle of 2013, risk premium started to increase mainly on account of the general increase in global risk aversion and regional tensions. However at the time of the approval of the IMF SBA (July 2014) risk premium indicators showed a distinct decline. The premium declined by about 100 basis points reaching 2.4 percent in mid-2014. In scenario B (no IMF SBA and no MFA loans), we assumed that without financial assistance from the IMF and the EU, the risk premium would not have declined in 2014. In order to quantify the risk premium shock of scenario B we assumed that all the 100 basis points decline in the premium in early-2014 can be attributed to the anticipated deal with the IMF and the EU. In the absence of the agreement, Georgia would have faced financing costs higher by 1 percentage points than in the baseline scenario for two years. This assumption is a lower bound estimate of the premium shock. We assume that in the lack of the agreement with the IMF and the EU, the risk premium would have not decreased. However, it is likely that "no deal" would have led to a severe loss of confidence and hence a sharp jump in the risk premium and a similar increase in the financing costs. Since it is impossible to make a reasonable estimate of the premium impact of such a scenario, we use our conservative estimation of a 100 basis points shock in our simulations.

Figure A.6.3 Interest rate spread between Georgia's Eurobond and the U.S. benchmark



Source: Bloomberg.

2. Apart from addressing the external financing need, the SBA and the MFA smoothed the external and fiscal adjustment process as well as aimed at fostering inclusive growth in order to reduce poverty and unemployment. Therefore, the analysis assumes that the SBA and MFA assistances had an impact on the GDP growth. This impact is expected to be reflected in the revisions of the GDP growth outlook in the IMF projections prepared before April 2014 (before the approval of the SBA) and October 2014 (after the SBA approval). However, the growth projection was not revised because the positive growth effect of the SBA program coincided with the negative impact of the Russian financial crisis and its regional spill overs. Hence, in order to quantify the negative GDP growth shock in the Scenario B, we compute the average change in the IMF GDP forecasts for the neighbouring countries (Armenia, Belarus, Moldova, Kyrgyz Republic, and Russia) of Georgia from April to October 2014. Finally, we assume that in the absence of the SBA, Georgia would have had a similar change in its growth performance (see Table A.6.1);
3. For scenario C (only IMF SBA loan, no MFA), we derive the corresponding premium and growth effects proportionally to the ratio of the MFA operation to the joint funding of the EU and the IMF. This means

that the scenario shocks are scaled down by a factor of 0.25, given that the IMF loan is around 25 percent of the joint financing.[132]

Table A.6.1 Calculation of the real growth shocks in the alternative scenario B

	Average growth outlook of Georgian neighbours (%), IMF WEO April 2014	Average growth outlook of Georgian neighbours (%), IMF WEO October 2014	Difference, pp
2014	3.0	2.1	**-1.0**
2015	3.8	2.8	**-1.0**
2016	3.9	3.2	**-0.7**
2017	3.9	3.5	**-0.4**
2018	3.9	3.6	**-0.3**
2019	3.9	3.7	**-0.2**

Source: IMF and own calculations.

Taking the shock profiles from above and adding consistent paths for the macroeconomic variables necessary for the DSA framework (real GDP growth, interest rates, inflation, current account and primary budget balance) produces the full-fledged projections for the different scenarios. The results for the main macroeconomic variables are compared to the baseline, and the differences are presented in Table A.6.2. According to our simulations, in the absence of financial assistance from both sources (Scenario B: no IMF, no MFA) the level of real GDP is projected to be 3.3 percent lower by the end of 2019. Effective interest rates would have been higher by 0.4 percentage points in 2019. The joint financial assistance also contributed to the achievement of lower primary deficits (mainly through the cyclical component) for the period under evaluation. The MFA loan had modest contribution to the improvement in the macroeconomic conditions consistently with the relative size of the assistance to the IMF programme.[133]

132 It is important to stress that with this approach, we assume that although the MFA was concluded in late 2013, financial markets expected a deal with the EC already after the IMF agreement was there, i.e. approximately one year before the actual EC agreement. In fact, the request for the MFA was indeed made in the same year as the SBA, so the confidence effect from a prospective EU deal could have materialized promptly after the IMF agreement.

133 This is visible from comparing scenario C (only IMF loan) to the baseline (joint financing).

Table A.6.2 Difference in key macroeconomic variables from the baseline

Scenario B (no MFA, no IMF loan) vs Baseline (both MFA and IMF loan)						
	2014	**2015**	**2016**	**2017**	**2018**	**2019**
Real GDP growth, pp deviation	-0.96	-0.96	-0.67	-0.38	-0.30	-0.22
GDP deflator, pp deviation	0.00	-0.08	-0.18	-0.26	-0.29	-0.29
Interest rate, pp deviation	1.00	0.95	0.81	0.64	0.49	0.38
Primary balance, pp deviation	-0.37	-0.65	-0.73	-0.64	-0.52	-0.39
GEL per USD (% deviation)	0.60	1.41	1.82	2.02	1.92	1.61

Scenario C (only IMF loan, no MFA) vs Baseline (both MFA and IMF loan)						
	2014	**2015**	**2016**	**2017**	**2018**	**2019**
Real GDP growth, pp deviation	-0.24	-0.24	-0.17	-0.09	-0.07	-0.05
GDP deflator, pp deviation	0.00	-0.02	-0.04	-0.07	-0.07	-0.07
Interest rate, pp deviation	0.24	0.24	0.20	0.16	0.12	0.09
Primary balance, pp deviation	-0.09	-0.16	-0.18	-0.16	-0.13	-0.10
GEL per USD (% deviation)	0.17	0.36	0.41	0.51	0.49	0.36

Source: Own calculations.

Once the full macroeconomic picture of the different scenarios were put together, we applied the IMF's DSA framework to make the projections for the external and public debt on both the medium-term (2014-2019), and beyond (up until 2050). The results from these simulations are presented in Section 6.2.1 (EQ2.1.1) and 6.7 (EQ7.1).

Annex VII Case studies

The evaluation team undertook two case studies: one on the financial sector reforms (related to actions 5 and 6) and another on the trade and competition policy reforms (related to actions 7 and 8), to be able to go more in-depth, place the structural reforms in a broader context and explore the causality between the MFA and the actual structural reforms.

Case study 1: Structural reforms in the area of Financial Sector

The first case study of this evaluation deals with the two actions of the MoU specifically aiming to improve financial regulation and supervision in Georgia. We examine the major challenges of the sector at the time of the design of the MFA and look at the relevance and effectiveness of the financial conditionality in light of the challenges. The study presents the structural reform efforts of the authorities and related developments in the key areas.

Challenges of the Georgian financial sector in 2014

The Georgian financial sector weathered through a number of significant shocks before 2014, i.e. the armed conflict with Russia, the global financial crisis as well as the regional instabilities. In spite of its resilience, the financial system had several structural weaknesses in 2014:

- *Dollarization*: Both loan and deposit dollarization had been traditionally high in Georgia, presenting a challenge for financial stability and monetary policy. FX loans represented 60 percent of the loan portfolio, while ratio of FX deposit to total deposits reached 58 percent on average in 2014. Loan dollarization could be associated with high interest rate spreads between the local currency and foreign currency denominated loans, while high deposit dollarization is explained by historic factors reducing confidence in the lari (high inflation; exchange rate fluctuations; and unstable political environment).[134] Therefore, in the long run, dollarization is not a question of regulatory measures, but rather of credible monetary and fiscal policy, as well as economic and political stability in general;
- *Highly concentrated banking sector:* In 2014 the two largest banks, The Bank of Georgia (BoG) and the TBC Bank[135] held 57 percent of the assets of the banking sector, while the top three banks covered about 65 percent of the total assets. The TBC and BoG are so large that their failure would be disastrous to the economy, presenting a “too big to fail” problem;
- *Heavy reliance on short term external funding:* Non-resident deposits increased rapidly after the 2008 crisis. By reaching 15 percent of customer deposits, it became an important source of financing by 2014. The NBG introduced measures to limit the reliance on this type of financing in 2013 (by adjusting the calculation of the required liquidity ratio), which visibly slowed the external deposit accumulation. Furthermore, a significant part of this financing is assumed to be originated from Georgian investors and diaspora. Despite these mitigating factors, the associated funding risk remained high, as deposits were mostly short term and denominated in FX;
- *Rapid credit growth*: The credit gap[136] was estimated at 2 percent of GDP in 2014[137], suggesting a risk of a slight overheating. Credit growth was mainly fuelled by retail credit, and had been focused on relatively risky products (consumer loans, credit cards, etc.). The household debt-to-GDP ratio approached 25 percent, which was relatively high compared to the peers (see chart). Retail loan

134 See National Bank of Georgia, Larization. https://www.nbg.gov.ge/index.php?m=566&lng=eng.

135 The BoG and TBC have been listed on the London Stock Exchange.

136 The credit-to-GDP gap (“credit gap”) is defined as the difference between the credit-to-GDP ratio and its long-term trend. Basel III uses this metric as a guide for setting countercyclical capital buffers.

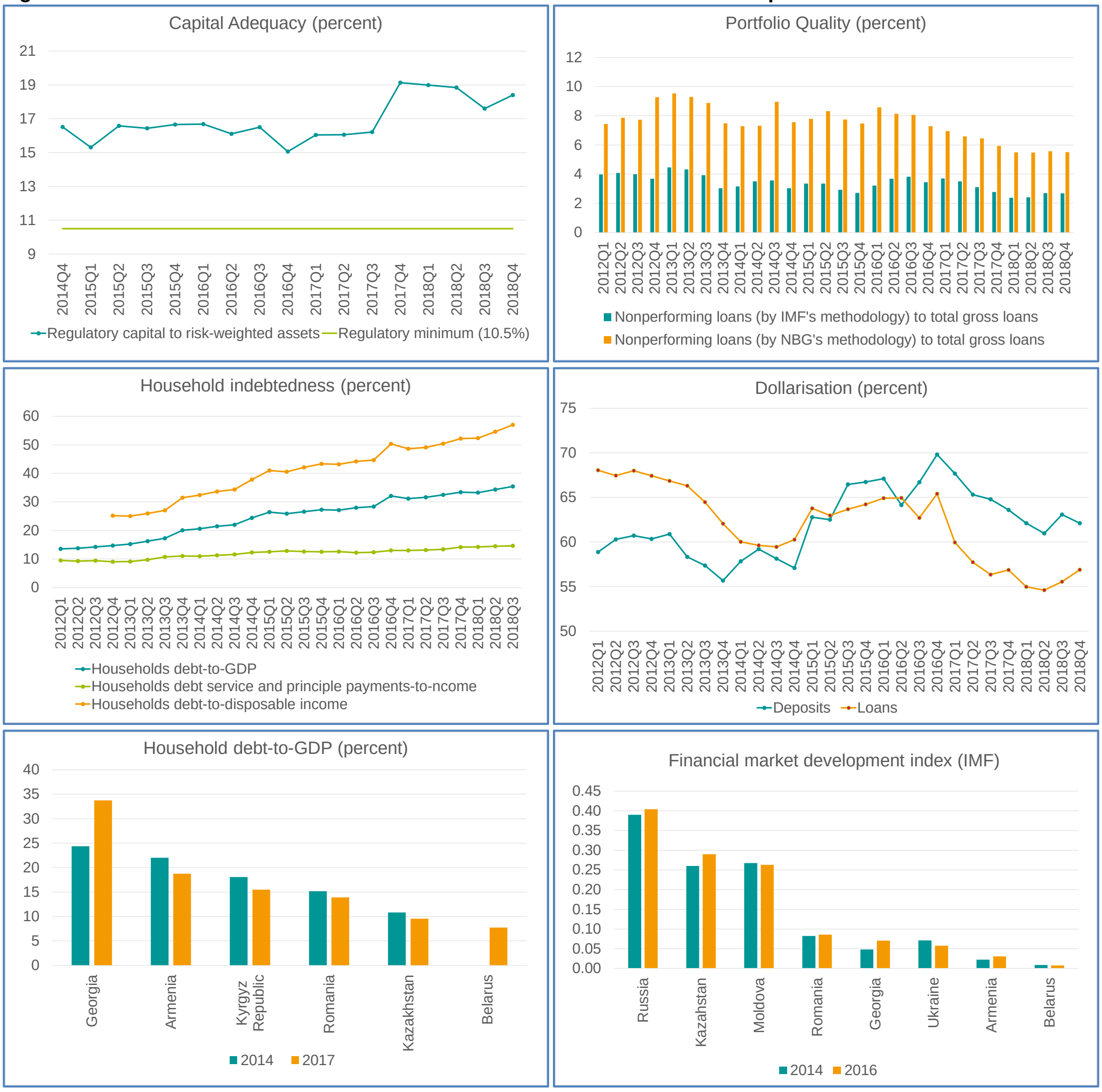
137 IMF 2014. Georgia Financial System Stability Assessment; https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2014/_cr14355.ashx.

growth was also supported by the easy access to loans provided by microfinancial institutions (MFIs) and private lenders[138];

- *Underdeveloped financial markets:* The non-banking financial sector was underdeveloped and capital markets were practically non-existent in Georgia in 2014. The equity market was highly illiquid, the insurance sector was small and presented a weak financial performance. The IMF index of financial development pointed to a potential for considerable growth benefits from financial deepening.

Some of these weaknesses created systemic vulnerabilities to the swings in the domestic and world economy and exchange rate volatility in particular. Others limited the efficiency of financial intermediation, i.e. the accumulation and channelling of domestic savings to borrowers.

Figure A.7.1 Financial soundness indicators and the financial market development index



Sources: NBG, IMF Financial Soundness Indicators, IMF Financial Development Database, IMF.

The financial sector supervision and regulation, while at a relatively advanced level in 2014 also had a room for improvement. The financial supervision and regulation has an important role in managing and controlling risks associated with the vulnerabilities, as well as in creating incentives to limit the accumulation of weaknesses. The IMF-WB FSAP[139] carried out in 2014 found that Georgia had introduced a comprehensive, forward looking, risk-based supervisory approach and its banking supervision and

138 Individuals lend money to each other based on formal contracts where interest rates are even higher than in case of MFI loans.

139 IMF. (2014). Georgia Financial System Stability Assessment; https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2014/_cr14355.ashx.

regulation shows “a very high degree of compliance with international standards”. Stress tests carried out suggested that the banking system was resilient in 2014, although it pointed to the need to strengthen capital and liquidity buffers.[140] At the same time, the report identified some “pockets of weakness” and stated that the new supervisory approach had not been fully implemented. The main areas for further development identified in 2014 were:

- *Banks' risk management:* In the process of implementing Basel II (Pillar 2), the commercial banks needed to express their risk appetite and set their internal processes for assessing capital and liquidity adequacy in relation to their risk profile (ICAAP). The NBG had to develop guidelines for determining the adequacy of the ICAAP in the SREP; had to examine that banks have a suitable risk appetite, and request banks to have contingency arrangements and forward-looking stress tests. Banks had to ensure that risk management and risk-taking functions are fully separated. The NBG had to develop Pillar 3 requirements for banks;
- *Macro prudential policy:* In line with Basel III, the NBG needed to further develop and introduce its macro prudential supervisory and regulatory framework;
- *Financial safety net and crisis management framework*. The framework for handling commercial banks in the times of stress had to be developed. The bank resolution framework required a further development and a deposit insurance scheme had to be established;
- *Regulation of non-deposit taking credit institutions:* MFIs – a rapidly developing financial segment since 2006 – was assuming an increasing role in the retail credit market in the period before the MFA implementation. Still, the regulatory framework for the MFIs had been much less strict than for the banks.[141][142] For instance, MFIs' clients were typically people who were not eligible for bank credits and were willing to borrow at high interest rates due either to a lack of alternative options or their financial illiteracy. The MFIs provided mainly collateralized loans at extremely high interest rates, allowing for maintaining their profitability in spite of high delinquency rates. Despite the issue of moral hazard (the incentive to ignore the financial strength of the borrower and rely solely on collateral), no credit standards and no consumer protection mechanisms were put in place. Besides MFIs, private collateralized lending - a sector outside the banking industry and out of control of regulators - also heavily contributed to an increasing indebtedness of the poorest segments of population in Georgia.

Impact of the conditions on strengthening the process of ensuring capital adequacy of banks

Action 5 of the MFA 2 stated that banks had to submit their ICAAP reports to the NBG. Based on the ICAAP, (defined under Basel Pillar 1[143]), the NBG had to provide assessments and recommendations to the two largest banks in the context of the SREP. The ICAAP supplements the minimum regulatory capital requirements (defined under Basel Pillar 1), as it considers a broader range of risk types and the bank's risk- and capital-management capabilities. The development and implementation of internal risk models are also key elements of ICAAP.

The introduction of ICAAP and the recommendations formulated by the NBG improved the commercial banks' risk awareness and their management practices, and addressed most of the issues identified by the FSAP in this field in 2014. The requirements introduced by the NBG under Pillar 2 consisted of the following buffers: the unhedged currency induced credit risk buffer; the credit portfolio concentration buffer; the net stress test buffer; and an additional buffer, set in accordance with the NBG's General Risk

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140 IMF. (2015). Georgia Financial Sector Assessment Program - Stress Testing the Banking Sector— Technical note https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2015/_cr1507.ashx.

141 EPRC. (2014). Management of Non-Performing Loans in Georgia, Analysis and Recommendations; https://www.eprc.ge/admin/editor/uploads/files/Sesxebi__Eng_WEB.pdf.

142 Regulation defined the minimum share capital for MFIs and limited the size of micro loan (30,000 USD).

143 Basel II sets out a three-pillar approach to risk and capital management for banks. Pillar 1 defines the calculation of minimum regulatory capital requirements. Under Pillar 2, banks have to conduct an ICAAP to demonstrate that they have implemented methods and procedures to ensure adequate capital resources, with attention to all risk. Regulators have to conduct a SREP to assess the soundness of a bank's ICAAP and take any appropriate actions that may be required. Under Pillar 3, banks are obliged to meet disclosure requirements in order to ensure transparency for improving market discipline. Basel III builds on Basel II and its main focus is to strengthen Pillar 1 by adding new requirements for capital, liquidity, and funding.

Assessment Program (GRAPE) and the assessment of the banks' internal capital. By strengthening the capital buffers of banks with specific vulnerabilities, the action helped increase the specific shock absorption capacity of commercial banks and thereby had an important role in increasing the resilience of the banking sector in Georgia.

Impact of the condition aiming at improving the risk management processes at the NBG

The second financial sector condition of the MFA 2 required the NBG to implement the centralized risk-management framework action plan approved by the NBG Council in April 2013. As part of this plan, the Centralized Risk Management Department (CRMD) had to be established at the NBG. The Department is in charge of managing operational risks, including Business Continuity Management Procedures. Besides the MFA conditionality, the establishment of the CRMD was also consistent with the NBG's commitment to an institutional development as well as the NBG's consideration of the findings of the 2011 safeguards assessment[144] of the IMF.

While addressing an important issue, we must note that this specific MFA condition did not address the relevant challenges of the financial sector and the action had a limited scope compared to other actions set in the MoU.

The global financial crisis highlighted the importance of the central banks' financial risk management capacities. The increased volatility of prices and exchange rates, and the rising balance sheets of central banks made the economic agents pay more attention to the management of financial risks. The IMF safeguard assessments also increased the emphasis on the central banks' risk management framework (IMF, 2011, 2017) and highlighted that in most emerging countries, the management of operational, reputational, and strategic risks still needed to be developed. [145] In order to establish and operate a proper risk management framework, central banks had to set up an independent risk control function, responsible for supervising risk-taking activities. [146]

The establishment of the CRMD was an important and relevant measure in this respect, supporting the harmonisation of the NBG's risk management with international best practices. The NBG collaborated with the Dutch and German central banks to develop the centralized risk management framework (NBG, 2015)[147]. The stakeholder consultations confirmed that the CMRD was relevant, as it increased the transparency and integrity of risk taking and risk management activities of the NBG.

The Financial sector measures and developments in the fields specified as major challenges in 2014

The NBG has continued the implementation of its risk-based supervisory approach in line with Basel II and III since 2014. Besides the NBG's commitment to follow international best practices, the process was supported by the financial sector related structural benchmarks of the IMF EEF programme since 2017 (see section 2.1.4) and the fact that under the AA, Georgia has committed to adopt the EU financial regulation. [148]

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144 IMF safeguards policy provides assessments of central banks for countries seeking financing from the IMF. The assessments provide assurance that governance and controls can protect Fund resources from misuse and guard against misreporting of data used for programme monitoring. IMF safeguards reports are confidential and shared only with the given central bank.

145 IMF. (2011). Safeguards Assessments—2011 Update, September 15, 2011 https://www.imf.org/external/np/pp/eng/2011/091511.pdf.
IMF. (2017). IMF Policy Paper, Safeguards assessment—2017 update https://www.imf.org/en/Publications/Policy-Papers/Issues/2017/10/26/pp10017safeguards-assessment-2017-update.

146 See Erkki Liikanen (2017). Central banking and the risk management of central banks - what are the links? Keynote speech by the Bank of Finland, at the Joint Bank of Portugal and European Central Bank Conference on "Risk Management for Central Banks", Lisbon, 26 September 2017; https://www.bis.org/review/r170929b.pdf.

147 NBG. (2015). Annual Report, 2014 https://www.nbg.gov.ge/uploads/publications/annualreport/2015/annual_eng_2014_131015.pdf.

148 Under the Association Agreement (see Annex XV-A Rules Applicable to Financial Services) Georgia committed itself to gradually approximate its legislation to the EU legislation on banking, insurance, securities, etc.

Besides the actions set by the MFA, the NBG and the government took several important measures to address the structural weaknesses in the financial sector. In 2017, the NBG introduced its complex macro-prudential policy framework. In line with the Basel III standards, commercial banks are required to meet a combination of capital buffer requirements, which consists of the conservation buffer (defined as 2.5 percent of risk-weighted assets to build up capital for stress periods), the countercyclical buffer[149] (to limit excessive credit growth leading to a build-up of systemic risks) and systemic buffer (a capital surcharge for systemically important banks). Since 2017, the minimum requirements of the Basel III-based Liquidity Coverage Ratio (LCR) became effective too.

The government and the NBG introduced a 10 point *Larization plan* in 2017. Most important measures of this plan included (i) the promotion of the use of the local currency; (ii) the improvement of access to long-term lari loans; (iii) the conversion program of FX loans into the lari and (iv) the prohibition of household lending in FX of amounts less than 40,000 US dollars.

Table A.7.1 Overview on the challenges, action and developments in the financial sectors

Challenge	Actions	Developments
Dollarization	• Larization plan (Pricing in lari; Conversion of FX loans into lari; Prohibition of FX loans under GEL 100,000); • Higher capital requirements for FX loans; • Liquidity coverage ratio (LCR) ensuring liquidity in FX.	• Some progress in 2017; • Dollarization is still high, remaining the key vulnerability of the banking sector; • Higher capital requirements for FX loans mitigates risks and contains supply of FX loan; • LCR guarantees appropriate level of FX liquidity; • Sharp depreciation of lari in 2014-2016 did not result in significant worsening of portfolio quality.
Concentrated banking sector	• Capital surcharge; and • Enhanced supervision for systemically important banks.	• Concentration increased further (assets of the top 2 banks increased above 70 percent and number of banks decreased to 15 by 2019); • BoG and TBC as systemic banks have substantial additional capital buffers, mitigating the risk of their failure.
Reliance on short-term external FX funding	• Liquidity coverage ratio (LCR) requiring extra liquidity in case of heavy reliance on external deposit funding.	• External short term deposit accumulation has slowed down considerably. However, short term external debt still has an important role in bank's funding; • Funding risks are mitigated by LCR.
Rapid retail credit growth	• Countercyclical capital buffer (2017); • Interest rate caps (2017); • Analysis of consumers' solvency is obligatory (2018); • Increased CAR for banks with lower credit standards (2018); • LTV and PTI (2019).	• Credit gap above 3 percent in 2018 Q3; • Household debt-to-GDP ratio increased above 35 percent of GDP by 2018 Q3; • Over-indebtedness especially among the poor became a key factor in a growing sense of social dissatisfaction.
Underdeveloped financial markets	• Adoption of Estonian tax model; • Pension reform; • Development of the insurance market.	• Georgia still stands out in respect to its underdeveloped capital markets; • Corporate sector and especially SMEs lack long term and domestic currency financing.

149 Despite the increasing credit gap, and the signs of overheating, the Financial Stability Committee of the NBG left the countercyclical buffer at 0 percent in 2018 (See Financial Stability Committee's Decision, 21 November, 2018, https://www.nbg.gov.ge/uploads/fsc/desicions/eng_fin_stab_november.pdf).

As of 2017, the NBG started to pay more attention to the developments in the non-bank retail lending: effective interest rates were capped (at 100 percent in 2017 and at 50 percent in 2018), and overdue fees were limited. However, the real intervention happened only in May 2018, by the introduction of the *responsible lending practices* - mandatory for banks, MFIs and other loan-issuing entities, aiming to improve consumer protection and support healthy lending. Measures were initiated by the government's and NBG's recognition that issuance of loans without meaningful analysis of consumers' solvency created a significant social problem and can weaken financial stability. As a part of this reform, the NBG applies the payment-to-income (PTI) and loan-to-value (LTV) ratios as of 2019, also with the intention of reducing credit growth to a macroeconomically and socially sustainable level.

The improvement of the *bank resolution framework* is an important element of the IMF EEF conditionality. The IMF, in its 3rd review under the EEF reported that efforts are underway to bring the resolution framework in line with best international practice[150]. Deposit Insurance System started to operate in 2018.

The government approved its *Capital Market Development Strategy* in 2016. The government introduced tax reforms to support investment: it adopted the Estonian tax model (reinvested profit deductible from tax base), and no capital gain or interest income tax is applied on listed securities. The authorities have established a funded pension system (Pillar 2) in August 2018. The pension agency started collecting contributions by 2019 and the fund will operate locally and participate in capital market operations. The authorities plan to formulate a private pension savings system (Pillar 3). The upcoming legislation on investment funds, improvement of trading infrastructure would also help mobilize savings[151].

Overall, the measures introduced since 2014 supported the development of the supervisory regime and improved the resilience of the banking sector. Banks are well capitalised (based on 2018 Q3 data the system wide CAR is above 17 percent, see chart) and their profitability is steadily high. The asset quality proved to be resilient despite the sharp depreciation of the lari in 2014-2016 (). The Larization plan helped to reduce the extent of dollarization somewhat, although dollarization ratios are still high (Figure A.7.1) and remained the main weakness of the Georgian banking sector.[152] While capital markets remain relatively underdeveloped (Figure A.7.1), market participants expect that the pension reform and other measures will catalyse financial markets.

Despite the measures aiming to contain credit growth, the credit gap increased above 3 percent in 2018[153] and household indebtedness became a pressing issue for both the NBG and the government. The household debt-to-GDP ratio increased above 35 percent, the highest among Georgia's peers (Figure A.7.1). While the aggregate delinquency rates are still moderate, about 630,000 people (i.e. close to 32 percent of the active labour force) have problems with servicing or repaying their loans.[154] Over-indebtedness especially among the poor became a key factor in the growing sense of social dissatisfaction.

Conclusion

The banking supervision and regulation were well developed, converging to the international best practices, by 2014 in Georgia. At the same time, the banking sector displayed several structural weaknesses, which necessitated policymakers' attention. Action 5 of the MFA on strengthening the

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[150] See IMF. (2018). Georgia Third Review Under the Extended Fund Facility Arrangement https://www.imf.org/~/media/Files/Publications/CR/2018/cr18373.ashx.

[151] See IMF. (2018). Georgia Third Review Under the Extended Fund Facility Arrangement https://www.imf.org/~/media/Files/Publications/CR/2018/cr18373.ashx.

[152] See Reuters. (2017). Fitch says Georgian banks well placed to absorb pressures, https://www.reuters.com/article/georgia-fitch-banks/fitch-says-georgian-banks-well-placed-to-absorb-pressures-idUSL8N1ML4Z7.

[153] See Financial Stability Committee's Decision (2018). 21 November, 2018, https://www.nbg.gov.ge/uploads/fsc/desicions/eng_fin_stab_november.pdf.

[154] Eurasianet. (2018). Georgia's predatory lenders are punishing the poor, https://eurasianet.org/georgias-predatory-lenders-are-punishing-the-poor.

process of ensuring capital adequacy of banks was very relevant, timely and efficient by improving the banks' risk management standards and setting additional capital requirements to cover for bank specific vulnerabilities.

Action 6 aiming at improving NBG's risk management was also a relevant condition, following the trends in international best practices. However, this condition did not address the particular challenges of the financial sector in Georgia and its scope was limited compared to other actions set in the MoU.

With the benefit of hindsight, given the pressing issue of over-indebtedness of households and especially of the poor population by 2018, a condition addressing the issue of irresponsible lending practices, particularly in the non-banking financial sector (MFIs and private lending), could have helped to introduce a more forward-looking approach in the regulation.

Case study 2: Structural reform in the area of trade policy

Introduction

Georgia has been one of the most trade-open economies in the world. It joined WTO in 2000 and currently has a FTA with the EU, Turkey and EFTA, as well as with eight CIS countries and China. The basic objectives of Georgia's trade policy are integration, liberalisation, diversification and transparency. The country does not apply contingency measures and there are minimal export restrictions in terms of export taxes or licensing. Georgia does not provide export subsidies, and does not have export financing instruments. The AA and the DCFTA with the EU signed in June 2014 and in force since September 2014, serves as a backbone for reforms. The DCFTA envisages a gradual implementation of reforms in areas such as trade, environment, agriculture, tourism, energy, transport, and education with the aim to bring Georgia in line with EU standards and regulations. It sets a path for further reforms in trade-related policies, such as hygiene standards for agriculture products (Sanitary and Phytosanitary, SPS), the approximation of regulations for industrial products (Technical Barriers to Trade, TBT), EUR1 rules of origin, enforcement of intellectual property rights at the border, rules on public procurement and approximation to EU rules in the services area.[155]

Based on EU recommendations in the framework of preparations for the DCFTA a Comprehensive Strategy of Competition Policy was adopted by the Georgian government in December 2010. In May 2012, Georgia has adopted the Law on Free Trade and Competition, which was further amended in 2014 in the course of DCFTA adoption. This law was developed as part of the anti-monopoly reform and aims to strengthen the institutional framework for promoting free trade and competition. The Government also issued a decree to set up the Competition Agency, which oversees most economic sectors except for energy and telecoms. In order to promote free trade and competition, in April 2014, a legal entity of public law, the Competition Agency of Georgia was established as an independent body.

Georgia has been also one of the most business-friendly transition economies. According to the latest Doing Business Survey (from October 2018) conducted regularly by the World Bank, Georgia's ranking has been continuously improving. The country ranked 6th out of 190 surveyed countries on the Ease of Doing Business in 2018. However, the outstanding doing business ranking does not provide a full picture about competitiveness. In fact, Georgia has just a few competitive export products and even those face considerable hurdles on the EU market owing to quality and other regulatory problems (non-tariff measures, NTM such as NTB and SPS). Georgian products will have to meet certain EU requirements not only for export, but also when consumed within the country.[156] As in Moldova and Ukraine, the implementation of AA/DCFTAs is rather challenging, the costs and benefits are unevenly distributed. While costs are immediate, the benefits are of theoretical nature and only materialize based on successful implementations.[157] Some of DCFTA provisions (customs and trade facilitation, public procurement, anti-trust and competition, etc.) are directly relevant for MFA conditionality (Actions 7 and 8), thus linking DCFTA implementation and MFA conditionality.

Georgia has been suffering from chronic goods trade and current account deficits (Table A.7.2). Overall merchandise trade deficit swelled to EUR 5 billion in 2018, about 25 percent of GDP (of which EUR 1.6 billion deficit with the EU – Figure A.7.2). Russia is the largest export market, ahead of Azerbaijan, Armenia, Turkey and China. Among the EU countries, the biggest markets for Georgian exports are Bulgaria and Romania. The copper ores and ferro-alloys represent the two top overall export positions,

155 See Emerson, M. and Kovziridze, T. (2018), op. cit.

156 As elsewhere in the EU, SPS hygiene rules do not apply to the production for private consumption or to small quantities supplied to local markets. Some Georgian officials complain that the EC regulations impair Georgian competitiveness and distract foreign investors (author's interviews in Tbilisi, November 2018).

157 More on DCFTA costs and benefits see Adarov, A. and Havlik, P. (2017), 'Challenges of DCFTA: How Can Georgia, Moldova and Ukraine Succeed?'. wiiw and Bertelsmann Stiftung. https://wiiw.ac.at/challenges-of-dcftas-how-can-georgia-moldova-and-ukraine-succeed--n-230.html.

even before wine, spirits and mineral water. Exports are highly concentrated and there has not been much export diversification yet. The main import partner is Turkey, followed by Russia, China and Azerbaijan. Within the EU, the biggest import partners are Germany, Italy and Romania. As far as imports from the EU are concerned, Georgia imported mainly mineral oils (other than crude), medicaments and passenger cars.

Trade between the EU and Georgia has been growing steadily over the years and nowadays the EU as a block is Georgia's main trading partner. Georgian exports to the EU remain highly concentrated on a few commodities: in 2017, the top five HS 4-digit export positions to the EU accounted for 65 percent of the total. Moreover, exports to the EU more or less stagnated during the last couple of years according to Eurostat data. Overall, DCFTA apparently did not have much effect on Georgian exports to the EU so far, despite some spectacular increases by individual products (e.g. by fruit, wine, pneumatic tyres, clothes and textiles). Just more than a dozen Georgian exporters managed to obtain EUR1 certificate of origin and many potential exporters struggle to meet the required SPS standards and TBT requirements.

Trade openness, regional and commodity trade specialisation

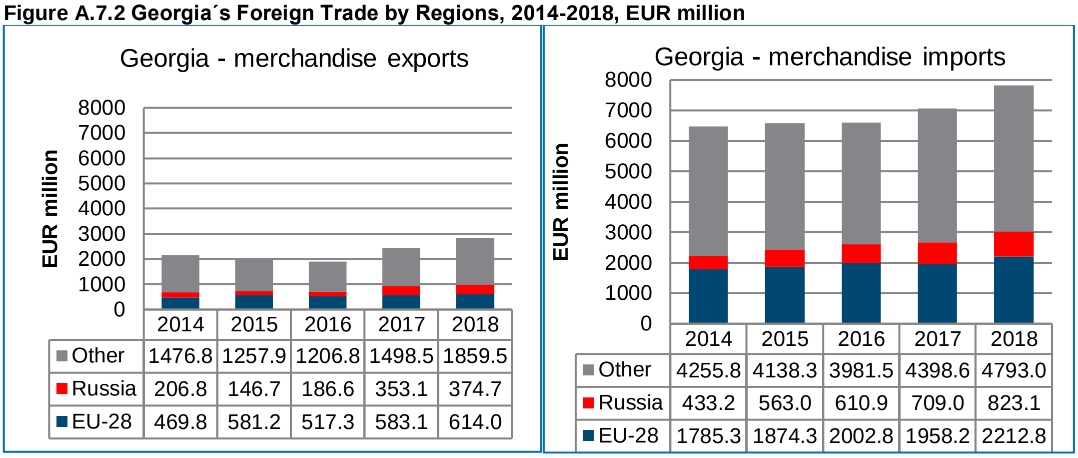
Total Georgian exports stagnated between 2013 and 2017, yet increased by 15 percent in 2018. Export base has been very narrow (moreover, about one third of goods exports consists of re-exports according to Geostat data). Rather than in goods exports, Georgia has a competitive advantage in services, especially in tourism and transit transport services, where it enjoys surpluses. (The services balance has been increasingly positive, reaching a surplus of more than 13 percent of GDP in 2017). In addition to the positive contribution of services, the current account deficit has been mitigated also by remittances sent home by Georgians working in the European Union, Russia and Turkey. Remittances accounted for nearly 10 percent of GDP on average for years 2015-2017 according to NBG.

DCFTA deepens Georgia's economic ties with the EU, and includes provisions on public procurement, common customs' rules, along with technical and sanitary standards for goods such as food items, intellectual property rights and competition rules.[158] Georgian exports to the EU increased by 27 percent between 2013 and 2017, yet exports to other countries grew by more than 50 percent in the same period.[159] As far as imports are concerned, there was an increase by 16 percent between 2013 and 2017. Imports from the CIS countries, in particular from Russia, have been much more dynamic: imports from the CIS countries increased by 25 percent between 2013 and 2017, imports from Russia even by 60 percent. Total Georgian imports increased by 13 percent in the period 2013 and 2017 and by another 9 percent in 2018. Imports from the EU grew by 13 percent in 2018 (Table A.7.2). Overall, the trade deficit swelled to EUR 5 billion in 2018 (of which EUR 1.6 billion with the EU).

[158] The State Procurement Agency (SPA) was established already in 2012. SPA runs a well-equipped training centre that trains both public officials and private entrepreneurs in procurement matters – see www.procurement.gov.ge.

[159] All growth rates calculated from EUR-based data. USD-based growth rates are lower owing to USD/EUR exchange rate fluctuations. For alternative, less detailed, trade figures see EC DG Trade, Units A4/G2. See: http://ec.europa.eu/trade/policy/countries-and-regions/countries/georgia/.

Figure A.7.2 Georgia´s Foreign Trade by Regions, 2014-2018, EUR million



Georgia - merchandise exports

	2014	2015	2016	2017	2018
Other	1476.8	1257.9	1206.8	1498.5	1859.5
Russia	206.8	146.7	186.6	353.1	374.7
EU-28	469.8	581.2	517.3	583.1	614.0

Georgia - merchandise imports

	2014	2015	2016	2017	2018
Other	4255.8	4138.3	3981.5	4398.6	4793.0
Russia	433.2	563.0	610.9	709.0	823.1
EU-28	1785.3	1874.3	2002.8	1958.2	2212.8

Note: Year 2018 estimated from data for Jan.-Sept. 2018.
Source: own calculations based on Geostat.

Georgian merchandise exports

Russia has again become the largest export market for Georgia, ahead of Azerbaijan, Armenia, Turkey and China. Among the EU countries, the biggest markets for Georgian exports are Bulgaria and Romania – the two countries sharing the Black Sea coast where bulky loads can be efficiently transported by ships (copper ores and ferro-alloys). The latter two export commodities represent the two top Georgian overall export positions, even before wine, spirits and mineral water. Georgian exports are highly concentrated: the top 10 export commodities accounted for 65 percent of overall exports in 2017). However, the analysis of commodity export specialisation is distorted since Georgian export statistics includes re-exports (indeed, exports of motor cars and medicaments most likely represent re-exports). There has not been much export commodity diversification yet.

The key Georgian exports to the EU (EU imports from Georgia since we use here Eurostat Comext database as a mirror statistics) include copper ores (39 percent of the total), nuts, nitrogen fertilizers and mineral oils (7 percent each). For more information, see Figure A.7.3).[160] Georgian exports to the EU are highly concentrated on just a few commodities: in 2017, the top five HS 4-digit export positions to the EU accounted for 65 percent of the total. Moreover, goods exports to the EU also more or less stagnated during the last couple of years according to Eurostat data, although exports of copper ores almost doubled, and exports of wine and spirits grew by 50 percent (in EUR terms).[161] So far, DCFTA apparently did not have much positive effect on growth and diversification of Georgian exports to the EU, despite some spectacular increases by individual products (e.g. by fruit, wine, pneumatic tyres, clothes and textiles).

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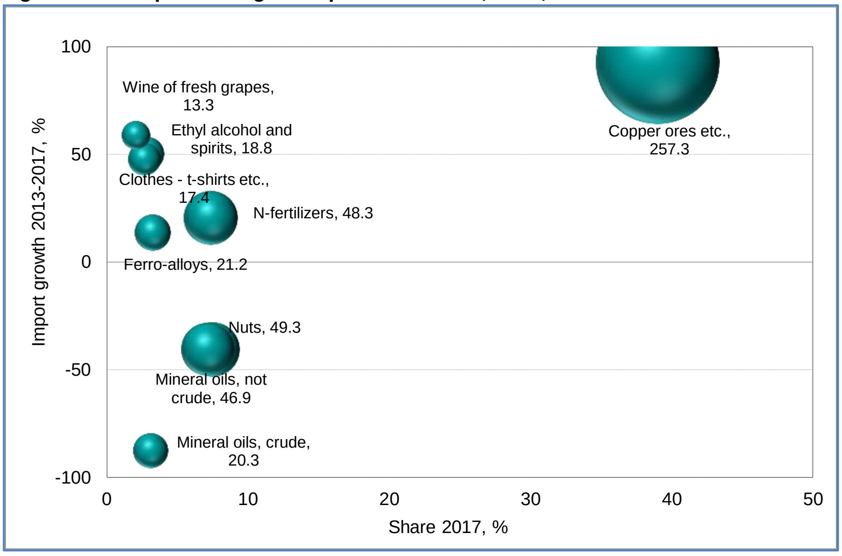
160 This, and the following figures, show on the vertical scale the shares of the key trading partners (commodities), and, on the horizontal scale, the increase of exports/imports between 2013 and 2017 (in current EUR terms). The bubble size corresponds to the value of exports/imports in 2017 in EUR million.

161 Note that there are considerable differences between Georgian (Geostat) and EU (Eurostat Comext) statistics. Exports of nuts were decimated in 2017 by a bug epidemic. EBRD is helping to foster hazelnut production by supporting small-scale farmers – see www.ebrd.com/news/2018 (as of 23 March 2018).

Figure A.7.3 Top 10 Georgian Exports to the EU, 2017, EUR million

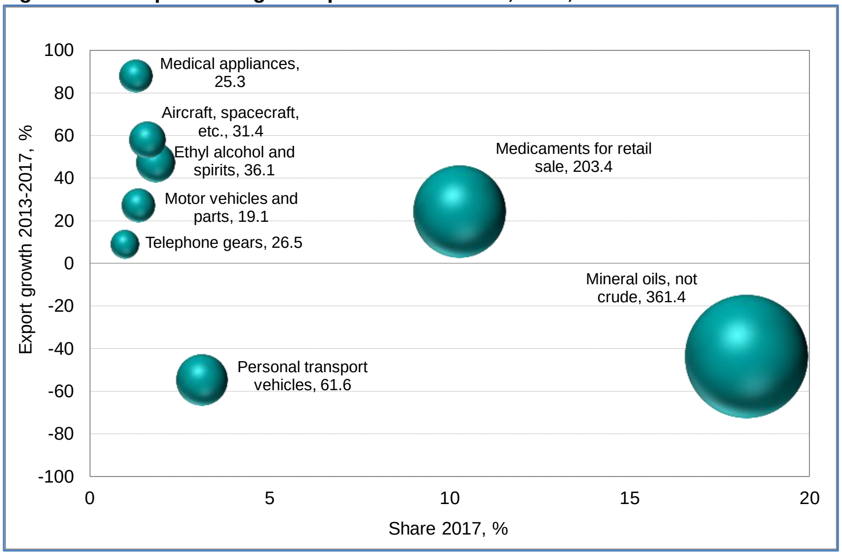


Note: The size of the bubble is proportional to the value of Georgian exports of the product in 2017 (EUR million). Product categories classified according to HS 4-digit classification.
Source: own calculations based on Eurostat Comext database.

Georgian merchandise imports

Georgia's main import partner is Turkey, followed by Russia, China and Azerbaijan. Imports from the EU accounted for 28 percent of the total, about the same share as combined Georgian imports from Turkey and Russia. Within the EU, the biggest Georgian import partners are Germany, Italy and Romania. Apart from Armenia, the fastest import growth during the period 2013-2017 was recorded by imports from Russia, China and the USA.

Figure A.7.4 Top 10 Georgian Imports from the EU, 2017, EUR million



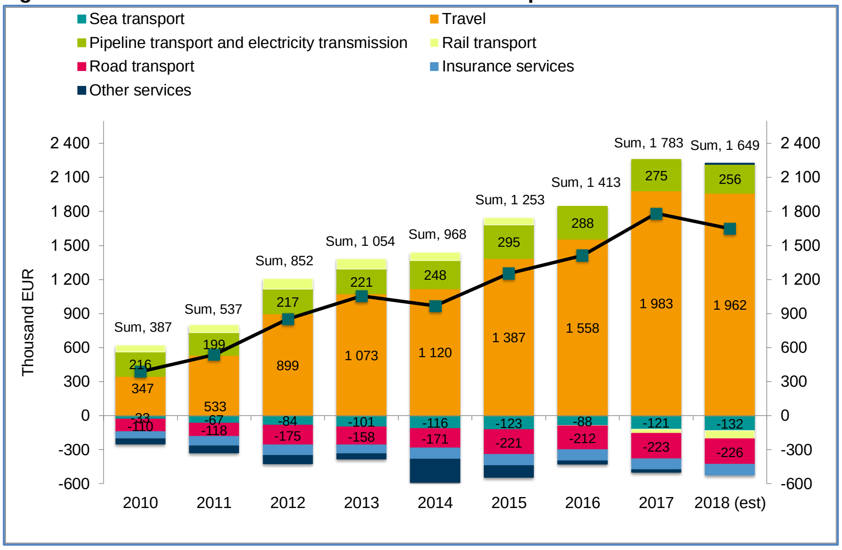
* Except radar, navigation, etc. gears and sugar which both recorded extremely high growth in 2017.
Note: Bubble size is proportional to value of exports in 2017 (EUR million). Product categories according to HS 4-digit classification.
Source: own calculations based on Eurostat Comext database.

Overall imports increased by 16 percent between 2013 and 2017 (and by another 9 percent in 2018), imports from the EU were up by 14 percent and 12 percent, respectively, in the same period (all growth figures again in nominal EUR-based terms). As far as imports from the EU (EU exports to Georgia in the Eurostat mirror statistics) are concerned, Georgia imported mainly mineral oils (other than crude), medicaments and passenger cars (Figure A.7.4; note that several growth outliers in 2017 such as radar and navigation gears, sugar and vehicles for public transport are not shown in the graph). The main part of motor vehicles and pharmaceuticals were imported from Germany.

Trade in services

The country records surpluses in services trade: about EUR 1.8 billion in 2017 (more than 13 percent of GDP). The main contributors to services net incomes are travel (tourism), pipeline and the rail transport (the latter, however, turned negative in 2016 – see Figure A.7.5). Negative contributions to services trade stem from the sea and road transport, as well as from insurance services. In addition to the positive contribution of services, the current account deficit (nearly 10 percent of GDP in 2017/2018) has been mitigated also by remittances. Georgia has been also relatively successful in attracting FDI: during 2013-2017, FDI inflows averaged EUR 1.6 billion per year and the cumulated inward FDI stocks reached nearly EUR 14.8 billion or EUR 4,000 per capita as of mid-2018.

Figure A.7.5 Net contributions of main services components to the current account

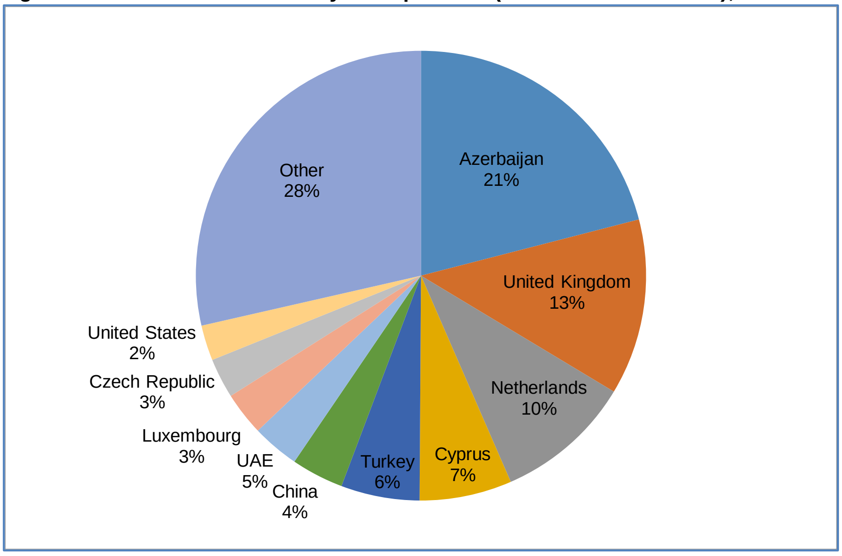


Source: own calculations based on NBG data.

Foreign Direct Investments (FDI)

Largely thanks to its business-friendly economic policies and a favourable geographical location as a transit country, Georgia has been relatively successful in attracting FDI – especially after 2013. As of mid-2018, the cumulated inward FDI stocks in Georgia reached nearly EUR 14,780 million – about EUR 4,000 per capita – and there has been a significant increase of annual FDI inflows since 2013 (around EUR 1.5 billion per year). Among the main investors are Azerbaijan, the United Kingdom, The Netherlands, Cyprus and Turkey (Figure A.7.6). Foreign investors are targeting mainly transport, energy, construction and real estate, as well as the financial sector.

Figure A.7.6 Inward FDI stocks by main partners (total: EUR 14.8 billion), as of mid-2018



Source: own calculations based on Geostat data.

Conclusions

Georgia has been pursuing very liberal trade and economic policies since at least two decades. The country has been one of the most business-friendly places in the world. At the same time, with more than 50 percent of GDP, the estimated share of the shadow economy – the informal sector that comprises a large part of the retail trade and small-scale farmers – is still among the highest in the world according to the IMF. Together with a number of free trade agreements (with the EU, EFTA, CIS, Turkey and China), Georgian foreign trade policy is governed by the implementation of AA/DCFTA that requires the adoption of a whole set of EU standards and regulations. The successful implementation of AA/DCFTA is expected to boost reforms and economic growth, and to bring the country closer to the EU. As elsewhere, the DCFTA implementation is rather challenging – with costs and potential benefits distributed unevenly in time and across sectors. In merchandise trade, Georgia has been suffering from huge trade deficits and the export base has been very narrow with just a few competitive products (both globally and in the EU market). Foreign trade is conducted mainly with neighbouring countries (Russia, Turkey, Azerbaijan, Armenia and China), with exports focused mainly on semi-manufactured products and agriculture. Trade between the EU and Georgia has been growing steadily over the years and nowadays the EU as a block is Georgia's main trading partner. Exports to the EU remain highly concentrated on a few commodities. Moreover, exports to the EU have been sluggish during the last couple of years, despite some spectacular increases by individual products (e.g. by fruit, wine, pneumatic tyres, clothes and textiles). Just more than a dozen Georgian exporters managed to obtain EUR1 certificate of origin and many potential exporters struggle to meet the required SPS standards and TBT requirements.

As in Moldova and Ukraine, purely trade economic effects from DCFTA implementation are yet to be materialised. Georgia enjoys competitive advantages in services, especially in tourism and transit transport. Together with remittances, surpluses in services trade are mitigating the excessive deficits in merchandise trade. With a further progress in AA/DCFTA implementation and lasting business-friendly institutional climate for FDI, Georgia has favourable chances continuing to outperform its DCFTA peers in institutional reforms, economic growth and attracting FDI – notwithstanding the lasting disputes regarding frozen conflicts in Abkhazia and South Ossetia. A development strategy combining existing competitive advantages of tourism with domestic agriculture (using the excellent domestic wine and delicious local food), supported by structural reforms in the agricultural sector and targeted FDI policies, could be a viable option to foster inclusive economic growth and mitigate external vulnerabilities.

Table A.7.2 Balance of Payments of Georgia (EUR thousands)

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018 est
Current Account	-901,919	-1,324,373	-1,468,210	-721,519	-1,347,279	-1,589,061	-1,706,889	-1,180,548	-1,398,729
Goods	-1,953,741	-2,509,927	-3,281,447	-2,629,797	-3,214,873	-3,546,215	-3,495,511	-3,359,866	-3,487,724
Credit	1,857,284	2,337,997	2,725,965	3,196,869	3,066,108	2,793,571	2,647,647	3,216,689	3,676,951
Debit	-3,811,025	-4,847,924	-6,007,412	-5,826,667	-6,280,981	-6,339,786	-6,143,158	-6,576,555	-7,164,674
General merchandise	-2,086,949	-2,647,005	-3,425,696	-2,750,552	-3,299,765	-3,654,010	-3,611,425	-3,474,544	-3,607,015
Exports FOB	1,687,453	2,168,447	2,543,358	3,031,278	2,918,349	2,624,368	2,480,701	3,049,258	3,519,519
Exports of goods in trade statistics	1,094,898	1,472,283	1,752,777	2,098,042	2,066,931	1,862,875	1,776,205	2,303,497	2,661,061
Adjustments	592,555	696,165	790,581	933,236	851,418	761,494	704,497	745,762	858,458
Imports FOB	-3,774,402	-4,815,453	-5,969,054	-5,781,830	-6,218,115	-6,278,379	-6,092,127	-6,523,802	-7,126,534
Imports of goods in trade statistics	-3,454,346	-4,493,118	-5,490,607	-5,346,372	-5,794,234	-5,863,788	-5,902,076	-6,307,516	-6,891,892
Adjustments	-320,056	-322,335	-478,447	-435,458	-423,881	-414,591	-190,051	-216,286	-234,642
For coverage	-320,056	-322,335	-478,447	-435,458	-423,881	-414,591	-190,051	-216,286	-234,642
Services	387,300	536,972	851,816	1,053,963	967,916	1,253,128	1,413,293	1,782,898	1,649,222
Credit	1,205,983	1,442,642	1,979,812	2,229,599	2,272,329	2,763,142	2,977,195	3,519,239	3,411,600
Debit	-818,682	-905,670	-1,127,996	-1,175,636	-1,304,414	-1,510,014	-1,563,901	-1,736,341	-1,762,378
Transportation, net	106,305	75,553	35,691	54,705	23,824	-6,753	-36,399	-111,351	-225,241
Sea transport	-32,633	-67,148	-83,852	-101,209	-116,172	-122,635	-88,004	-121,438	-132,043
Air transport	-22,864	-5,379	-13,274	7,089	-6,497	-19,421	-22,527	-5,129	-50,462
Rail transport	55,792	66,510	90,366	86,231	69,393	61,420	-1,684	-36,608	-72,641
Road transport	-109,832	-117,888	-174,653	-158,275	-171,083	-220,694	-212,160	-223,444	-225,601
Pipeline transport and electricity transmission	215,843	199,458	217,104	220,868	248,183	294,577	287,976	275,268	255,506
Travel	347,100	532,672	898,585	1,073,440	1,120,044	1,387,027	1,557,880	1,983,494	1,962,393
Insurance services	-61,607	-83,514	-92,206	-78,652	-96,241	-98,088	-97,726	-97,469	-91,948
Other services	-46,014	-58,060	-72,120	-44,270	-204,625	-103,618	-28,591	-21,134	7,600

Source: own calculations based on NBG (https://www.nbg.gov.ge/uploads/banalceofpayments/bopbpm5eng.xlsx).

Annex VIII Timeline of the MFA operations to Georgia

Table A.8.1 Timeline, milestones and amount of MFA operations

Date	MFA progress	MFA milestones	Amount
22 October 2008 **2009-2010**	At the donors' conference held on 22 October 2008, the EU pledged to provide MFA to Georgia. The first MFA (EUR 46 million, all in grants) was implemented.		EUR 46 million
13 January 2011	The EC adopted a proposal to provide up to EUR 46 million of MFA 2 to Georgia in the form of a grant of EUR 23 million and a medium-term loan of EUR 23 million, which was accompanied by a detailed evaluation of Georgia's needs (links to proposal[162] and ex-ante .evaluation[163]).	Proposal	
January 2011 - August 2013	Delays on account of 'procedural disagreement between the co-legislators'.		
12 August 2013 **30 July 2014**	Agreement was reached and the decision[164] on MFA 2 was adopted by the European Parliament and the Council. (Decision No 778/2013/EU of the European Parliament and of the Council of 12 August 2013 providing macro-financial assistance to Georgia). Stand-By Arrangement by the IMF approved.	Decision	
11 December 2014	The Memorandum of Understanding (MoU) was signed outlining specific reform criteria attached to the assistance.	MoU	
December 2014	Signature of the LFA and the Grant Agreement, ratification by the Parliament of Georgia of the MoU, LFA and the Grant Agreement.		
January 2015	First tranche of the first EUR 13 million in grants in MFA 2 programme to Georgia were disbursed.	1st instalment grant component	EUR 13 million
April 2015 **November 2015**	Second tranche of EUR 10 million in loans were disbursed. Review mission of MFA implementation succeeded; disbursement of the second tranche delayed due to the lack of progress reform programme implementation with the IMF.	1st instalment loan component	EUR 10 million
April 2017	EC approved the release of the second loan tranche of EUR 23 million in light of the satisfactory progress of the Georgian authorities with implementing the policy conditionality under the MFA programme, as laid down in the MoU, and the IMF programme (following the compliance review on November 2015 and approving of a new USD 285 million arrangement under the EEF by the IMF Executive Board on 12 April 2017).	Progress review per MoU, 2nd instalment approved	

162 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52010PC0804.
163 See https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52010SC1617&from=EN.
164 See https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1487267047919&uri=CELEX:32013D0778.

Date	MFA progress	MFA milestones	Amount
April 2017	Disbursement the grant element of EUR 10 million and loan element of EUR 13 million of the second instalment, thereby completing the MFA 2 operation.	2nd instalment grant and loan component	EUR 23 million
September 2017	EC proposes new MFA programme worth EUR 45 million (of which EUR 10 million in grants).	Proposal	EUR 45 million
April 2018	The EU Parliament and the Council adopted the Decision (EU 2018/598)[165] providing further macro-financial assistance to Georgia (MFA 3).	Decision	
August 2018	The MFA 3 Memorandum of Understanding (MoU) was signed[166].	MoU	
December 2018	1st instalment was disbursed.	1st instalment	EUR 20 million

165 See https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018D0598&from=EN.

166 See https://ec.europa.eu/info/sites/info/files/economy-finance/signed_mou_final.pdf.