



# Georgia – Reforms to Development



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## Georgia – The Case of Success

During last two decades, Georgia has undergone though a remarkable period of economic transformation led by major institutional and structural reforms. The reforms succeeded in building smart and low regulations, business friendly tax system, private sector driven and corruption-free country.

With the achieved success Government of Georgia initiated new economic program – “Four Point Reform Plan”. The Plan embarks on four strategic directions:

1. **Education Reform** - supporting skills development through education reform targeted at bridging the gap between skills demand and supply. Promotion of vocational education, fundamental reforms in general and higher education systems will guarantee increased overall skill level of the local labor force leading to increase in employment and wages, thus, increasing the pace of local economic development.
2. **Economic Reforms** - Growth oriented reforms to provide the country with proper legal base and institutional development that are of significant importance for encouraging economic prosperity. Entrepreneurship facilitating jobs creation by improving business and investment environment further, including, inter alia, by implementation of tax reform and supporting entrepreneurship;
3. **Spatial Development Reform** - investing in core infrastructure development supporting expansion of the east-west and south-north trade corridors. The objective of the plan is to utilizing Georgia’s potential of a transit country between Europe and Asia, as well as its touristic potential, thus creating economic opportunities

for our citizens. Given better infrastructure and regional development, which will break down transportation and communication barriers, will provide faster growth of investments and create favorable conditions for overall economic growth.

4. **Open Governance** - enhance the principles of inclusive decision making process, where voices of opposition, civil society and private sector are heard and by improving and modernizing public services, including by introducing “single Window Principle” for all government services. Transparency and open governance will guarantee higher integration of public and private sectors. This will increase the level of trust of the society towards public institutions and public administration.

Reforms in all four directions In particular higher quality and quantity of infrastructure, human capital, trade openness, efficient and well-developed financial systems, and economic institutions that promote competition, facilitate entry and exit, and encourage entrepreneurship and innovation will boost productivity capacity at the cross-country, industry, and firm levels.

These reforms through productivity growth will accelerate growth potential and foster convergence to higher income levels.

## Education Reform

*The main goal of education Reform is to make the education system flexible to modern approaches and oriented on qualitative educational outcomes, to maximize quality of teaching in all levels of education, to match skills of potential labor force with those demanded by the market. The reform envisages fundamental transformation of the education system and will consequently increase the pace of local economic development and create favorable conditions for overall economic growth.*

**Education system should be aligned with the development trends of the country.** The reform involves professional education development, the ultimate objective of which is to bridge the supply-demand gap of labor market, fundamental transformation of higher education system and improvement of quality of teaching in secondary schools.

- **Development of professional education is in line with the dualistic model.** It envisages involvement of the private sector in the educational process, strengthening of the practical component, identification and promotion of the labor market-oriented professions. Students will be enabled to explore professions that are highly demanded on the market, acquire business management skills, continue education at Higher Education Institutions, launch their start-ups or get employed with their professions;
- **Higher education will be based on the fundamental analysis of the demands on the labor market in the country.** Namely, based on the research, the most demanded professions will be identified. Funding

priorities will be coordinated with the relevant areas. Assessment of the Higher Education Institutions will become more comprehensive and thorough. It will be oriented on the institutional development and approximation with international standards. The program “Study in Georgia” will be implemented in order to promote courses in foreign languages.

- **Increase of the quality of secondary education by targeting both students and teachers.** Students will be provided with updated books and their electronic versions and all courses will be adjusted according to students’ age. Schools will have free choice of implementing extracurricular activities of their own interest. On the other hand, the Program on Improvement of Teacher Qualification will contribute to the professional enhancement of teachers in schools. In addition, highly motivated teachers will be awarded with special support from the government. Finally, all teaching institutions will be provided with high frequency internet and students and teachers will have an access to e-learning.
- **Education reform and its priorities are in full in compliance with a 4-point reform plan of the Government.** The main goal of the reform is to create an educational system, which will make high quality education available and affordable to any citizen and will feel harmonized and protected in the society. In this way, the reform will support enhancing qualification and improving professional skills, leading to stable employment and regional development.

Education reform will be implemented on three stages:

In the short-term perspective, the reform will aim at increasing motivation among teachers and students

by introducing at schools various incentive-providing programs such as Professional Development and Career Advancement scheme and system of credit accumulation.

In addition, free lessons will be introduced at schools; educational services will be defined for those children, staying out of school; school management will be refined and improved; activities of research institutions will be enhanced. Work-based educational programs will be introduced into practice at vocational colleges: quality of vocational education will be improved, practical learning will be enhanced, mechanisms for funding the field will be refined, and colleges meeting modern standards will become functional in different regions of Georgia on the basis of public-private partnership.

The Medium Term objective of the Education reform will be to create system based on educational needs of adult age groups. All vocational education institutions will get involved in the process of adult education, offering to all those willing short-term work-based (dual) vocational programs. Furthermore, modern educational technologies at all levels of education will be introduced, such as table and computer games, e-learning, proper electronic/computer equipment, techno parks and labs. The government also aims to launch a new concept for school development and support - “Georgian School 2.0”, which is a project focusing on principles of differentiated teaching, school infrastructure, learning resources, etc.

In addition, the reform aims to introduce educational services for out of school students; significantly increase the quality of higher education; link vocational education to the labor market needs more closely and make it available for every segment of the population. Full and equal opportunities for employment and self-employment will be provided with the prospects of career development and self-realization.

In the long-term period, “Educated Georgia” – a powerful society, oriented towards dissemination of education will be formed. Education Support Society will be established with the objective of boosting motivation to study among the youth. The project will be based on private –public partnership model. Funding will be provided by state agencies, donors, private patrons and business sector representatives.

One of the objectives of the education reform is to establish a regional science hub in Georgia. The concept will be reinforced by number of major projects, in particular: Establishment of Kutaisi Technological University. Grant Funding system for students will be put into practice. Within education reform government will be seeking that Georgia-awarded diplomas is recognized in the region. This will make academic degrees received in Georgian universities more attractive. To attract students from abroad investment in dormitory infrastructure for 10 000 students is planned. This will be made available to international students as well.

Government will promote and facilitate involvement of far more Georgian professors and scientists in international exchange programs. In addition, support programs for both young scientists and Georgian scientists working abroad will be elaborated. Unified science information system will be created. Information on Georgian professors and scientists, their scientific works, researches and achievements will be collected in one place. Various international science foundations will be carried on and enhanced. Protection of patents and copyright will be strengthened by legislative amendments.

The education system will adopt e-learning mechanism, offer inclusive education to pupils/students with special educational needs (SEN) at all levels of education.

Therefore, high quality learning resources, including: virtual labs, video versions of the lectures given by distinguished professors and lecturers, contemporary programs for learning foreign languages, and etc. will become accessible to pupils and students. Mobile, computer, virtual and blended reality will be applied in e-learning. This will contribute to enhancing knowledge in various subjects and boosting interest in studying.

Finally, number of projects will encourage healthy lifestyle, involvement of the youth in sports activities. In addition, popularization of arts through launching circles, as well as other thematic activities will be encouraged.

## Pension Reform

*The objective of the Pension Reform is to introduce the second pillar in the pension system and to gradually decrease the reliance on existing pension system in which pension allowances to the elderly are fully provided from the budget. The reform aims to address demographic and fiscal challenges related to the system that will ensure social and fiscal sustainability of the system. On the other hand pension reform will have very important economic development role by stimulating savings, helping de-dollarize financial sector and supporting capital market development.*

The Government of Georgia by reforming pension system plans to introduce a multi-pillar pension system. The reform aims at ensuring adequate income level at the retirement and fiscal sustainability of pension system.

Demographic trend in the country is similar to those in the developed economies. The share of working age people in the total population is declining. This demographic transformation is a result of decreased birth and migration and increasing life expectancy. Pension spending has grown substantially in last years - in 2006 it amounted to 10 percent of budgeted spending, while in 2015 has reached 17 percent of budget spending. According to the forecasts given tendency will remain during the decades. In longer-term pension spending may extend to 10% of GDP, which may become immense burden for the fiscal policy.

Georgia has single tier pension system which is not efficient type of intergenerational contract. Pension reform objectives are to achieve increase in replacement rate in long-term period and ensure the fairness in the system. Based on analyses, it is evident that current 18

percent replacement rate (ratio of average salary to social pensions) cannot be significantly improved and brought to decent levels without implementation of private pension system. In long term the state social pension will become focused on poverty reduction.

Pension Reform has a very strong role in economic development. Pension reform will facilitate the development of capital market; it will expand the alternative sources of financing of the investments.

Reform intends to introduce defined contributory pensions system (Pillar II), where employee, employer and the Government each will contribute 2 percent of the salary to individual pension account. For employees below 40 year participation in the system will be on mandatory basis and for those above 40 years can voluntarily participate in the system. Pensions system (Pillar II) will enjoy EEE tax regime and contributions, accrued profits and distributed pensions will be exempted from taxes.

The scheme will be managed by a Pension Agency. The Agency will have independent, professional Investment Board, responsible on the investment of the pension assets. Pension Reform will facilitate savings and respectively the accessibility to long-term financial resources.

Reform envisages development of regulation on the licensing, investment, supervision, financial reporting, and administrative procedures for pension Agency.

Therewith, the GoG is in the process of elaboration of communication strategy that will raise awareness of the reform within the wider public.

Development of sound IT and financial infrastructure of the pension system is backbone of the reform and we are actively working in this direction with our partners (IFI's). An

administrative architecture will have to be established for the new pension system to be able to receive contributions, individual account record keeping, asset management, and eventually the payment of pension benefits.

Draft Pension Bill will be submitted to Parliament during 3<sup>rd</sup> quarter of 2017. It is expected that defined contributory pension system will start functioning from mid-2018.

## Capital Market Reform

*Capital market development is a strategic priority of the Government. Deep, efficient local capital markets create access to long-term, local-currency finance, and is important for private sector development as the key driver of economic growth. Sound local capital markets reduce volatilities and boost efficiency in the economy.*

*Developed capital markets will create important incentives for growth of savings and expand investment opportunities in the country. For this purpose, creation of proper legislative and institutional background as well as introduction of modern infrastructure is planned.*

Capital market is considered to be an effective tool for attracting financial resources. Developed capital market creates competitive environment and encourages effective allocation of savings.

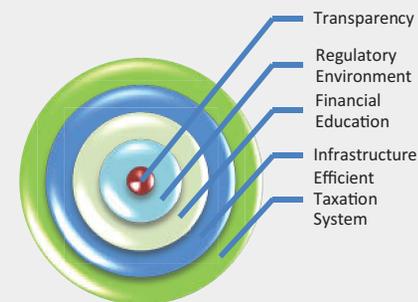
Capital market represents an additional significant instrument for households to allocate their savings and for companies to attract investments. Developed (enhancing, transparent and well-regulated) capital market contributes to stable economic growth and increase in social welfare.

An important prerequisite for capital market development in Georgia is to create environment, which is efficient, innovative, high performance-based and in line with country's long-term economic development strategy.

For achieving given targets, Georgia needs to adopt modern infrastructure, tax regime and package of financial services, which will provide the country with competitive advantage in the region.

Georgia has a potential to create an attractive marketplace and serve as a regional financial hub.

Capital market reform envisages complex set of reforms that government needs to implement in two stages or phases.



**Transparency** - Creating competitive environment, which will eliminate discrimination on any particular segment, instrument or participant. Ensure that companies presented on the capital markets are transparent in-line with the best international practices.

**Regulatory Environment** - Improving legal framework with introducing the Law on Securities, the Law on Investment Funds and the Law on Derivatives. In addition, enhancing of external auditing is another major part of regulatory environment.

**Financial Education** - The government will provide the society with information on the importance of capital markets for economic growth as well as on fluctuations and risks characterizing capital markets and possibilities of periodic losses. During such fluctuations, the government should not intervene to the principles of the market or communicate inefficiently.

**Infrastructure** - Infrastructural development includes IT systems, processes and procedures covering trading, payment and accounting parts. In addition, creation of clearing and central counterparty (CCP) institution will be

supported in the county. For smooth and uninterrupted functioning of market infrastructure, they will have relevant business continuous plans. In terms of payment and settlement, it is important to effectively use already existing infrastructure and enlarge its scope, in order to settle all types of securities through the Securities Settlements System of the National Bank: In addition to the Government bonds, through commercial CSD, corporate bonds and shares will be added to the Securities Settlement System.

There will be implemented and integrated trade and payment electronic systems for stock as well as non-stock segments. Clearstream is already presented in the Georgian market and introduction of Euroclear is planned at the next stage.

There will be promoted development of the Georgian custodian business. Currently such services are provided by few banks in the country. It is necessary to accumulate relevant knowledge and experience in other banks as well. It will increase the competitiveness and will simplify process for investors. Also it will decrease risks as developed infrastructure of securities saving will create additional controls and separate functions between asset management and saving.

**Efficient Taxation System** – Government of Georgia plans to initiate set of changes in the tax code which will lower tax burden environment and create fair taxation system and negligible compliance costs for investors. The general approach in the taxation will exempt individual transactions from taxes and tax realized profit which investors decide to withdraw from investment activities.

## Public Private Partnership Reform

*Public Private Partnership (PPP) Reform aims to Introduce transparent and efficient PPP framework. As a result, efficiency of infrastructural projects will be improved though optimal risk allocation; and self-sustainable projects and credible financial instruments will be in place.*

Growing demand for the public infrastructure and public service delivery in Georgia has contributed to rising pressure for private sector participation, including private funding.

The Government of Georgia is dedicated to promote PPP opportunities. Therefore, the Government of Georgia has a political determination to conduct necessary legal and economic reforms in order to create an enabling environment for attracting private investments and participation, to benefit from the private sector's experience, technologies, innovation and efficiency to match investment needs, modernize the economy and thus meet public needs and facilitate economic growth.

The PPP reform entails the development of modern legislative framework for PPPs, including adoption of the PPP Law. The main objectives would be the following:

- Creating new and enhancing existing public infrastructure and services;
- Sending clear message to investors that the Government is ready to promote PPP and support PPP projects;
- Defining key principles for PPP's;
- Defining an institutional framework, this is conducive and efficient in handling the PPP projects as well as effective to protect public interest.

The PPP reform will ensure:

- Transparency;
- Foreseeability;
- Non-discrimination;
- Value for Money;
- Adequate risk sharing;
- Fiscal Responsibility;
- Environmental and social sustainability.

The PPP mechanisms in Georgia will be used in all sectors of public infrastructure and services. Potential sectors would be:

- Transport
- Social infrastructure
- Utilities

For the promotion and efficient handling of PPP projects, responsible central PPP Unit will be established under its umbrella, which will perform key functions related to PPPs.

At this stage the development of draft Law on on Public-Private Partnerships and secondary regulations are in progress with active participation of International Financial Institution such as WB, EBRD and ADB. Draft Law will be submitted to the parliament in December 2017.

## Corporate Income Tax Reform

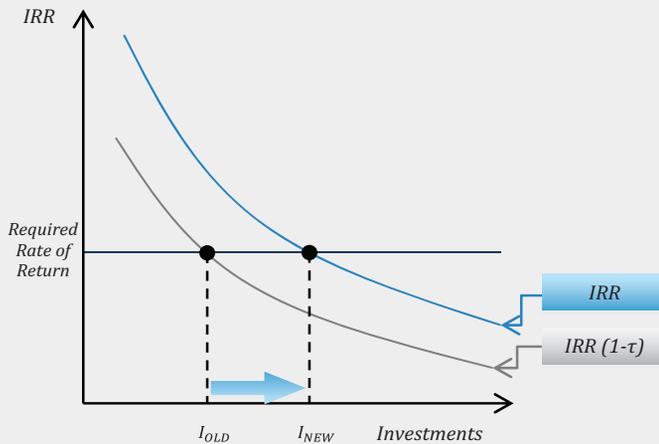
*Government has implemented Corporate Income Tax Reform. The new model of the profit tax has come into force since January 2017. In the new system corporates profits are taxed only after distribution thus exempting savings and investments of the corporations from the tax base. The reform increases efficiency in the economy by removing distortionary effects of conventional CIT. According to preliminary estimation, the reform will have a substantial positive impact on economic growth.*

Government of Georgia has introduced new CIT model. The new system is exempting retained earnings from tax base and profits are taxed only at the stage of distribution. Reform became effective from the beginning of 2017. Taxation of retained profits is more distortionary than taxation of distributed profit. Taxation of retained earnings reduces potentially highly productive investment ability of constrained firms, since it reduces internal funds and therefore reduces investment capacity by the amount of taxation. Furthermore, the demand for investment at the company level is very volatile and pro-cyclical in general and the new system allows businessmen to adjust to changing environments with more flexibility.

The new model of Corporate Income Tax has several advantages:

- **It does not change Internal Rate of Return.** In traditional CIT model, after-tax rate of return of reinvestment equals , while in case of the new model rate of return will be unchanged. Consequently, under the new model more projects will be financed.
- **It removes discrimination against longer-term investment projects.** Conventional income tax negatively affect the IRR. The size of distortion is bigger for longer-term projects. With the new tax model this distortion is removed.

- **Differentiates taxation of consumption and savings.** The funds until it is distributed to the individuals are considered as saved amounts and are exempted from taxation.



- Government's role in the economy is similar to that of minority shareholder. Government gets the share from company profits only when profits are distributed.

#### Estimated results:

According to the ex-ante regulatory impact assessment the reform will have positive impact on economy:

- Potential GDP will increase by 1.44% roughly within 1.5 years;
- The stock of capital will increase by 3.23% within 1.5 years. Aggregate private consumption will increase by approximately 0.85% within 1.5 years
- Current account deficit in terms of GDP will decrease by around 1 percentage points;
- This is SME supporting tax policy. The reform will have significantly higher positive effect for SMEs than for the big and established companies.

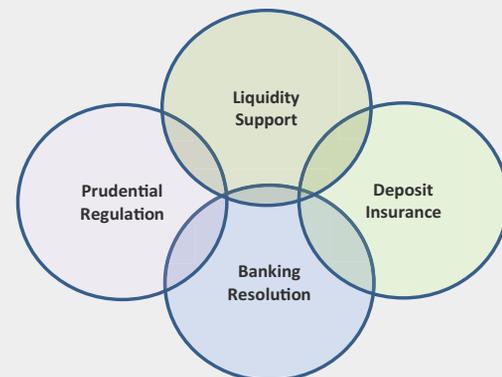
## Deposit Insurance

*Deposit Insurance System is a significant component of financial stability and safety. Deposit Insurance is a driving tool for protecting depositors, ensuring stability of banking system within the country as it can mitigate potential negative shocks. Deposit insurance system will be based on "Pay-Box" principle and the world-renowned method for depositor protection. Given stability of banking sector in current period and high level of capitalization, introduction of deposit insurance and transition process must be smooth.*

The Government of Georgia introduces Deposit Insurance reform, as envisaged under the Social - Economic Development Strategy Georgia 2020 and the Association Agreement with the European Union.

Deposit Insurance is an approved system applied for protecting depositors across the world, which ensures guaranteed compensation of deposits in the specific amount when a commercial bank faces problem with respect to their payment.

Deposit Insurance System is a significant component of financial stability and safety. The purpose of implementing this system in Georgia is to support stability of financial system in the country, encourage savings, facilitate economic development and mitigate internal and external shocks through raising public confidence in commercial banks.



The current stable situation in the Georgian banking industry, as well as high capitalization and profit levels create the best precondition for introducing countercyclical and buffer measures enhancing safety net and ensuring smooth implementation of the deposit insurance system. Such a favorable environment reduces costs for banks related to DIS introduction, on the one hand, and ensures fast accumulation of premium and fund growth on the other. The system can prevent bank run and is directed at mitigating potential risks/ shocks to financial stability.

DIS, in association with prudential regulation, liquidity support and effective supervision, creates the system for ensuring financial stability and safety. All commercial banks licensed by the National Bank of Georgia shall be members of the Deposit Insurance System.

According to the international standards, the Deposit Insurance System is to ensure protection of 90-95% of depositors and 20% of the total number of deposits.

The upper limit of insured deposits is defined under the Georgian Legislation. According to the Association Agreement, Georgia has the right to define threshold itself based on financial and economic situation in the country. At the first stage it would be expedient to define the threshold amount (limit) of compensation for insured deposit as GEL 5,000, which corresponds to the abovementioned international practice and will cover majority of depositors. 97 % of depositors in Georgia have deposits in the amount less than GEL 5,000 and their share in total deposits equals 15.25 %. This coverage area is optimum given the Georgian circumstances for the first phase of DIS development. However, DIS coverage level will be regularly reviewed and increased in accordance with international standards, and following to the size of collected deposit insurance funds and overall financial stability.

The international practice recognizes four broad mandates of deposit insurance based on their role in the financial safety system and in the problem resolution, these are: Pay-Box, Pay-Box Plus, Loss Minimizing and Risk Minimizing models. Pay-Boxes system is generally confined to collection of insurance premiums and reimbursing deposits when insurance case occurs, while in case of each following model the mandate gets wider with the analytical and administrative instruments of problem resolution. Given the international experience, at the first stage, so-called Pay-Box will be implemented in Georgia. Later on the country's economic development and acquisition of institutional experience will make it possible to further elaborate the system and expand the mandate if needed.

Financial resources required for compensation of insured deposits accumulate in the Deposit Insurance Fund. Main sources of the Fund's revenues are: initial membership fee, regular and extraordinary insurance premiums paid by commercial banks, income from investment activities, funds recovered from assets of commercial banks where insurance case occurred and the other resources. Amount of target fund in Georgia was defined as 6% of the total insured deposits. This will ensure the possibility to fully reimburse depositors of all commercial banks (except for the largest three banks) in Georgia.

The Law on the Deposit Insurance System is submitted to the parliament and system itself will be launched in 2018.

## Accounting Reform

*The main objective of accounting and auditing reform is to improve investment climate and investment protection in Georgia. For this purpose, the Government aims to encourage better corporate governance; facilitate development of the capital market and enhance transparency and reliability of accounting and auditing.*

By signing the Association Agreement with the European Union, Georgia has demonstrated its commitment to the reforms in adapting and aligning its legislation and practices with respective EU norms. Georgia took a significant step towards this goal recently in the area of corporate financial reporting by adopting a new Law on Accounting, Reporting and Auditing, effective since June 24, 2016, to bring its legislative framework in conformity with the requirements of the EU in general, and in particular the following Directives:

- Directive No 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings;
- Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards;
- Directive No 2006/43/EC of the European Parliament and of the Council of 17 May, 2006 on statutory audits of annual accounts and consolidated accounts.

In order to implement the requirements defined by the law on Accounting, Reporting and Auditing of Georgia, the Service for Accounting, Reporting and Auditing Supervision was established under the Ministry of Finance of Georgia (MOF) in September 2016, the main responsibilities of which include Audit oversight and Entities' Reporting

supervision, which therefore encompasses activities such as:

1. Administering the register of auditors (individuals) and audit firms (both, PIE and non-PIE)
2. Adoption of ISA, ISQC, Code of Ethics in Georgian
3. Performing recurring audit quality inspections of PIE and non-PIE auditors
4. Investigation and discipline for auditors/ audit firms (PIE and non-PIE)
5. Setting the standards/rules for, and recognition of professional certification programs, examination process and CPD based on IFAC's IESs
6. Adoption of IFRS, IFRS for SMEs and local accounting standards for micro entities
7. Administering the registry (portal) of entities' (4 size categories, + PIE) financial statements and non-financial statements
8. High level review of submitted statements.

To effectively and efficiently develop the right **processes procedures and methodologies for enforcement of both financial reporting and auditing requirements**, SARAS is actively collaborating with the world's leading countries' oversight and standard-setting bodies, among which are IFAC, PIOB, IFIAR, as well as international experts, which therefore will foster good-practice exchange and provide SARAS with diagnostic assessments, expert advice and technical assistance in the implementation process of the reforms.

### Reform benefits

The collective benefits of the reforms implemented by SARAS will be to enable and enforce globally accepted standards for high quality financial reporting. These underpin economic growth, transparency and confidence in the private sector. Increased capacity in accounting and auditing also benefits the public sector and, through increased accountability and information flow, helps to reduce inefficiencies and opportunities for corrupt practices.

## Insurance Reform

*Georgia's insurance market is still weakly developed. Development of insurance market is important in terms of existing of long-term local-currency resources in the market. In order to progress in this direction changes in legislative base and regulations of the sector and introduction of modified insurance products are needed. The Government of Georgia is actively working to support the development of the insurance sector.*

### Insurance sector – brief overview:

- 15 Insurance companies
  - 1 non-life; 14 life + non-life;
  - 5 insurance companies with international shareholders structure ( 2 are members of Vienna Insurance Group, 1 from Turkey; 1 from Azerbaijan; 1 with minority shares presented by Global Benefit Group)
- 20 Insurance brokerage companies
- Market Penetration:
  - Health Insurance – 14.3%
  - Auto insurance – 4.3%

### General data

	Gross Written Premiums:	Gross Claims Paid:
2016	GEL 393 mio	GEL 232 mio
2015	GEL 360 mio	GEL 211 mio

### Financial data

	Assets	Equity	Net Income
2016	GEL 542 mio	GEL 136 mio	GEL 18.86 mio
2015	GEL 520 mio	GEL 101 mio	GEL 2.63 mio

### Recent Changes in Regulation

1. Implementation of Solvency 1 capital requirements in accordance with the EU standards: Insurance companies are obliged to fully comply with the Solvency I requirements by the end of 2017. Meantime following threshold for Solvency I compliance is applied by ISSSG (which was agreed with the World Bank); 1) From 1<sup>st</sup> of January 2017 the insurance companies already comply 50% of Solvency I requirements; 2) From 1<sup>st</sup> of July 2017 the insurance companies will have to comply 75% of Solvency I requirements; 3) From 1<sup>st</sup> of January 2018 the insurance companies will have to comply 100% of Solvency I requirements;
2. Rise in Minimum Capital Requirements (MCR): In order to strengthen the financial liquidity of Insurance sector, from January 2017, Insurance companies were required to rise capital till GEL 2 mio (for the ones with only non-life insurance license) and till GEL 2.2 mio (for the ones with life insurance license). Before 2017 MCR was GEL 1 mio (non-life) and GEL 1.5 mio (life). As a result, additional GEL 23 mio cash injection was made in the sector.
3. Strengthening Corporate Governance requirements: A) The only one legal form of insurance companies was determined to be Incorporation (Joint Stock Company); B) Two level of management became compulsory for the

insurance companies (Supervisory board and Executive management); C) Special Fit and Proper criteria for the insurance companies managements were created and implemented;

4. Strengthening the AML supervision standards: A) Special separate division was created in order to enhance the AML supervision B) Off-Site AML supervision was implemented and Insurance companies started sending special AML report to the regulator

5. Strengthening Consumer Protection Model: Special Regulations, which are in compliance with Insurance Core Principles (ICP) and Principles of European Insurance Contract Law, were created and introduced in the market. In accordance to that, the insurance companies will be obliged to: A) Provide the customer with fully transparent information during the OFFER phase as well as during the Contracting phase, the information should include the pricing, claim reimbursement process and exclusions for reimbursements. B) The insurance companies are obliged to form a separate division in their structure that will be in charge of consumer protection issues. Mentioned division will rapport to the ISSSG;

Mentioned requirements were introduced in April 2017 and until the end of 2017 Insurance companies will have to fully comply with them.

6. Strengthening the Supervision of Brokerage companies: Since January 2017 brokerage companies become obliged to deliver special reporting documents to ISSSG for their off-site regulation purposes.

### Future Targets:

1. Introduction of Compulsory MTPL insurance in the country: We divide MTPL into 2 phases:

- a. Compulsory MTPL insurance for the vehicles with foreign plates. Currently we are in the process of finalizing the law (World Bank is actively engaged in the process of drafting the law). The target is to lunch mentioned insurance product in 2017
- b. In 2018 we consider to introduce MTPL insurance for the local vehicles together with accompanied issues (e.g Guarantee fund ...)

2. Introductions of other Compulsory insurance products:

Launching of Compulsory insurance products which are oriented to protect third parties. Compulsory General Third Party Liability insurance products at public gathering places as well as some compulsory professional third party liability insurances will be introduced in Georgia during 2017 and 2018.

3. Shifting to the Risk Based Supervision (RBS) Model by ISSSG: ISSSG intends to adopt Risk Based Supervision approach into its regulatory process. ISSSG works with World Bank in order to draft and to execute the RBS model in its daily work.

4. Introduction of Net Retain Margins: ISSSG works with World Bank in order to create and implement a prudential model for Net Retention Rates on the risks taken by the insurance companies. (targeted year to introduce is 2017);

5. Insurance licensing Classification: Currently only 2 types of insurance licenses (Life and non-life) exist in Georgia , ISSSG works to classify licenses in accordance to the EU standards. (targeted year to introduce is 2017);

#### 6. Strengthening Corporate Governance requirements:

The Requirement to have an internal Audit within the insurance companies will be mandatory. The detailed fit and proper criteria for the audit as well as the requirement to have the audit will be introduced in 2017.

#### 7. Strengthening Consumer Protection Model:

Creation and execution of mysterious visitors in the insurance companies by ISSSG is targeted in 2018. The objective of mysterious visitors is to ensure that consumer protection standards in the sector is protected.

#### 8. Changing the model of financing ISSSG:

ISSSG is currently financed from the government budget. In 2017 it is targeted to change the source of its financing from government to the insurance sector, meaning that the insurance companies will have to pay 1% from their premiums to the ISSSG. Mentioned changes will:

- 1) Increase the level of independence of the ISSSG;
- 2) Secure the salary level in ISSSG in accordance to the level of the sector (FSAP recommendation);
- 3) provide financial recourses to ISSSG to adopt modern IT infrastructure to better regulate the sector remotely;

## ■ Larization Reform

*High dollarization is one of the main obstacles of Georgian economy. Under the dollarization, economy is imposed to currency risk, thus resilience to the external shocks declines, having a negative impact on the economy. Increase in larization will contribute to the effective implementation of monetary policy and reduce the risks to financial stability. In general, sustainable long-term economic growth will be achievable only in terms of low-dollarization*

To increase larization, the Government of Georgia in close cooperation with the National bank developed larization strategy aiming at reducing dollarization in the economy through series of reforms. The strategy aims to fully define all those measures which will increase the attractiveness of national currency. It should be mentioned that reforms package does not intend to apply prohibition and other administrative measures.

The confidence to the Government - the basis for the reform: macro stability must be provided which implies debt stability through fiscal consolidation and sustainable growth; maintaining floating exchange rate regime, inflation targeting monetary policy, containing current account deficit via increasing savings are crucial elements.

### Measures:

- Conversion of loans in GEL – the action A one-off social action was held in early 2017, which lasted 2 months
- Increase the attractiveness of GEL loans
  - ✓ Prohibiting loan issuance in foreign currency by commercial banks and micro-financial institutions organizations below the threshold of 100 thousand GEL;

- ✓ Prohibiting mortgage registration in foreign currency below the threshold of 100 thousand GEL on one unit of real estate;
  - ✓ Projects under the State programs (Invest in Georgia, Invest in future, Agricultural credit and other) to be financed only in the national currency;
  - ✓ Supply of GEL extension instruments within the state program in proportion of loans provided by the banking sector;
  - ✓ Use of loans of commercial bank under the state project as collateral in operations with the NBG
  - ✓ Increase capital requirement of unhedged loans;
  - ✓ Introduce committed liquidity facility (CLF). According to the liquidity ratios under the Basel III, strictly define the function of the NBG as the monopolistic supplier of GEL and create the collateral base for monetary policy operations;
- Counter-cyclical monetary policy;
  - Increase confidence to the refinancing window;
  - Calendar-based foreign exchange interventions;
  - Development of Government securities market;
  - Financial instruments for individuals;
  - Development of capital markets;
  - Pricing in GEL;
  - Adjustment of reserve requirements;
  - Deposit insurance;
  - Abolish of subsidies on fuel and cars

## Land Reform

*The main goal of the Land reform is to eliminate difficulties that landowners are facing while registering their property. According to the law, procedures of land registration have been simplified, barriers have been eliminated and some incentives were created in registration process. Current focus is on further simplification of property registration and protection of property rights.*

State Reform of Land Registration has been initiated by the Ministry of Justice and implemented on August 1, 2016.

The main goal of the reform is to eliminate difficulties that landowners are facing while registering their property. According to the law, procedures of land registration have been simplified, barriers have been eliminated and some incentives were created in registration process.

State Reform of Land Registration has two stages. The first stage is sporadic registration which is operating throughout the entire country based on individual applications and lasts until July 1, 2018. Systemic registration is the second stage of the reform and includes registration of lands based on systematically collected and processed information from geographical areas intended for registration and specified in-advance. Pilot project will be launched in 12 areas with financial assistance of the World Bank. Lands of private, state and municipality ownerships will be fully recorded and registered under the program. Unified database will be created, cadastral data inconsistencies will be fixed, etc.

State Reform of Land Registration is oriented on simplifying real estate registration procedures and protecting owner's rights.

The need for the reform was determined by the problems

with land registration. There were number of issues resulting from land reform wrongly implemented in 1990s. Thousands of citizens were unable to register as landowners, the trials on disputed lands lasted for years, which, combined with other factors, delayed development of real estate market. Before introducing the reform, only 25% of existing land within the country was registered. During the 8 months after implementation of the new law, there was 12% increase in registering lands that were not registered previously.

The reform changed fundamentally the approach of National Agency of Public Registry regarding the process of registration. The agency obtained the authority of, when needed, being able to obtain documentation from different state entities instead of a citizen and create base for simple and fast registration of the land.

Number of documents for registering the property has increased. Notaries are permanently communicating with citizens for correcting incidental illegalities. Declaration of facts is part of the reform as well. Municipalities play the major role in determining property rights as the most effective local source for information.

The reform will continue until July 1, 2018. All registration processes are free of charge.

## Development of SME's

*Development of small and medium size enterprises is a focal point for the Georgian Government as it highly determines economic outcomes of business sector. Georgia has simplified legislative and administrative procedures such as tax exemptions on particular activities that promote ease of making business within the country. In this regard implemented CIT tax reform has a positive contribution as well.*

Well-developed SME's contribute to increased production and economic growth. It employs most of the labor force within the country and has the biggest potential for creating new job opportunities.

Georgia has one of the most simplified tax system around the world, which makes doing business in Georgia comparatively cheaper and easier. Next step forward in this regard was to introduce some major tax reforms that will create incentives for investing in business sector. Estonian tax model was introduced in January, 2017, it exempts companies from the corporate income tax in case of reinvestment of the profits and positively affects expanding existing production. Companies will have more access to financial resources and increase their productivity. It is assumed that positive implementation of given reform will contribute to accelerating potential economic growth by around 1.44 percentage points and capital accumulation growth by 3.23 percent.

The government of Georgia has also introduced Import VAT exemption on fixed assets, which will enable local producers to import modern machinery and adopt new technologies without additional costs.

State program “Produce in Georgia” has been launched, it provides financial assistance (co-financing of the interest of 8%-12% and partial collateral support of 50% for the first 2-4 years) and infrastructural support to enterprise (transfer of state owned assets for investment obligations).

Another initiative “Start-Up Georgia” is the program that provides funding for high tech and innovative startups up to 50% of equity. Georgia’s Innovative and Technology Agency (GITA) and Partnership Fund finance the program.

Additionally, there is micro and small business support program providing funding up to 15 000 GEL for businesses, 20 percent co-financing, grant financing and capacity building mechanism.

## ■ Insolvency Reform

*Insolvency Reform will encourage rehabilitation processes, provide adequate protection of creditors’ rights and improved creditor recovery rate, strengthen job reservation, and increase access to finance with lower costs of credit. Properly functioning modern system of Insolvency will ensure a fair, transparent and predictable business environment in Georgia.*

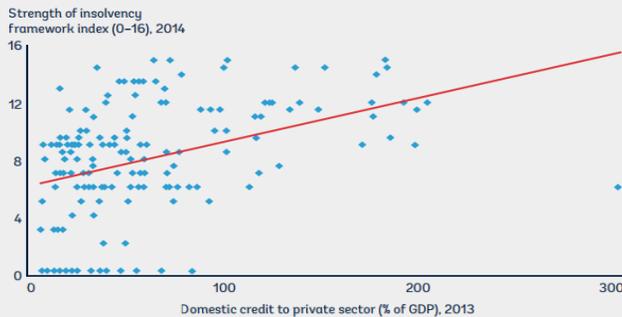
Properly functioning modern system of Insolvency ensures a fair, transparent and predictable business environment. It affects the country’s economic growth and its determinant factors, such as access to finance, capital costs, business environment, employment, investment environment, investment funds and others.

It is important to create, via legislation, options for the reorganization of business operators. Although procedural alternative allowing the reorganisation of a business operator is present in the insolvency law, questions remain in the thresholds that have to be met for initiation of reorganisation proceedings and in how reorganisation proceedings are positioned vis-à-vis bankruptcy proceedings structurally. The plan is to increase insolvency system’s ability to promote reorganisation via legislation for viable business operators whose sustainable management after reorganisation would be possible.

According to the World Bank study „Measuring the strength of insolvency laws“ there are solid ties between effective insolvency system and financial markets. In countries, which are the leaders in terms of strong insolvency framework, crediting of the private sector by the commercial banks appears to be much higher. This is partly due to the fact that credit institutions and entrepreneurs are able to pre-

determine the “worst-case scenario” results

**FIGURE 12.3** Economies with strong insolvency frameworks have higher levels of domestic credit provided to the private sector



Fast and efficient insolvency regime ensures that inactive are returned in the economy quickly, reduces the share of non-performing loans and releases new financial resources. Under the condition of high recovery rates, creditors continue to invest in other viable companies, which further increases the availability of credit and has a positive impact on economic growth. At the same time, under the smooth and predictable insolvency regime, investors feel more secure thus investment incentives are greater.

The Insolvency Law is considered to be in the range of laws having economic essence, because it affects almost all areas and sectors in the country’s economy, regulates relations between economic agents and determines their collective redressing mechanisms.

According to the study “Potential Economic Benefits from Insolvency Reforms in Europe” made by the “Association for Financial Markets in Europe” (AFME) in 2016, expected growth in recovery rate by 10 percent will lead to 37 basis points decline in bond spread. **Thus new legislation is needed to ensure the highest growth in assets recovery, promote property selling as one complex**

## process of rehabilitation

### Why rehabilitation?

1. Regaining of investments/credits by creditors are increased;
2. Company employees keep their jobs;
3. Company preserves connections with suppliers and customers;
4. credit resources are cheaper;
5. Credit availability increases;
6. Reduces the risk of job cuts;
7. Creditors continue to invest in in other viable companies.

For companies without the possibility of rehabilitation, the insolvency regime, is considered to be the organizational form to exit the market, which enables orderly collection of assets and the satisfaction of creditors proportionally thus ruling out aspiration of creditors “to collapse” the company.

Company bankruptcy may be considered as the beginning of a new entrepreneurial life and new financing opportunities for the banking sector.

## Economic Governance Reform

*Economic Governance Reform is oriented on increasing efficiency of public institutions through supporting participation of society, including private sector and other civil groups. It will improve open governance via enhancing transparency and lower administrative costs. As a result, the level of trust towards public institutions and public administration will improve immensely.*

Involvement of private and public sectors in economic governance is a driving force for open governance. For better coordination of public and private sectors, Georgian Government is going to introduce Business House. This system is new vision in public-private communication, which represents a unified physical and electronic space of business service.

Basic principles of Business House are:

- Single Window Principle
- Only Once Principle
- Digital by Default
- Everything and Everywhere
- Transparency
- Efficiency
- Consumer-oriented service

In Business House, investors will be able to receive more than 600 types of public service operating under “Single Window Principle”, which by now is provided by 60 different entities.

In addition to physical space, Business House represents a front office for representatives of all public services, business promoting government programs, investment-consulting services, natural monopolies and financial and legal services.

The concept of Business House was developed based on international experience, consumer needs and, as mentioned above, “Single Window Principle” approach. Therefore, the space is divided by type and time of service(s): self-service, fast, long and consulting parts. In addition, there are spaces for conferences, exhibitions and also cafes/bars/restaurants. Booking of meetings and VIP services are available there as well. All these facilities concentrated together will intensify cooperation between the government and business through providing transparent, friendly and confidential environment.

According to “Only Once” principle, after providing information once, businessmen will be free from providing information to the same or other public entity several times (repeatedly). In addition, “Digital by Default” principle obliges public entity to convert any service provided into electronic format. And finally, due to the principle of “Everything and Everywhere”, individuals will get needed service at any place: home, office or Business House.

This three principle ensure time efficiency and lower administrative costs for both, the state and the private sector. It also resolves the problem of data collection and data mismatch.

Moving further, transparency of economic processes will be guaranteed in order to ensure fair supply of servers and unbiasedness. As a result, confidence level regarding the service of public sector will improve. Orientation of efficient consensus minimizes time and effort needed for obtaining desired information, while consumer-oriented service provides design and supply of services based on business needs and comfort.

### Regulatory Impact Assessment

Regulatory Impact Assessment (RIA) intends to evaluate and analyze legislative initiatives that significantly affect

business environment and economy, prevent additional burden for the business and limit state intervention in social and economic relations.

Need of RIA implementation derives from EU-Georgia Association Agreement and the broad strategic vision of the Government of Georgia reflected in Government's 4-point Reform Plan, Social-economic Development Strategy of Georgia - "GEORGIA 2020", Governmental Program "For Strong, Democratic and Unified Georgia" and SME Development Strategy of Georgia.

A number of RIA capacity building efforts have already taken place in Georgia since 2007, most important of which was to establish RIA Unit in the Ministry of Economy and to launch RIA promotion activities. Several RIA trainings was also organized since then, including RIA courses delivered by USAID Good Governance in Georgia Project (G3), Cost-Benefits Analysis (CBA) courses delivered by ISET Policy Institute and other RIA related trainings offered by various experts and technical assistance projects.

At the next step legal framework will be prepared for introducing mandatory RIA and its unique, unified and standardized procedure. Methodology, rules of procedures and guidelines for Regulatory Impact Assessment will be also elaborated and adopted as well as criteria and checklists for RIA documents.

RIA system will cover not only laws, by also by-laws and other regulations.

For proper implementation of the system it is important to strengthen internal capacities by training relevant employees, preparing guidelines and creating databases for Regulatory Impact Assessment.

## Public Investment Management

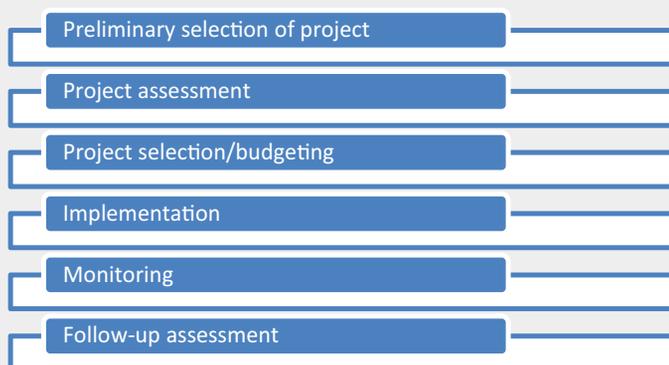
*In order to further strengthen the fiscal governance and discipline it is important to increase efficiency of spending and transparency of budget process.*

A new structural unit is being set up under the Ministry of Finance focusing on two major goals:

- 1) Setting up a system to analyze budget programs' efficiency and prepare recommendations about the possibilities of achieving more efficiency, as well as reveal the programs which don't have enough positive effect on the sector or economic growth in general and respectively modernize the programs; and
- 2) Support Public Investment Management tools to be introduced in practice which will allow having a sound system of preparing pipeline of investment projects before the decision on financing in made; The World Bank is supporting the Ministry of Finance in this regard. Trainings will be provided to Municipalities, MRDI and MOF in May and June and experts will be attached to 5 pilot projects. We plan to support Public Investment Management tools to be introduced in practice which will allow us to have a sound system of preparing pipeline of investment projects before the decision on financing in made.

**Setting full cycle of PIM** – Decision making on Public Investment Projects will follow the comprehensively defined framework set by the Government. Methodology sets procedures for pre-selection, evaluation, selection/ budgeting, implementation, monitoring and ex-post evaluation. This will allow the government to set framework for having a pipeline of projects which have already been analyzed, risks assessed and benefits evaluated. With WB

support the methodology will gradually be implemented by all the stakeholders (Ministries, Municipalities etc.). After full implementation of the reform decision making on capital spending and defining the mid-term framework for public investment will be completely rule-based which will support Government's main goal to have efficient fiscal policy in place.



## Public Finance Management

**Fiscal Discipline** – Developing existing practice of Fiscal Governance and further harmonizing with EU and International Standards. Effectiveness of existing fiscal rules (Debt rule, Budget balance Rule and Expenditure Rule) will be assessed and possible amendments prepared with the support of IMF. This will strengthen the fiscal discipline and set more accurate framework for fiscal policy on planning as well as budget execution stages. To reach higher standards of accounting GFSM 2014 will be introduced. Further Reforms in PFM will follow the agenda of the action plan defined by the Fiscal Transparency Evaluation Report provided by the International Monetary Fund.

**Midterm Planning and Results Oriented Budgeting** – Quality of Midterm Expenditure Planning and the role of the Midterm plans in fiscal policy decisions will be strengthened further. Linkage of annual budget planning and midterm framework as well as decision making on allocations and performance based evidence will be strengthened.

**Fiscal Risk Management** – The Government is committed to contain fiscal risks to safeguard fiscal sustainability. Disclosure of fiscal risks in Georgia has improved substantially over recent years. The key advance has been the publication of a fiscal risk statement (FRS), beginning with the 2015 Budget, and improving considerably in the 2016 and 2017 Budgets. The government now discloses and assesses many of the fiscal risks it faces, including from macroeconomic shocks, public corporations, and the long-term costs to the state associated with power purchase agreements. This process will be strengthened further by assessing more comprehensively all existing PPP-associated firm and contingent liabilities, include a quantitative reporting of quasi-fiscal relationships, and expand the analysis of contingent liabilities associated to State Owned Enterprises.

## Domestic Public Debt Market Development

*Major focus of domestic debt market development program is to provide sufficient funds for government's financing needs and payment obligations and at the same time facilitate capital market development. In this regard, Government of Georgia is going to incentivize issuance of benchmark bonds and introduce primary dealer system. As a result, government debt service will become more sustainable in both medium and long-term perspectives.*

Georgia is upper middle income country and still benefiting from concessional borrowing, but time to time eligible concessional resources for Georgia has been declining. In 2014 Georgia graduated from IDA and it is intended to graduate for ADF in 2017. In this response, Georgia has to find new ways of attracting favorable financing. Hence, development of domestic market of government securities moved to active phase.

One of the goals of domestic market development is to cover government's financing needs and payment obligations, while minimizing medium and long term costs, consistent with a prudent degree of risk. Another goal is to create a good background and facilitate capital market development.

**Issuance of Benchmark Bonds** is one of the actions that is intended to be launched. Use of modern techniques, such as reopening issues and buyback programs, would accelerate the elimination of market fragmentation. The issuance of Benchmark bonds will help to establish yield curve and facilitate pricing on the domestic market.

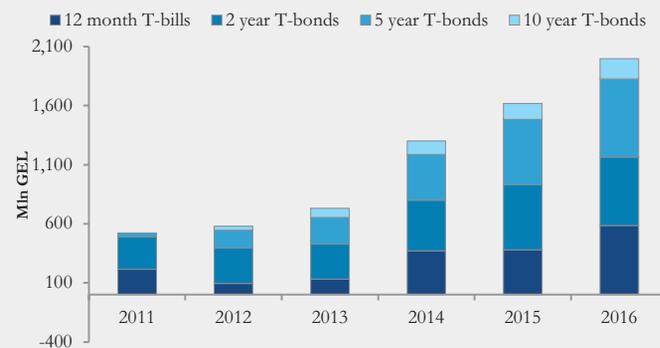
**Primary dealer system introduction** is another action to support domestic market development. The appointment

of a network of primary dealers with specific privileges and obligations will stimulate the growth of secondary-market trading.

In order to provide detailed and comprehensive information to investors **Analytical Information Preparation and Distribution** will be enhanced.

Domestic market of government securities has been developing rapidly, from 2011 to 2016 it has increased by 280% (see table 1.) in nominal terms. Government of Georgia constantly maintains a positive net issuance of government securities and it intends to further extend the net issuance volume. Consequently, there is an increasing interest towards domestic market coming from foreign investors.

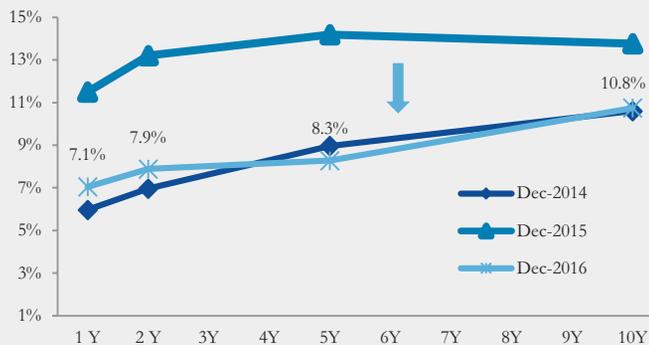
Table 1.



With regards to interest rates on government securities, due to negative external conditions they have increased in 2015, but currently impacts from external instability have vanished and therefore interest rates have reached

their original level. As a consequence of the domestic market development further decline of interest rates is expected.

*Table 2.*



## Spatial Development Reform

*The Government of Georgia intended to unify reforms and strategies under one major goal and conclude the spatial development of the country in the medium term. Construction of backbone infrastructure will ensure proper transportation and communication network all across the country, which will enhance Georgia's integration in world trade and provide bigger range of touristic potentials.*

The Government of Georgia has planned to accelerate infrastructure development. In 2017-2021 GEL 15 billion will be spent to finish construction of the backbone infrastructure of the country. During four years, east-west highway and south-north trade corridors, connecting Georgia with all its neighboring countries, will be completed.



Georgia has a potential to form transport and logistics hub between Europe and Asia and to enhance its role in the world economic and security system. It will enable the country to engage in foreign trade more intensively. Access to larger number of markets and world prices, especially in agricultural sector, will create incentives for increasing

domestic production and promote development of new export-oriented sectors. In addition, Georgia will have a better access to modern technologies and know how that will positively contribute to competitiveness of Georgia on the world market.

Economic decentralization will be resolved by creating a single frame, connecting all regions across the country via building new roads, bridges and tunnels. It will make travel safer, faster, and easier. Regions will be able to highly integrate in economic development of the country. Modern technologies and standards will become more accessible for the regions. In addition, interconnection will increase the quality of life of the local population through increasing access to health care and education.

Under the umbrella of spatial development ports, airports, railways, energy transit infrastructure will be built enhancing county's cargo potential. In line with increasing turnover capacity fields related to transportation, storage and processing will develop. Logistic centers and new businesses will be established utilizing benefits from geographic location, transport infrastructure and free trade agreements.

Infrastructural development will have a significant impact on Georgia's tourism potential. Georgia is attractive tourism destination for all four seasons. Due to infrastructural projects, all touristic attractions will be accessible throughout the year providing time efficiency and costs minimization. These will result in higher number of tourists and diversification of tourism sector itself.

