FISCAL AFFAIRS DEPARTMENT

Georgia

Fiscal Transparency Evaluation

Amanda Sayegh, Jason Harris, Roderick O'Mahony, Sami Yläoutinen, and John Zohrab

INTERNATIONAL MONETARY FUND

F I S C A L   A F F A I R S   D E P A R T M E N T

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GLOSSARY

BD	Budget Department
BDD	Basic Data and Directions Document of Georgia
DSA	Debt Sustainability Analysis
ESCO	Electricity System Commercial Operator
FAD	Fiscal Affairs Division
GEL	Georgian Lari
GFSM	Government Finance Statistics Manual
IPSAS	International Public Sector Accounting Standards
IRR	Internal Rate of Return
LEPL	Legal Entities of Public Law
MAFD	Macroeconomic Analysis and Forecasting Department
MESD	Ministry of Economy and Sustainable Development
Move	Ministry of Finance
MTBF	Medium-term Budget Framework
NBG	National Bank of Georgia
NPV	Net Present Value
PDEFD	Public Debt and External Financing Department
PBO	Parliamentary Budget Office
PC	Public Corporation
PPA	Power Purchasing Agreement
PPP	Public-Private Partnership
SAO	State Audit Office of Georgia
SFR	Statement of Fiscal Risks
USD	United States Dollar
VAT	Value-added Tax

LEVEL OF PRACTICE	RATING			
	Not Met	Basic	Good	Advanced

LEVEL OF IMPORTANCE	RATING		
	High	Medium	Low

PREFACE

At the request of the Georgian Deputy Minister of Finance, Mr. Giorgi Kakauridze, an IMF technical assistance mission was in Tbilisi from December 6–19, 2016 to conduct a Fiscal Transparency Evaluation based on the IMF's Fiscal Transparency Code. The mission comprised Amanda Sayegh (head) and Jason Harris of the IMF's Fiscal Affairs Department (FAD), Roderick O'Mahony of the IMF's Statistics Department, John Zohrab (FAD regional advisor), and Sami Yläoutinen (FAD expert). A preliminary visit by Amanda Sayegh to Tbilisi also took place from October 5–7 to provide an overview of the framework for the evaluation and gather initial documents and data.

In the conduct of the evaluation, the mission met with representatives of the Ministry of Finance (Move), including: Mr. Giorgi Kakauridze (Deputy Minister); Mr. Tsotne Kavlashvili (Deputy Minister and Head of State Treasury); Ms. Ekaterine Guntsadze (Head of Budget Department (BD)); Ms. Nino Tchelishvili (Deputy Head of Treasury Service); Ms. Ekaterine Mikabadze (Head of Macroeconomic Analysis and Forecasting Department); Mr. Ioseb Skhirtladze (Head of Public Debt and External Finance Department); Mr. Giorgi Maldzigashvili (Head of Tax Policy Division); and Mr. Mikheil Chikviladze (Georgia Revenue Service).

The mission also met with senior officials from the Ministry of Economy and Sustainable Development (MESD), the National Agency of State Property, the Ministry of Energy, the Ministry of Environment and Natural Resources Protection, the Ministry of Regional Development and Infrastructure, and the Procurement Agency of Georgia. In addition, the mission benefited from discussions with representatives from the State Audit Office of Georgia (SAO), the Parliamentary Budget Office (PBO) of Georgia, the Parliamentary Budget and Finance Committee, the National Bank of Georgia (NBG), Tbilisi Municipality, and Transparency International Georgia.

The evaluation is based on information available at the time of the visit in December 2016. The findings and recommendations of the report represent the views and advice of the IMF mission team and do not necessarily reflect those of the Georgian government. Unless otherwise specified, the data presented in text, figures and tables in the report are estimates made by the IMF mission team and not official estimates of the government of Georgia.

The mission would like to thank the Georgian authorities and other officials for their excellent collaboration in the conduct of this evaluation and for the frank and open exchanges of views on all matters discussed. Particular thanks go to Ms. Ekaterine Guntsadze and Ms. Natia Gulua for their ongoing support to the mission. The mission would also like to thank Ms. Rohini Ray (FAD Research Assistant) for her support in compiling data and cross-country comparisons. Finally, the mission would like to express its appreciation to Ms. Khatia Chanishvili and Ms. Lali Gagnidze for their interpretation and translation services.

EXECUTIVE SUMMARY

Georgia has taken important steps to enhance its fiscal transparency practices over the past decade. Fiscal reports have become more comprehensive, with the development of a central government balance sheet and income statement. Fiscal forecasts and budgets have become more forward looking and policy oriented, with the introduction of a four-year medium-term budget framework (MTBF), formal fiscal objectives, and a program budget classification. In addition, fiscal risk disclosure and analysis have improved dramatically, with the publication of a detailed statement on fiscal risks. As a result of the improvements in fiscal transparency practices, Georgia's Open Budget Index score has improved substantially, from 34 to 66 between 2006 and 2015, with Georgia now being ranked 16 out of the 102 countries surveyed.

Many elements of sound fiscal transparency practices are therefore in place. Based on an assessment of fiscal transparency practices against the IMF's Fiscal Transparency Code, Georgia meets the standard of good or advanced practice on 18 of the 36 principles, and the basic standard on a further 10 principles (Table 0.1). Georgia's fiscal transparency practices are stronger in the areas of fiscal forecasting and budgeting and summary fiscal risk disclosure. Some of the key strengths are:

- Publication of detailed information on the use of public resources in fiscal reports, in accordance with international classifications (GFSM 2001) and a program classification, and extensive in-year reporting on budget execution;
- The presentation of medium-term forecasts and spending plans in the budget, which is submitted to parliament in a timely manner in accordance with the provisions of a clear organic budget law and is subject to independent scrutiny by a Parliamentary Budget Office; and
- Analysis of the impact of alternative macroeconomic scenarios on public finances and assessment of the main specific fiscal risks relating to public corporations (PCs) and power-purchase agreements.

At the same time, the evaluation highlights a number of areas where Georgia's fiscal transparency practices could be further improved:

- Fiscal reports provide a fragmented picture of government activity, with varying coverage of stocks and flows and institutions across different reports. While it is common for reports produced for varying purposes to differ, no individual report provides a complete picture of general government activity. The evaluation found that the most complete fiscal report covers only three-quarters of public sector expenditure.
- Differences in fiscal aggregates within and between reports are substantial but are not explained. For example, no report reconciles the change in the stock of the government's

debt with the budget deficit, an important omission given that a significant share of the debt stock has arisen from factors other than deficit financing needs.

- Neither the government's fiscal statistics nor the annual financial statements are subjected to independent and complete verification of their accuracy, which is a major deficiency in assuring the integrity of the public finances. The SAO does not audit the annual financial statements of the central government. Although, the SAO publishes an assessment of the annual budget execution report, and comments on the reliability of some of the financial data in it, it does not provide an overall conclusion that the report is a true and fair reflection, in all material respects, of the cash flows according to specified accounting standards, subject to stated qualifications.
- The government does not report on performance against its fiscal objectives. Although the government publishes relevant fiscal indicators in the annual budget, budget execution reports, and statistical reports, the absence of a discussion on whether the key fiscal indicators are consistent with the fiscal rules, in terms of both budget plans and outcomes, can make it difficult to monitor compliance. This is a significant problem given that budget outcomes have sometimes deviated substantially from budget plans and there have been breaches of the expenditure rule.
- Expenditures carried out by legal entities of public law (LEPL) that are financed from their own revenues are not incorporated into the main fiscal aggregates in the annual budget and budget execution reports, understating central government expenditure by around 4 percent of GDP. Information on LEPL activities are instead provided in a statement separate from data about the rest of central government. Central government cash flows are further understated in most fiscal reports as well as the statistical reports as they do not account for payments of invoices from the previous year, although these have not been large in recent years.
- While there have been improvements to assessments of risks to public finances from PCs and power purchasing agreements (PPAs), weaknesses in controls over, and management of them present heightened risks, given their combined gross contingent liability exposure of 36 percent of GDP. Efforts are underway to introduce a framework for managing fiscal risks from PPAs which will go some way to closing the gaps identified in the evaluation.

The evaluation provides eleven recommendations to further enhance fiscal transparency in Georgia. Specifically, it recommends that the authorities:

- Consolidate activities of LEPL into government finance statistical reports and produce an annual consolidated general government sector financial report on an International Public Sector Accounting Standards (IPSAS) basis.
- Enhance the quality of fiscal reporting by: (i) appropriately accounting for payments of invoices from the previous year; (ii) expanding the balance sheet to all financial liabilities and conducting a valuation of state assets; and (iii) publishing reconciliations of differences between fiscal aggregates within and across reports.

- Strengthen the integrity of fiscal reports by requiring the SAO to provide a conclusion on the annual budget execution report that is in substance the same as a financial audit opinion, and to audit the central government's annual financial statements as soon as is practicable.
- Publish a statement on revenue foregone from tax expenditures and establish control over, or budgetary limits for their size.
- Include own source revenue and related expenditures of central government LEPL in reporting of the main central government fiscal aggregates on a gross basis.
- Publish regular statements on performance against the fiscal rules that provide an explanation of whether budget plans and budget outcomes are consistent with the fiscal rules.
- Provide a reconciliation of changes to the key fiscal aggregates between successive forecasts and more detailed explanation of the macroeconomic forecasts.
- Extend the time horizon of the debt sustainability analysis (DSA) to ten years and incorporate anticipated expansion of public investment, public-private partnerships (PPPs), and PPAs.
- Restrict criteria for drawing on the main budget contingency reserves to those expenditures demonstrated to be unforeseeable, unavoidable, and unable to be absorbed.
- Strengthen controls on loans on-lent, and equity injections, to PCs by subjecting them to a transparent test that ensures there is a reasonable expectation of commercial returns and set limits on PPP liabilities (including PPAs).
- Publish an annual report on sub-national finances, providing key financial information on individual municipalities and the sector as a whole.

The fiscal transparency evaluation also estimates Georgia's public sector financial position, in order to provide a more comprehensive view of public finances. It estimates consolidated public sector expenditures of 41 percent of GDP, public sector asset holdings and liabilities of around 96 and 79 percent of GDP, and a public sector net worth of 16.8 percent of GDP in 2015 (Table 0.2). While the public sector deficit and net worth do not differ substantially from the reported central government aggregates, overall public sector activities, gross assets, and liabilities are considerably larger.

The remainder of this report provides a more detailed evaluation of Georgia's fiscal transparency practices against the standards of the Code. It is organized as follows:

- Chapter I evaluates the coverage, timeliness, quality, and integrity of fiscal reporting;
- Chapter II evaluates the comprehensiveness, orderliness, policy orientation, and credibility of fiscal forecasting and budgeting; and
- Chapter III evaluates arrangements for disclosure and management of fiscal risks.

Table 0.1. Georgia: Summary Assessment Against the Fiscal Transparency Code

I. Fiscal Reporting	II. Fiscal Forecasting & Budgeting	III. Fiscal Risk Analysis & Management
Coverage of Institutions	Budget Unity	Macroeconomic Risks
Coverage of Stocks	Macroeconomic Forecasts	Specific Fiscal Risks
Coverage of Flows	Medium-term Budget Framework	Long-term Fiscal Sustainability
Coverage of Tax Expenditures	Investment Projects	Budgetary Contingencies
Frequency of In-Year Reporting	Fiscal Legislation	Asset and Liability Management
Timeliness of Annual Accounts	Timeliness of Budget Documentation	Guarantees
Classification	Fiscal Policy Objectives	Public-Private Partnerships
Internal Consistency	Performance Information	Financial Sector
Historical Revisions	Public Participation	Natural Resources
Statistical Integrity	Independent Evaluation	Environmental Risks
External Audit	Supplementary Budget	Subnational Governments
Comparability of Fiscal Data	Forecast Reconciliation	Public Corporations

Table 0.2. Georgia: Public Sector Financial Overview, 2015

(Percent of GDP)

	General Government				Public Corporations			Eliminations for Consolidation	Public Sector
	Central Government	Local Governments	Consolidation Gen. Govt.	Consolidated Gen. Govt.	Nonfinancial	Financial	Central Bank		
Transactions									
Revenue	30.3	6.4	3.9	32.8	6.8	0.0	0.3	0.0	39.9
Expenditure	31.3	6.3	3.9	33.7	7.0	0.2	0.2	0.0	41.0
Expense	30.0	4.0	3.9	30.1	5.4	0.2	0.2	0.0	35.9
Investment in non-financial assets	1.2	2.3	0.0	3.5	1.6	0.0	0.0	0.0	5.1
Net operating balance	0.3	2.4	0.0	2.7	1.5	-0.2	0.1	0.0	4.0
Net lending/borrowing	**-1.0**	**0.1**	**0.0**	**-0.9**	**-0.1**	**-0.2**	**0.1**	**0.0**	**-1.1**
Stocks									
Assets	**65.7**	**0.4**	**0.5**	**65.5**	**28.8**	**1.2**	**24.2**	**-23.8**	**96.0**
Nonfinancial	33.0	n.r.	0.0	33.0	20.2	0.0	0.2	0.0	**53.4**
Financial	32.7	0.4	0.5	32.5	8.7	1.2	24.0	-23.8	42.6
Loans	6.2			6.2				-4.2	
Equity	14.9			14.9				-14.9	
Liabilities	**48.6**	**0.7**	**0.5**	**48.8**	**28.8**	**1.2**	**24.2**	**-23.8**	**79.3**
Liabilities, other than equity and pensions	45.1	0.7	0.5	45.2	17.1	1.2	21.1	-8.9	**75.7**
Cash in circulation							19.5		
Public servants pensions	3.6		0.0	3.6	0.0	0.0	0.0	0.0	3.6
Equity	0.0	0.0	0.0	0.0	11.7	0.1	3.1	-14.9	**0.0**
Net worth	***17.1***	***-0.3***	***0.0***	**16.8**	***0.0***	***0.0***	***0.0***	***0.0***	**16.8**
Net financial worth	***-15.9***	***-0.3***	***0.0***	**-16.3**	***-20.2***	***0.0***	***-0.2***	***0.0***	**-36.6**

Source: Government Finance Statistics, Georgia Annual Financial Statistics 2015, Move, and IMF staff estimates.
Note: Expenditure includes expenses plus net investment (acquisitions less disposals) in nonfinancial assets. The above figures do not include foreign exchange gains and losses from PCs and the central bank, estimated to be -1.3 and +2.2 percent of GDP respectively, as reported in their financial statements.

I. FISCAL REPORTING

1. **Fiscal reports should provide a comprehensive, timely, reliable, comparable, and accessible summary of the government's financial performance, financial position, and cash flows.** This chapter assesses the quality of Georgia's fiscal reporting practices against the standards set by the IMF's Fiscal Transparency Code for the following dimensions:

- Coverage of public sector institutions, stocks, and flows;
- Frequency and timeliness of reporting;
- Quality, accessibility, and comparability of fiscal reports; and
- Reliability and integrity of reported fiscal data.

2. **Georgia has taken substantial steps over the past decade to improve government accounting and fiscal statistics compilation.** Some important advancements include the:

- Adoption in 2008 of some of the classifications of the Government Finance Statistics Manual 2001 (GFSM 2001) on a cash basis as the economic budget classification;
- Publication of more frequent reports on budget execution on a GFSM 2001 cash basis; and
- Preparation and publication of annual financial statements, which includes accrual flows and a balance sheet for the central government, as part of accounting reforms due to be completed in 2020.

3. **While Georgia publishes a large volume of fiscal data, reporting is somewhat fragmented.** Fiscal data differ in terms of coverage of institutions, flows and stocks, and some reports are prepared on different accounting bases. While it is common for reports to vary where they are produced for different purposes, this can create gaps and add to complexity. The most significant difference relates to the treatment of LEPL that collect own revenues to supplement grants provided by the government. These own-source revenues and related expenditures, which account for around 4 percent of GDP, are not consolidated in most fiscal and statistical reports. As LEPL can carry over unused balances, the exclusion of these transactions can impact on the fiscal balance, in addition to aggregate revenue and expenditure. Georgia's main summary fiscal reports, presented in Table 1.1. comprise:

- **Monthly and quarterly budget execution reports**, produced by the Treasury Service under the Move and the BD of the Move, respectively, present cash-based outturns for revenue, expenditure, and financing of central government units on the same basis as the budget, but do not consolidate own-source revenues and related expenditures of LEPL, which are reported in a separate chapter of the report;
- **Annual budget execution reports**, produced by the BD, present cash-based outturns for revenue, expenditure, and financing of central government units on the same basis as the budget. As with the monthly and quarterly reports, information about the operations of LEPL is presented in a separate chapter, but is not consolidated;

- **Monthly fiscal statistics**, produced by the Macroeconomic Analysis and Forecasting Department (MAFD) of the Move, present cash-based outturns for revenue, expenditure, and financing, compiled on a GFSM 2001 cash basis for general government budgetary units, which do not include LEPL;
- **Quarterly fiscal statistics**, produced by the MAFD, present cash-based outturns for revenue, expenditure and financing, as well as gross debt, compiled on a GFSM 2001 cash basis for the general government budgetary units, and do not include LEPL;
- **Public sector debt bulletins**, produced by the Public Debt and External Financing Department (PDEFD) of the Move, present the stock of domestic and external borrowing, guarantees, and historical debt obligations (see principle 3.2.2) of the central government; and
- **Annual financial statements**, produced by the Treasury Service, currently on a modified cash basis until full compliance with IPSASs currently planned for 2020, present outturns for cash revenues and expenditures as well as some accrued expenses, for the whole of the central government (including LEPL) and includes a balance sheet for the central government including most financial liabilities and assets, as well as information on nonfinancial assets.

Table 1.1. Georgia: List of Fiscal Reports

REPORT	Author	COVERAGE				ACCOUNTING		PUBLICATION	
		Inst.	LEPL	Flows	Stocks	Basis	Class.	Freq.	Lag
IN-YEAR REPORTS									
Daily Operation Reports	Treasury	CG	Not consolidated	R, E	…	Cash	Nat.	Daily	1d
Monthly Budget Execution Tables	Treasury	CG	Not consolidated	R, E, Fin	…	Cash	Nat.	Monthly	20d
Quarterly Budget Execution Reports	BD	CG	Not consolidated	R, E, Fin	…	Cash	Nat.	Quarterly	30d
Monthly Debt Statistics	PDEFD	GG	..	…	Debt	…	Nat.	Monthly	n.a.
Public Debt Statistics Bulletin	PDEFD	…	..	…	Debt	…	PSDS	Semi-annual	3m
Government On-lending Data	PDEFD	CG	…	…	Loans	…	Nat.	n.a.	n.a.
Monthly Government Financial Statistics (GFS)	MAFD	GG	Not consolidated	R, E, Fin	…	Cash	GFSM 2001	Quarterly	30d
Quarterly Government Financial Statistics (GFS)	MAFD	GG	Not consolidated	R, E, Fin	Debt	Cash	GFSM 2001	Monthly	30d
YEAR-END REPORTS									
Annual Budget Execution Report	BD	CG	Not consolidated	R, E, Fin	…	Cash	Nat.	Annual	3m
Annual Financial Statements	Treasury	CG	Consolidated	R, E	L, FA, NFA	Mod-cash	Nat.	Annual	6m
Government Financial Statistics (GFS)	MAFD	GG	Not consolidated	R, E	A, L	Cash	GFSM 2001	Annual	6m

Note: CG: Central Government; LG: Local Government; GG: General Government; NFPS: Nonfinancial Public Sector; PS: Public Sector; LEPL: refers only to consolidation of LEPL own-source funding and related expenditures; R: Revenue; E: Expenditure; Fin: Financing; NFA: Nonfinancial Assets; FA: Financial Assets; L: Liabilities.

1.1. Coverage of Fiscal Reports

1.1.1. Coverage of Institutions (Basic)

4. Georgia's public sector comprises 2,284 separate units of various legal forms. As shown in Table 1.2 these are distributed in the following subsectors:

- **Central government**, which comprises 731 units, including 235 central government budgetary units, including the central government administration and ministries, and 496 LEPL that are controlled by central government units.
- **Local government**, which comprises 1,285 units, including 78 municipalities, 2 autonomous regions, and other government bodies, including those LEPL that are controlled by municipalities.
- **Public nonfinancial corporations**, which comprise around 266 corporations, of which 175 are controlled by central government units and 91 by local government units.
- **Public financial corporations**, which comprise the Partnership Fund[1] and the NBG.

Table 1.2. Georgia: Public Sector Institutions and Finances, 2015
(Percent of GDP, unless otherwise stated)

	Number of Entities	Revenue	Expenditure	Balance	Intra-PS Expenditure	End-Point Expenditure	Percent of Total
Public Sector	**2,284**	**39.9**	**41.0**	**-1.1**	**0.0**	**41.0**	**100.0**
General Government	**2,016**	**32.8**	**33.7**	**-0.9**	**0.0**	**33.6**	**82.0**
Central Government	**731**	**30.3**	**31.3**	**-1.0**	**3.9**	**27.3**	**66.7**
Budgetary central government	235	25.9	27.1	-1.2	9.1	18.0	44.0
LEPL	496	9.5	9.3	0.2	0.0	9.3	22.7
Local Government	**1,285**	**6.4**	**6.3**	**0.1**	**0.0**	**6.3**	**15.4**
Tbilisi		2.7	2.6	0.1	0.0	2.6	6.3
Adjara AR		0.6	0.4	0.2	0.0	0.4	0.9
Batumi		0.3	0.4	-0.1	0.0	0.4	0.9
Public Corporations	**268**	**7.1**	**7.4**	**-0.3**	**0.0**	**7.4**	**18.0**
Nonfinancial public corporations	266	6.8	7.0	-0.1	0.0	6.9	16.9
JSC Georgian Railway		2.0	2.2	-0.2	0.0	2.2	5.4
JSC Georgian Oil and Gas Corporation		1.7	1.5	0.1	0.0	1.5	3.8
LLC Marabda-Kartsakhi Railway		0.0	1.0	-1.0	0.0	1.0	2.6
JSC ESCO		0.7	0.7	0.0	0.0	0.7	1.8
JSC State Electric System of Georgia		0.4	0.7	-0.4	0.0	0.7	1.8
Partnership Fund	1	0.0	0.2	-0.2	0.0	0.2	0.6
Central Bank	1	0.3	0.2	0.1	0.0	0.2	0.4

Source: Government Finance Statistics, central government annual financial statements, 2015, and IMF staff estimates.

Note: Expenditure includes expenses plus net investment (acquisitions less disposals) in nonfinancial assets. End-point expenditure refers to spending that is ultimately undertaken by that entity, rather than being transferred to another. Of LEPL expenditure of 9.3 percent of GDP, 4.2 percent of GDP is funded from own-source revenues.

[1] The Partnership Fund (see principle 2.1.1) is classified, by the authorities, as a public financial corporation. While it undoubtedly a public sector unit, questions remain on its classification as a general government unit or as a financial public corporation. The Partnership Fund is a passive owner of some of its assets, and it is not yet clear whether all of its investments will turn out to have been made on a commercial basis as many of them are yet to pass beyond the construction phase.

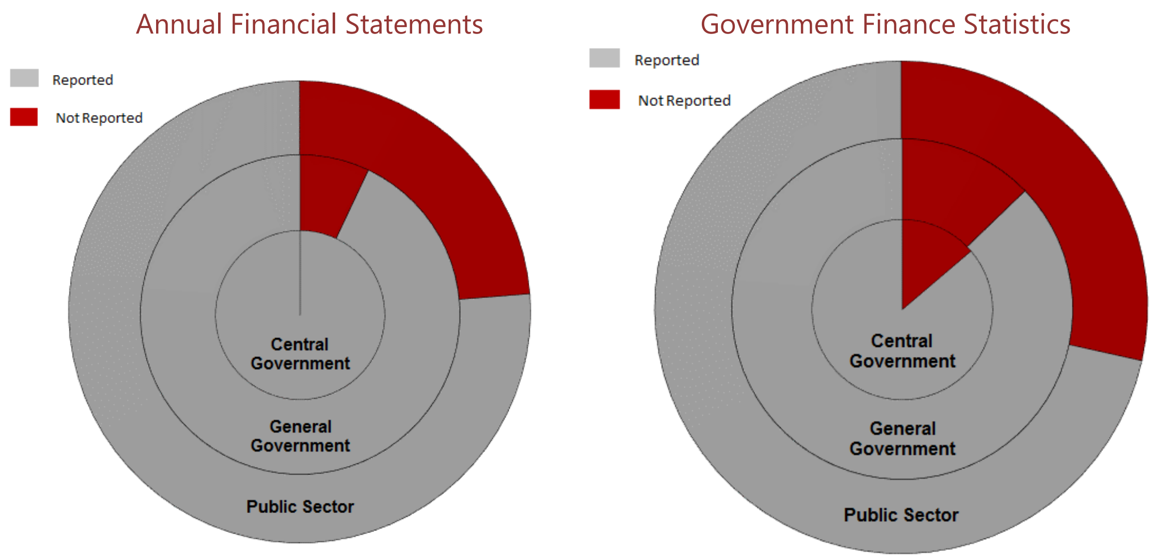
5. Georgia's public sector expenditures accounted for 41 percent of GDP in 2015. Table 1.2 summarizes the distribution of public resources across the different subsectors of the public sector in 2015 and shows that:

- **General government** expenditure accounted for 33.6 percent of GDP, of which around 80 percent was spent by the central government and 20 percent through local governments. Expenditures of LEPL controlled by central government totaled 9.3 percent of GDP (around half of which is financed through own-source revenues); and
- **Public corporation** expenditures accounted for a further 7.4 percent of GDP, the vast majority of which was spent by nonfinancial corporations.

6. There is no single report that provides complete coverage of either general government or public sector activity. Statistical reports present fiscal data for the consolidated general government sector (central and local governments), but these do not capture the self-funded activities of LEPL, which represent around 12 percent of general government expenditure (or 4.2 percent of GDP). While the central government annual financial statements consolidate activity for central government units, including LEPL, they do not cover the activities of local governments.[2] There is no reporting on the consolidated public sector, with PCs presenting the largest gap. As shown in Figure 1.1, the central government annual financial statements cover around 76 of total public sector expenditure, while the government finance statistics reports cover 72 percent.

Figure 1.1. Georgia: Coverage of Public Sector Institutions in Fiscal Reports

(Percent of expenditure at each level)



Source: Georgian authorities and IMF staff estimates.
Note: "Not Reported" refers to expenditures of units not consolidated in summary fiscal reports.

[2] As municipalities are not controlled entities of central government in terms of IPSASs, they are not formally consolidated into the financial statements.

7. Expanding the institutional coverage of Georgia's fiscal reports to the entire public sector would have a substantial impact on many of the fiscal aggregates, but limited impact on the fiscal deficit or surplus. The reported general government deficit was 1.1 percent of GDP in 2015. Including LEPL under the control of central government would add around 4.4 percent of GDP to revenue and 4.2 percent of GDP to expenditure, which would have the effect of reducing the size of the reported deficit for the general government sector by 0.2 percent of GDP, to 0.9 percent of GDP. Expanding the coverage to the public sector by including PCs, would add 7.1 percent of GDP to revenue and 7.4 percent of GDP to expenditure, resulting in an overall public sector deficit of 1.1 percent of GDP.

1.1.2. Coverage of Stocks (Good)

8. A balance sheet for the central government is published on an annual basis, but is not complete. The government began publishing a central government balance sheet in 2012, but it is still a work in progress and is not expected to be complete until 2020. The balance sheet includes estimates for most financial and nonfinancial assets and liabilities. The balance sheet also provides a detailed breakdown of the reported central government assets and liabilities.

9. However, the balance sheet likely understates the value of some central government assets and liabilities, and excludes those held by local governments and PCs (Figure 1.2). The main gaps reflect the following:

- The central government balance sheet does not include government estimates for historical debts recognized by the government in the Law on Public Debt, annual budget, and other debt reports, the inclusion of which could increase liabilities by Georgian Lari (GEL) 672 million (2.1 percent of GDP), although there is considerable uncertainty around this estimate (see principle 3.2.2);
- Although there is no general civil servant pension scheme in Georgia, certain eligible groups of the civil service, such as law enforcement and military personnel, are entitled to a supplement in addition to the general age pension. The accrued value of these special category civil service pensions—estimated to be around 3.6 percent of GDP[3]— are not included in the central government balance sheet. This liability might be considerably higher when recognized, as it is based on a flat-rate pension that is not indexed under current policies, although the practice has been to increase it over time;
- Central government equity holdings in PCs are undervalued by around 9.2 percent of GDP, as they are recorded based on original share capital and not the current net worth of those units as reported in their financial statements;
- Local governments have an estimated 0.4 percent of GDP in financial assets and 0.1 percent of GDP in loans that are not reported; and

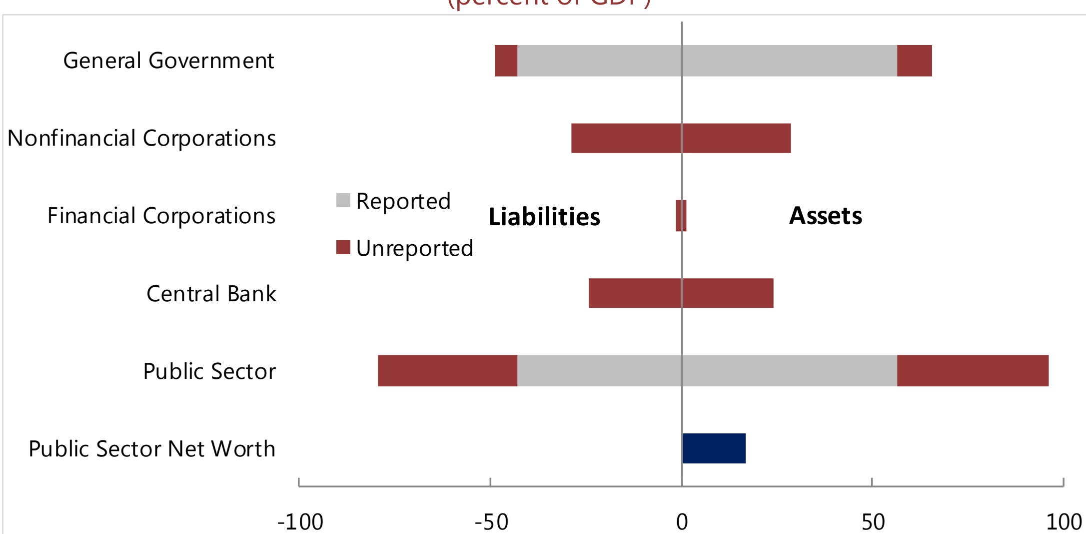
[3] This is a preliminary estimate based on calculations of IMF staff.

- PCs (including the NBG) have 54 percent of GDP in assets and 39 percent of GDP in non-equity liabilities, of which 9 percent of GDP in liabilities are owed to the central government and reported on the central government's balance sheet.

10. Addressing these gaps and expanding the balance sheet to the public sector would provide a more comprehensive view of public finances. As shown in Table 0.2 and Figure 1.2, consolidated public sector asset holdings and liabilities are estimated to have been around 96 percent of GDP and 79 percent of GDP, respectively, in 2015. Public sector net worth and net financial worth are estimated to have been 16.8 percent of GDP and -36.6 percent of GDP. This is similar to central government net worth of 13.6 percent of GDP reported in the central government annual financial statements, but is considerably larger in terms of gross assets and liabilities, and net financial liabilities. The main components include:

- **Nonfinancial assets** of 53.4 percent of GDP, which primarily comprise building and structures, plant and equipment and public land holdings;
- **Financial assets** of 42.6 percent of GDP, the bulk of which comprise assets of the central bank and PCs; and
- **Liabilities** of 79.3 percent of GDP, which primarily comprise debt securities and other borrowing, and cash in circulation (which is a liability of the central bank).

Figure 1.2. Georgia: Public Sector Balance Sheet Coverage in Fiscal Reports, 2015
(percent of GDP)



Source: IMF staff estimates, Georgian authorities.

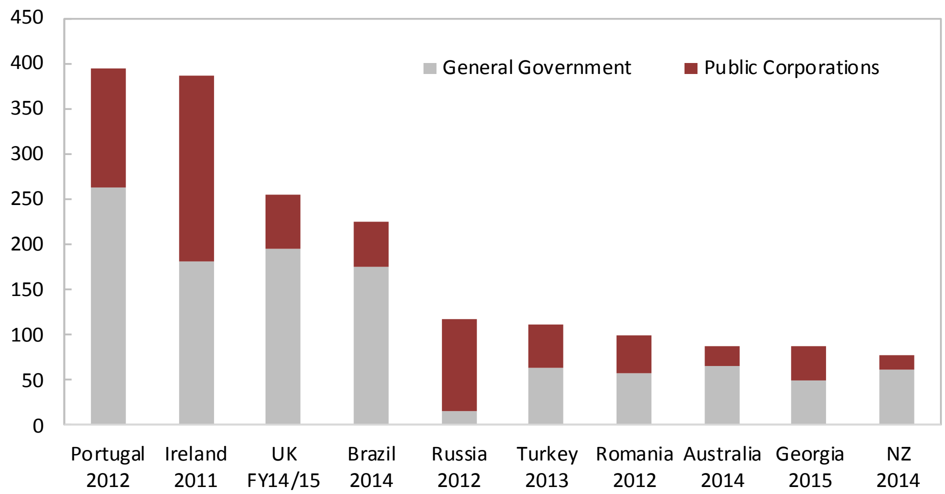
11. There remains substantial uncertainty around the value of public sector nonfinancial assets. Local government nonfinancial assets are not reported despite the fact they are responsible for about half of general government investment. In addition, there is limited data on public infrastructure assets constructed prior to the 1990s, and many of the fixed assets on the central government balance sheet are valued at historic cost with adjustment for depreciation, and have not been revalued. The National Agency of State Property under the

MESD is in the process of completing an inventory of central government assets, but plans for their valuation are not yet established.

12. Georgia's net worth sits in the mid-range of other countries and gross liabilities are relatively low (Figure 1.3 and 1.4). This in part reflects the fact that Georgia does not have any state-owned banks and does not have a defined civil servant pension scheme (other than for certain categories of employees). For Georgia, the costs of civil servant pensions, along with those of the general population, are reflected as long-term fiscal pressures rather than balance sheet liabilities (see principle 3.1.3).

Figure 1.3. Public Sector Gross Liabilities in Selected Countries

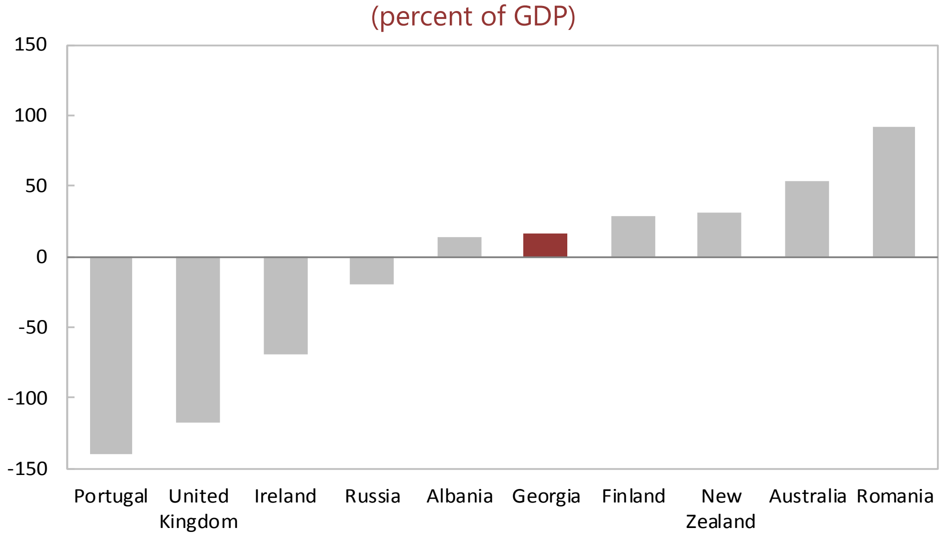
(Percent of GDP)



Source: IMF staff estimates, National Financial Statements for countries (excluding PPP liabilities).

Figure 1.4. Public Sector Net Worth in Selected Countries

(percent of GDP)



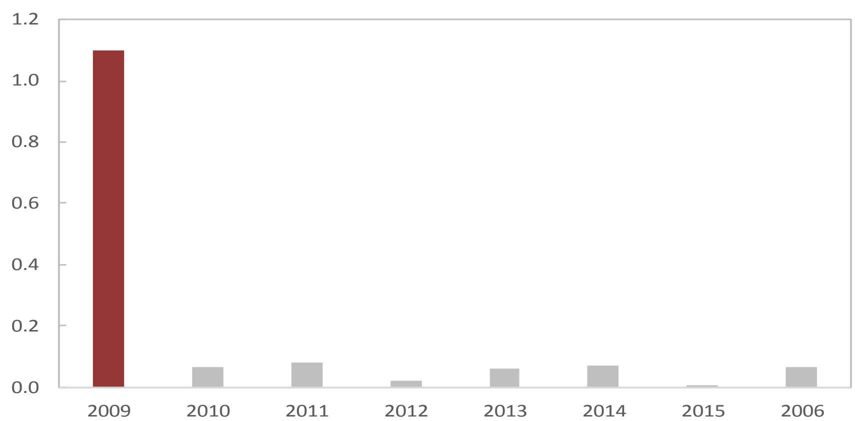
Source: IMF staff estimates, Fiscal Transparency Evaluations.

1.1.3. Coverage of Flows (Basic)

13. The central government's consolidated annual financial statements provide the most comprehensive picture of central government flows. They include tax revenues on a cash-basis and expenses on an accrued basis, but some accrual flows are not yet captured. For example, they do not cover the net annual accrual of special pensions for a defined group of civil servants and PPPs.

14. The central government budget execution reports systematically understate cash flows of central government entities, although by a small margin over recent years. Cash payments associated with previous years' invoices are recorded below-the-line as a decrease in liabilities. Because the budget classification is cash-based, this treatment means the payments are never recorded in the total expenditure of the central government in the budget or execution reports, since they are not recognized when the obligation to pay arises or when the cash payment is made. This is not a cash-accrual adjustment, but a permanent understatement of expenditure. The amounts have been small over recent years, averaging around 0.1 percent of GDP, but were as high as 1.1 percent of GDP in 2009 (Figure 1.5).[4] The central government annual financial statements, in contrast, record expenditures when they accrue.

Figure 1.5. Georgia: Payment of Prior Period Invoices
(percent of GDP)



Source: MoF.
Note: 2016 figure is based on first 11 months of the year.

1.1.4 Coverage of Tax Expenditures (Not Met)

15. Georgia does not publish regular estimates of the revenue loss from tax expenditures. Estimates of individual tax expenditures may be released publicly at the time of

[4] This figure may be understated. The annual financial statements report total payables of 1.1 percent of GDP, which is larger than the reported gross payment of payables. This implies a stock of payables that are growing more overdue.

presentation of tax laws to parliament, but there is no systematic reporting of the overall costs of existing and new tax expenditures in budget documents or fiscal reports.

16. Significant tax exemptions are provided for value-added tax (VAT), but there is uncertainty around their size. Exemptions include zero-rating VAT for certain goods and sectors of the economy, reduced rate VAT and the tax privileges of free industrial zones. While there are currently no formal estimates of the size of these tax expenditures, one study, which was based on highly simplified assumptions and is not complete, estimated the revenue loss from VAT and profit tax exemptions at 5.4 percent of GDP.[5]

1.2. Frequency and Timeliness of Fiscal Reporting

1.2.1. Frequency of In-Year Fiscal Reporting (Advanced)

17. Budget execution reports provide a detailed and timely picture of unfolding fiscal developments. The monthly cash-based budget execution reports cover central government budget execution and general government revenues, and are published within 20 days of the end of month. More detailed quarterly execution reports are also published, within one month of the end of each quarter. These reports provide the most comprehensive evaluation of budget execution, with information on expenditure outturns by administrative, functional, program, and economic classification, with some discussion on their performance. In addition to these reports operation reports provide daily updates on central budgetary expenditure and general government revenue performance.

1.2.2 Timeliness of Annual Financial Statements (Advanced)

18. Annual budget execution reports and final annual consolidated financial statements, for central government, are published before or around the end of June the following year. The Treasury has published the annual financial statements since 2012. These statements comprise: a balance sheet, a statement of financial performance, a cash flow statement, a statement of changes in equity, and a statement reconciling the budget with actuals. Attached to the financial statements are annexes disclosing nonfinancial assets and explanatory notes.

19. The annual financial statements are not yet fully developed and are not audited. The accounting framework underlying these statements is modified cash. IPSAS-based standards have been introduced progressively since 2012, and it is intended that they will be based entirely on IPSASs from 2020. The SAO does not audit the consolidated central government financial statements at present although it does audit most of the financial statements of line ministries and their subordinate organizations. The SAO intends to audit the consolidated central government financial statements when they are complete, planned to be for the 2020 year. Until

[5] Source: ECOPA, *Tax Expenditure Analysis in Georgia*, 2014. The IMF is currently undertaking tax-gap analysis of Georgia, including estimating the size of tax expenditures under existing policies. The methodology will be shared with the authorities once the analysis has been completed.

the statements are fully or nearly fully IPSAS compliant, and are audited credibly according to international standards on auditing, they will continue to be used only partially for analysis and risk assessment. Auditing of the annual financial statements involves significant effort and will take some time, often as long as three months. The preparation of the financial statements will therefore need to done in a shorter timespan in future to allow time for their auditing, in order to continue to meet the advanced standard under the Fiscal Transparency Code.

1.3. Quality of Fiscal Reports

1.3.1. Classification (Advanced)

20. Fiscal reports show detailed information on spending by administrative, economic, and functional classification, as well as by program. Expenditure data are published by economic classification of expense in line with the IMF's GFSM 2001 and by function according to the United Nations' Classification of Functions of Government. Revenue data are classified according to the GFSM 2001 revenue classification by type (taxes, grants and other revenue, and with a further breakdown provided in statistical reports). Spending is also presented by program and subprograms in a detailed annex to the budget execution reports. Expenditure classifications are broadly consistent across fiscal reports.

1.3.2. Internal Consistency (Basic)

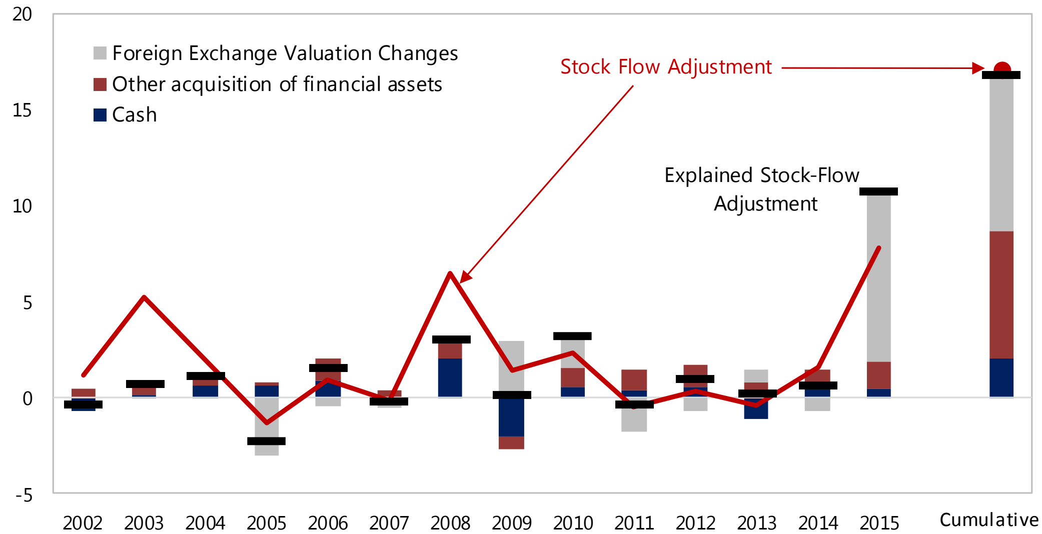
21. Georgia reliably publishes one of the three internal consistency checks on fiscal data required under the Code. The statistical reports provide a full reconciliation between the above-the-line fiscal deficit and the below-the-line financing, detailing the movement in cash, acquisitions of other financial assets and incurrence of financial liabilities. These are provided in gross terms, and net out so that net financing needs match the fiscal balance. There is reporting on the holders of government debt that can be compared with debt issued, but this information is spread across a range of documents, including the public debt bulletin and the central bank statistics, with no formal reconciliation. In addition, historical debt is a challenge for reconciliation, as there are no reliable records of who the holders of the debt are (see principle 3.2.2 for further discussion).

22. There is no reconciliation between the increase in debt and debt issued in any given year—the stock flow adjustment—despite large differences between them. This is a major shortcoming, as debt has increased by 28.6 percent of 2015 GDP since 2002, yet cumulative financing needs to fund budget deficits have been 11.5 percent of 2015 GDP over the same period (Figure 1.6).[6] This implies a stock flow adjustment of 17.1 percent of 2015 GDP—that is, the increase in debt which is due to reasons other than budget deficits. Some of the causes of this difference can be gleaned from reported data. Increases in cash deposits and investments in equities and loans account for 2.1 and 6.6 percent of 2015 GDP. These are below-the-line

[6] These figures represent the nominal figures divided by 2015 GDP, rather than the change in debt to GDP ratio. For example, in 2002 debt was GEL 4.3 billion, increasing to GEL 13.2 billion in 2015, an increase of GEL 9.1 billion, equivalent to 28.6 percent of 2015 GDP.

financing transactions that increase borrowing, but not the deficit. The other key factor is the impact of the depreciation of the Lari, particularly in 2015, on foreign currency denominated debt. This accounts for an additional 8.2 percent of GDP increase in the value of debt, meaning that almost all of the stock-flow adjustment can be accounted for.

Figure 1.6. Georgia: Stock-flow Adjustment, 2002 to 2015
(Percent of GDP)



Source: IMF staff estimates, Georgian authorities.

1.3.3 Historical Revisions (Not Met)

23. Fiscal statistics are not revised. For submissions to the IMF's Government Finance Statistics Yearbook, for example, the government submits only the latest year in each submission; no revisions are made. The recommendations of this fiscal transparency evaluation would result in meaningful revisions to the GFS data, which, if adopted by the government, should be disclosed.

1.4. Integrity of Fiscal Reports

1.4.1. Statistical Integrity (Good)

24. Fiscal statistics are compiled and disseminated by in the MoF on a GFSM 2001 basis. The MAFD is responsible for collecting and consolidating information in accordance with GFSM 2001. The statistical reports are published on the MoF's website. The National Statistics office of Georgia also publishes the GFS tables provided by the MoF on its website. The law of Georgia on Official Statistics defines the principles for statistical compilation, including professional independence, and is applicable to the compilation of GFS data. Further, GFS compilers may not change any of the source data unless such changes are the result of revisions made during the process of compiling the GFS.

1.4.2 External Audit (Basic)

25. The SAO does not audit the central government annual financial statements, but publishes an assessment of the central government's annual budget execution report. The SAO's assessment includes commentary on the reliability of some of the financial data in the budget execution report. This assessment is informed by financial audits it conducts of ministries and their subordinate LEPL, which according to the SAO, accounted for around 90 percent of all central government expenditures in 2015. However, the assessments of reliability of data in the budget execution report are not financial audits. The SAO intends to commence financial audits of the central government's consolidated annual financial statements, according to international standards on auditing from the 2020 year, when the statements are in full compliance with IPSASs.

26. The lack of any independent complete verification of the central government's consolidated statements is a major deficiency in assuring the integrity of Georgia's public finances. The SAO is able to issue conclusions on the consolidated central government annual budget execution reports that are, in substance, the same as financial audits (that is, that the reports are, in all material respects, true and fair reflections of the consolidated central government's finances in terms of the defined cash accounting standards, subject to stated qualifications). In order for the SAO to be able to issue explicit conclusions of this nature, however, there would need to be some clarification of the cash accounting standards. In addition, adjustments to auditing practices would be required to enable the Treasury to make corrections in response to preliminary conclusions, so that any qualifications in the final conclusion published by the SAO are minimized. It would be desirable for the SAO to begin issuing such conclusions as soon as practicable.

1.4.3 Comparability of Fiscal Data (Basic)

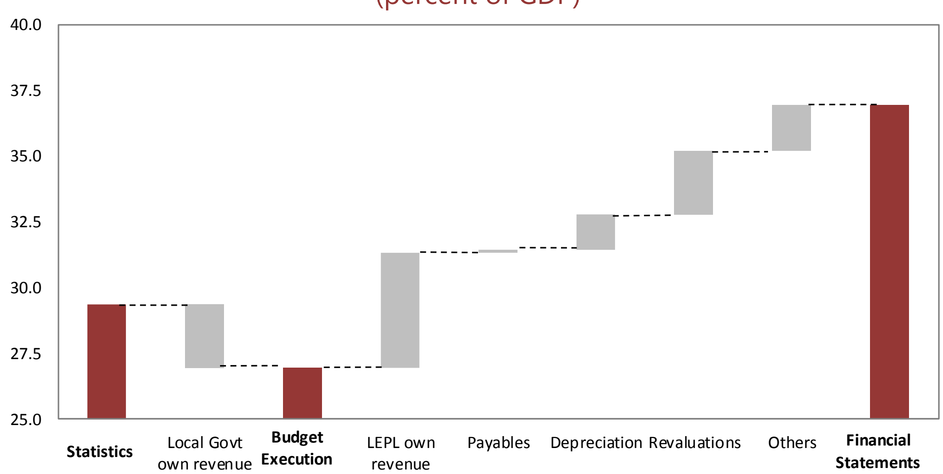
27. Fiscal reports provide a comparison of outturns to the approved budget, but there are large differences in fiscal data across reports for which no reconciliation is provided. The budget execution reports provide information on the budget, adjusted budget, and final outturn for the fiscal aggregates and detailed expenditure and revenue items. This provides clear information on how the government has performed in executing the budget. However, different coverage and different recording bases lead to large differences between the budget execution reports, the statistical reports and the annual financial statements. While it is normal for reports produced for different purposes to differ from one another; these differences should be made clear, using a reconciliation table to explain the reasons for them.

28. The differences in aggregate expenditure across reports are large. For 2015, there was a 10 percent of GDP difference in reported central government expenditure between the budget execution report and annual financial statements (Figure 1.7). The three key reports are:

- The **annual budget execution report**, which reports total expenditure of GEL 8.6 billion (27 percent of GDP) on a cash basis for the central government, but not municipalities or LEPL, although it does include transfers to these sectors;
- The **government financial statistics**, which reports total expenditure of GEL 9.3 billion (29.4 percent of GDP), on a cash basis for the general government sector (central plus local governments), but not including LEPL expenditure. Transfers to the municipalities are consolidated; and
- The **annual financial statements**, which reports total expenses and investment expenditures on an accrual basis of GEL 11.7 billion (37 percent of GDP) for the consolidated central government sector, including LEPL, but not municipalities. Transfers to LEPL are consolidated.

29. Much of these differences are likely to be explained by differences in coverage and classification. For example, information contained within the different financial reports can explain differences in expenditure amounting to 8 percent of GDP. This primarily relates to the different treatment of LEPL expenditures and reported cash and accrual adjustments. Some of the remaining difference, may also be due to differences in classification of certain expenditures, such as the accounting for free goods received as expenditures (e.g., medical supplies) in the annual financial statement. A full reconciliation is necessary to identify whether accounting and coverage differences explain the full discrepancy across reports, and differences should be made transparent within the reports.

Figure 1.7. Georgia: Reconciliation of Expenditure Between Fiscal Reports, 2015
(percent of GDP)



Source: MoF GFS, Budget Execution and Financial Statements.

1.5 Recommendations

30. Georgia's fiscal reports meet good or advanced practices in a number of areas. The assessment against the Code, summarized in Table 1.3, shows that monthly and quarterly fiscal and statistical reports are published in a timely manner and provide detailed information on the use of public resources in accordance with good international classifications. In addition, the central government's annual financial statements, though still a work in progress, provide a detailed central government balance sheet.

31. However, there is a need to further enhance the coverage, quality, and integrity of fiscal and statistical reports. No individual fiscal report provides a complete picture of general government activity, while some cash-based reports are not accurately capturing all central government transactions. Differences between fiscal aggregates within and across reports—which are not themselves a problem and can be largely reconciled—are nevertheless sizeable and should be explained within reports. The assessment also shows that there is no independent complete verification of the central government's consolidated financial statements or the fiscal statistics. Furthermore, tax expenditures, which appear large by international standards, could be more effectively monitored and managed.

32. Based on the above assessment, the evaluation highlights the following priorities for improving the transparency of fiscal reporting:

- **Recommendation 1.1: Expand the institutional coverage of fiscal and statistical reports.**
    a. Include all LEPL operations in the GFS reports; and
    b. Extend accounting reforms to local government and produce an annual consolidated general government sector financial report, covering all general government transactions and stocks according to the same IPSAS-based accounting framework.

- **Recommendation 1.2: Enhance the quality of fiscal reporting.**
    a. Record all payments in cash-based reports when those payments are made against the account of the budget classification item applied in the original budget approval;
    b. Progressively expand the coverage of the central government balance sheet to include all liabilities and better reflect the value of nonfinancial assets by completing the inventory of state assets and establishing a process for their valuation; and
    c. Publish reconciliations of changes in the stock of debt and net financing in fiscal reports and including a reconciliation table in the central government annual financial statements to reconcile differences between it and other fiscal reports.

- **Recommendation 1.3: Strengthen the integrity of fiscal reporting.** The SAO should provide a conclusion on the consolidated central government's annual budget execution report that mirrors the substance of a financial audit and commence financial audits of the consolidated central government annual financial statements as soon as practicable.

- **Recommendation 1.4: Enhance reporting and control over tax expenditures.** Publish an estimate of revenue foregone from tax expenditures in the budget documentation, including individual costs for the major measures as well as the groups and sectors benefiting from exemptions, and establish control over or budgetary limits for their size.

Table 1.3. Summary Evaluation: Fiscal Reporting

	Principle	Assessment	Importance	Recs
1.1.1	**Coverage of Institutions**	**Basic**: A consolidated GFS report for general government is published, but excludes LEPL and does not separately report finances of local governments.	**High**: LEPL with 4 percent of GDP in expenditure and PCs with 7 percent of GDP in expenses are outside the fiscal statistics.	**1.1**
1.1.2	**Coverage of Stocks**	**Good**: Fiscal reports cover financial assets and most financial liabilities, but coverage and valuation of nonfinancial assets is incomplete.	**Medium**: Unreported central government liabilities of 5.5 percent of GDP (incl. historic debt and special category pensions) and assets of 9.2 percent of GDP.	**1.2**
1.1.3	**Coverage of Flows**	**Basic**: Annual financial statements cover cash revenues and expenditures, and some accrued expenses. Cash based execution reports systematically understate expenditure.	**Medium**: Accrual expenses related to special category pensions are not reported, nor are payments related to previous period invoices, which were as high as 1 percent of GDP in 2009.	**1.2**
1.1.4	**Coverage of Tax Expenditures**	**Not met:** The estimated revenue loss from tax expenditures is not regularly published.	**Medium**: Revenue loss could be as high as 5½ percent of GDP.	**1.4**
1.2.1	**Frequency of In-Year Reporting**	**Advanced**: Cash-based budget execution reports are published monthly, with a lag of less than a month.	**Low**: The government has a strong grasp of unfolding budget execution over the course of the year.	
1.2.2	**Timeliness of Annual Financial Statements**	**Advanced**: Audited budget execution reports and unaudited annual financial statements are published within six months of the end of the financial year.	**Medium**: Incorporating recommended audit requirements will lengthen the timeframe for publication of the Annual Financial Statements.	
1.3.1	**Classification**	**Advanced**: Fiscal reports include administrative, functional, and economic classifications consistent with international standards, and program classifications.	**Low**: Detailed information on the use of public resources across classifications provide a sound information base for decision making.	
1.3.2	**Internal Consistency**	**Basic**: Fiscal reports include only one reconciliation of the budget balance and financing.	**High**: Difference between increase in debt and debt issued was 17 percent of GDP over 2002-2015.	**1.2**
1.3.3	**Historical Revisions**	**Not met**: Fiscal Statistics are not revised.	**Medium**: Revisions are valuable, but the priority is to prepare comprehensive and robust fiscal statistics.	
1.4.1	**Statistical Integrity**	**Good**: Fiscal statistics are compiled by a specific government unit and disseminated in accordance with international standards.	**Medium**: There are no independent checks on the fiscal statistics.	
1.4.2	**External Audit**	**Basic:** The SAO publishes an assessment of the annual budget execution report, but does not provide an overall opinion of its reliability in terms of cash accounting standards.	**High:** Financial audits of financial statements of individual budget units have identified a large number of discrepencies.	**1.3**
1.4.3	**Comparability of Fiscal Data**	**Basic**: Budget execution reports are prepared on the same basis as the budget.	**High**: Expenditure in annual financial statements and budget execution reports differ by 10 percent of GDP.	**1.2**

II. FISCAL FORECASTING AND BUDGETING

33. **Fiscal forecasts and budgets should provide a clear statement of the government's budgetary objectives and policy intentions, and comprehensive, timely, and credible projections of the evolution of the public finances.** This chapter assesses the quality of Georgia's fiscal forecasting and budgeting practices against the standards set by the four dimensions of the fiscal transparency code:

- The comprehensiveness of the budget and associated documentation;
- The orderliness and timeliness of the budget process;
- The policy orientation of budget documentation; and
- The credibility of the fiscal forecasts and budget proposals.

34. **Georgia's fiscal forecasts and budgets have become more comprehensive, forward-looking, and policy-orientated over the past decade.** The most important developments include:

- Extending the timeframe for budget planning with the introduction of a four-year medium term budget framework (MTBF) in 2004;
- Enactment of the Budget Code in 2009 prescribing the content and framework for publication of the main fiscal documents;
- Enshrining numerical fiscal objectives in the Economic Liberty Act (2011), which took effect from 2014;
- Introducing program budgeting in 2012; and
- Establishing an independent PBO in 2014.

Table 2.1. Georgia: Fiscal Forecasting and Budget Documents

Document	Agency	Coverage			Accounting		Publication Date
		Institutions	Flows	Stocks	Basis	Class	
Basic Data and Directions (BDD) Document	MoF	GG and subsectors	R, E	Debt	Cash	Nat	July (and subsequently revised)
Annual Budget and annexes	MoF	CG	R, E	Debt	Cash	Nat	Sep
Analysis of Macroeconomic Risks in the Fiscal Sector	MoF	GG and subsectors	R, E	Debt	Cash	Nat	Dec
Annual Report on State Budget Execution	MoF	CG	R, E	Debt	Cash	Nat	Jan

Note: GG: General Government; CG: Central Government; R: Revenue, E: Expenditure; Nat: National.

2.1. Comprehensiveness of Budget Documentation

2.1.1. Budget Unity (Basic)

35. Budget documentation presents details of all tax revenues and expenditures of central government units on a gross basis, but not all revenues and expenditures are incorporated into the fiscal aggregates. The annual budget incorporates domestic and external revenues, expenditures, and financing of budgetary central government units. Presentation of the main budget aggregates include transfers to LEPL, but not the own-source revenues of LEPL and related expenditures. The gross revenue and expenditures of LEPL are presented in an annex within the budget documentation and their spending is also reported in both the capital and program annexes. However, there is no presentation of the consolidated expenditure, revenue, and financing for budgetary central government units and LEPL combined (see principle 1.1.1 for a discussion of LEPL).

36. The proportion of central government revenues and expenditures that are not included in the main budget presentation is significant (Figure 2.1). The omission understates central government revenues and expenses, and potentially the central government fiscal balance. LEPL own source revenues were 4.4 percent of GDP in 2015 and their expenditures were 4.2 percent of GDP, giving a surplus of 0.2 percent of GDP which is not reported in the central government fiscal balance. Although there was a surplus in 2015, this might not always be the case.

37. Dividends received by the Partnership Fund from corporations it owns but does not actively manage are not reported in the budget, although these are currently small. The Partnership Fund is treated as a public financial corporation by the authorities. It is the legal owner of several commercial PCs transferred to it from direct government ownership and, has in the past, retained dividends from them to invest in infrastructure and other economic development opportunities. However, the Partnership Fund is a passive holder of these corporations, and is not their active and effective owner.[7] In accordance with GFSM 2001 and 2014, the equity in, and dividends from, those corporations should be recorded as assets and revenues of the central government. Dividends of PCs retained by the Partnership Fund were only 0.1 percent of GDP in 2015, reflecting weak financial performance.

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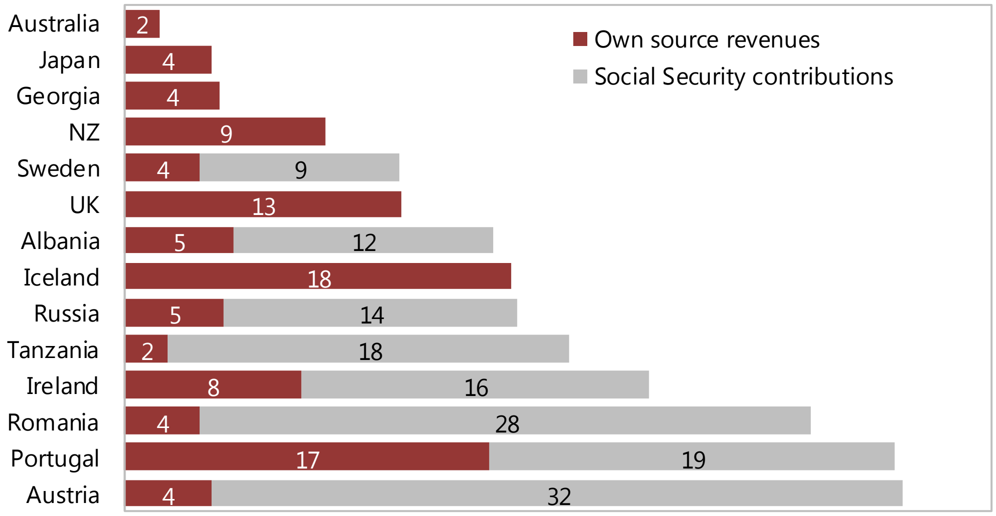
[7] The Partnership Fund is a hybrid entity. In its capacity as owner of GSE, ESCO, GR, and GOGC, it does not produce any output and does not execute any ownership functions, but is instead a passive holder of these assets. The case for treating it as a public corporation in its capacity as an investor, lender and borrower for new projects, is stronger. On the basis that these activities produce market output at economically significant prices, as is assumed in this report, the stocks and flows relating to this component should not be included in central government unit statistics. This treatment should be kept under review.

Figure 2.1. Own Source Revenues
(Percent of Total Revenues)



Source: IMF staff estimates.

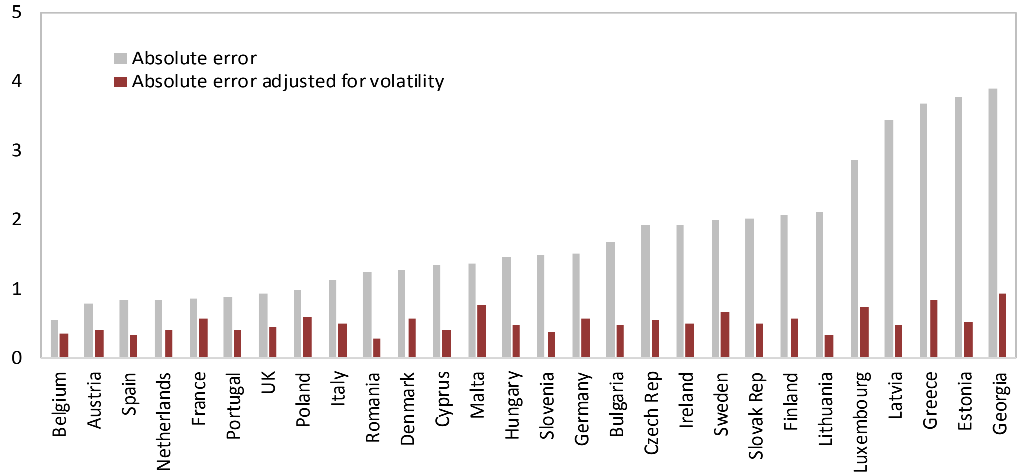
2.1.2. Macroeconomic Forecasts (Good)

38. The budget documentation includes four-year forecasts for the main macroeconomic variables, their components, and underlying assumptions. Forecasts are included in the BDD, which is presented to parliament in early July of each year. Forecasts are also presented, and updated if necessary, in subsequent iterations of the BDD which are presented alongside the second and third draft of the budget which are submitted to parliament at the end of October and end of November. The forecast tables include outcomes for the three previous years, and forecasts for the current year, the budget year and three following years. While the key assumptions underpinning the forecasts are disclosed in the BDD, the explanation accompanying them, including description of the key drivers and relationships, is limited.

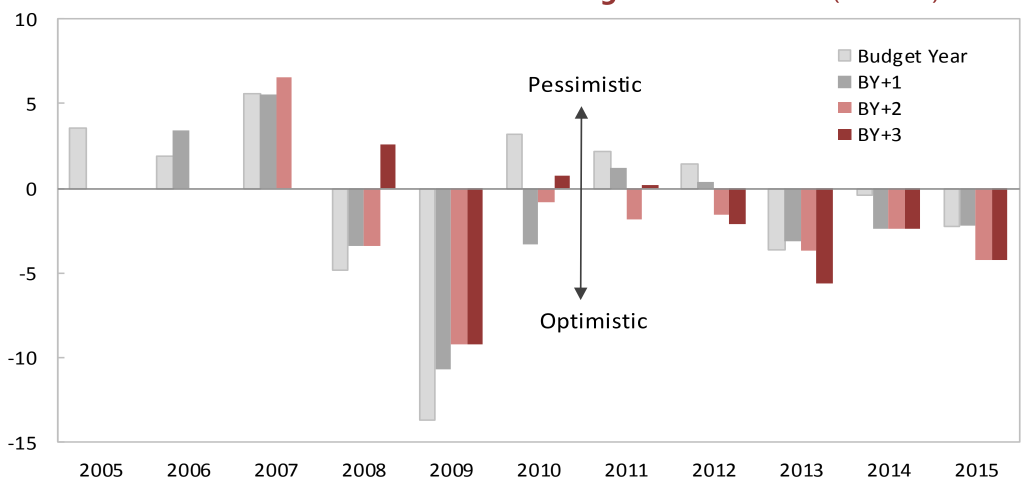
39. Over the past decade, medium term real GDP forecast errors have been substantial. Georgia's macroeconomic forecasts have been relatively inaccurate, with an average absolute real GDP forecast error of 3.9 percent. This in part reflects the fact that economic volatility has been high. Allowing for Georgia's highly volatile economy, the absolute forecast error is smaller, but still larger than other European economies (Figure 2.2, panel a).

Figure 2.2. Medium-Term Macroeconomic Forecast Error for Real GDP Growth (2005–15)

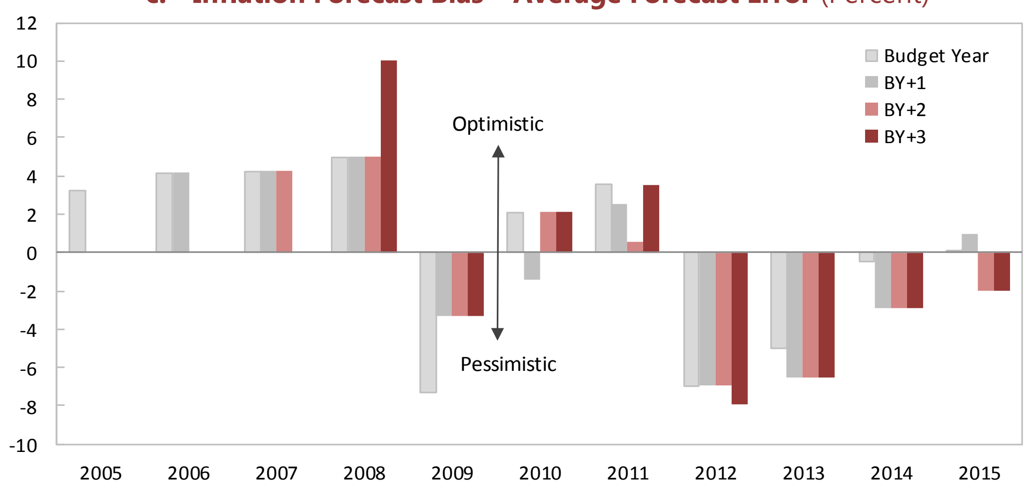
a. Real GDP Forecast Accuracy – Absolute Error for Budget Year (Percent)



b. Real GDP Forecast Bias – Average Forecast Error (Percent)



c. Inflation Forecast Bias – Average Forecast Error (Percent)



Source: MoF, IMF staff estimates.

Note: Volatility adjustment is average absolute forecast error divided by standard deviation of growth over the period.

40. In recent years, real GDP forecasts have had an optimistic bias, in contrast to the pre-2008–09 crisis periods (Figure 2.2, panel b). For the period before the crisis, real GDP growth outturns were consistently stronger than forecast. However, since then forecasts have predicted both a smaller downturn and stronger subsequent recovery in economic growth than actually materialized. For the third forecast year (BY+3), real GDP forecasts exceeded outcomes by an average of 2.5 percent over the sample period. Inflation during the pre-crisis period was generally higher than forecast, whereas inflation has been considerably lower than forecast in the post-crisis period (Figure 2.2, panel c). During the post-crisis period, the average absolute forecast error for budget year's inflation averaged -1.1 percentage points.

2.1.3. Medium-Term Budget Framework (Advanced)

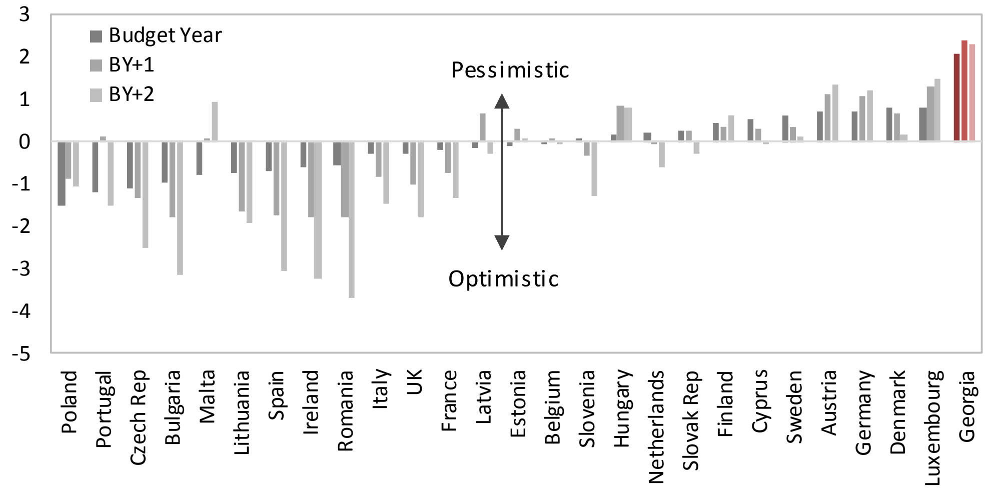
41. Georgia introduced a MTBF in 2004, based on four-year fiscal projections and expenditure plans. The BDD includes medium-term expenditure plans for central government entities by administrative unit as well as by program, and reports outcomes for the main budget indicators for the two preceding years. It also presents four-year plans for expenditure by economic classification at the aggregate level. The BDD and, the budget plans included in it, provide the basis for the draft budget. Medium-term budget plans are updated and presented alongside the draft budget law submitted to parliament in September, October, and November.

42. Actual fiscal developments have deviated substantially from the medium-term plans over the past decade, although with markedly different trends before and after the crisis (Figure 2.3). Revenues were consistently and significantly underestimated prior to 2009. This reflects a number of factors, including the practice employed at the time of adopting unambitious revenue targets as forecasts, improvements in tax administration, and the fact that macroeconomic outcomes exceeded forecasts during this period. This resulted in larger than expected revenues and sizeable increases in spending above original budget plans. Since then, revenue projections have been more realistic and expenditure outturns have been more in line with medium term plans. However, deviations have still occurred, with 2015 spending overshooting original budget plans in the 2014 and 2015 budgets by 0.6 and 0.4 percent of GDP. The budget balance has been slightly better than expected in recent years, with an average budget year forecast error of 0.6 percent of GDP for the period 2010–15.

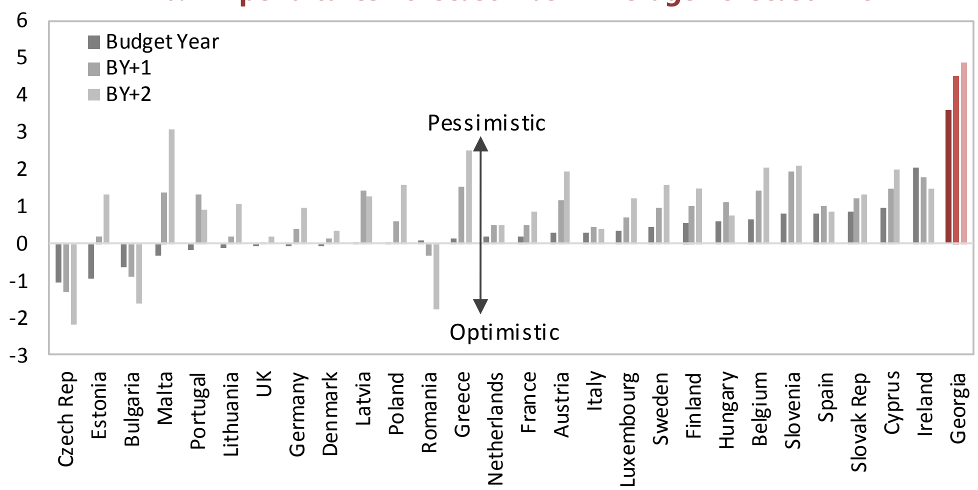
43. Although medium-term expenditure forecasts have improved considerably in recent years, forecast errors have been larger when policy lending is taken into account. Using a broader measure of expenditure that includes lending to other entities for policy purposes, which is classified below-the-line, can provide a more comprehensive picture of the government's policy activities. The average forecast errors have been larger for this measure of expenditure than for the traditional expenditure measure, with an average budget year forecast error of around 1.7 percent of GDP (Figure 2.4). This suggests that there has been a tendency for policy lending plans to be revised up during the budget year as well as across successive medium-term plans.

Figure 2.3. Average Medium-Term Fiscal Forecast Error, 2005–15, (Percent of GDP)

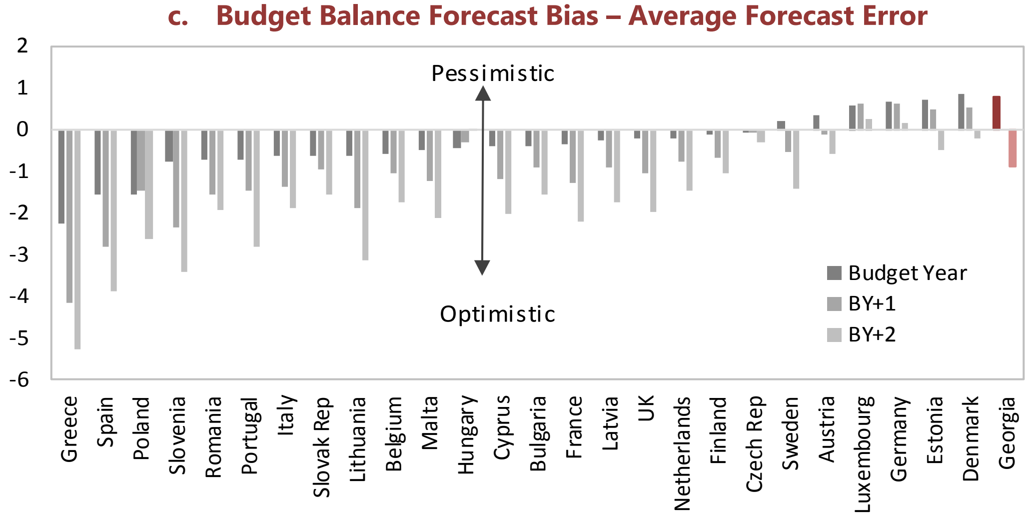
a. Revenue Forecast Bias – Average Forecast Error



b. Expenditures Forecast Bias – Average Forecast Error

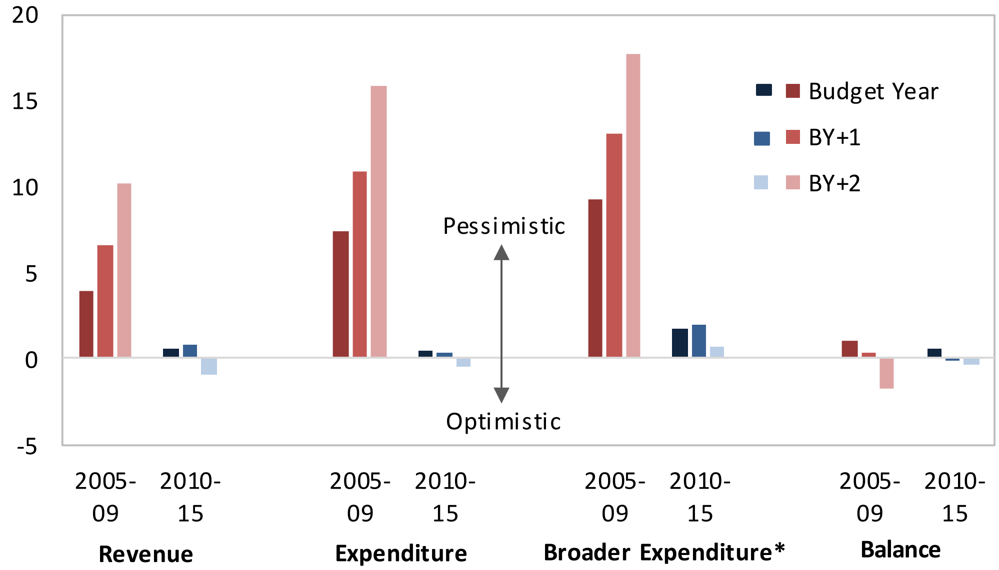


c. Budget Balance Forecast Bias – Average Forecast Error



Source: MoF, IMF staff estimates.
Note: Data are for general government.

Figure 2.4. Georgia: Evolution of Fiscal Forecast Errors (Average Forecast Error)



Source: MoF, IMF staff estimates.
Note: Data are for general government. Expenditure includes expenses plus net acquisition in financial assets, while the broader expenditure measure includes expenses, increases in financial and nonfinancial assets, plus decreases in liabilities.

2.1.4. Investment Projects (Good)

44. **The total costs of central government multiannual investment projects are reported in the annual budget documentation.** The medium-term and total cost of investment projects over their construction period are reported in an annex within the budget documentation, along with details of major projects and their objectives.

45. **Major investment projects are subject to open and competitive bidding, but with some exceptions, as specified in the Law on Procurement**. Under the e-procurement system introduced in 2010, electronic tenders for large procurements are subject to the requirements of openness and competitive bidding. Direct contracting is permitted for smaller purchases (no more than GEL 200,000, and these are disclosed. In 2015, about two-thirds of all procurement was contracted through competitive bidding processes. However, there are some exceptions to the law. The government may, on a case-by-case basis and on recommendation of the State Procurement Agency,[8] approve procurement by direct contracting. In addition, some PCs (the Partnership Fund, Georgian Railways and Georgian Oil and Gas Corporation) operate under special procurement rules, and information on their procurements is not readily published. Projects funded by the Reserve Funds of the President of Georgia, Government of Georgia

[8] According to the Procurement Law, conditions for the simplified procurement are: supply of the object is an exclusive right of a natural person, urgency, prevention of deterioration of the quality of the object of procurement, tight deadlines for state activity. The requirement for approval by the State Property Agency was only added to the law in November 2015. Prior to this the government alone took the decision. Between November 1 and December 31, 2015, the SPA received 1540 requests and approved 1034.

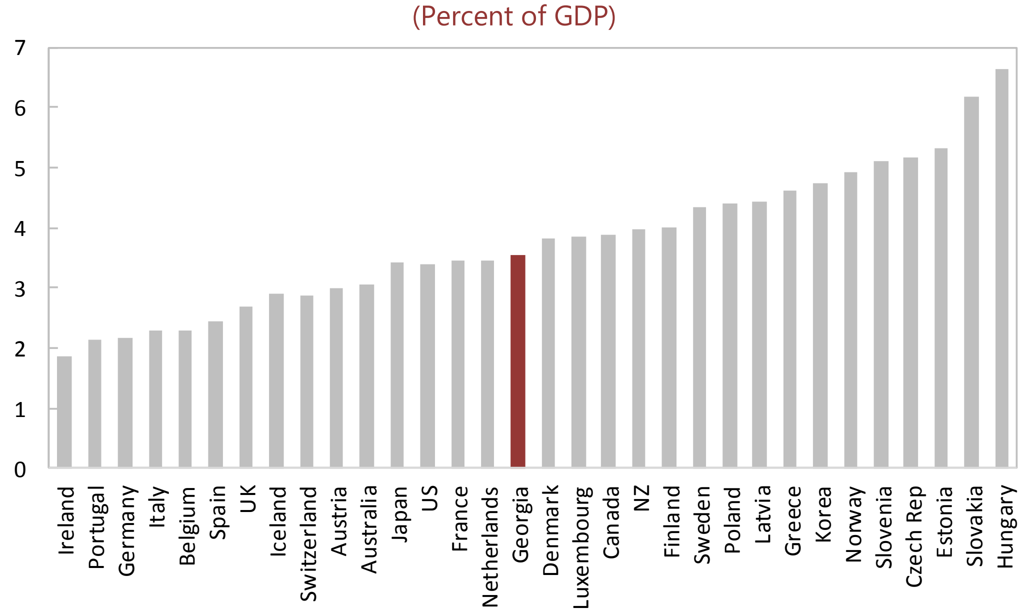
(discussed in principle 3.2.1) and Tbilisi Municipality are not covered by the procurement law, but these are typically small. Donors, who are responsible for funding almost all major investment projects, require their own rules for procurement to be followed, although the major international financial institutions follow competitive tender processes.

46. Cost-benefit analysis for major investment projects are not always performed prior to their approval and are not always published. Donor financed investment projects are typically undertaken on the basis of a cost-benefit analysis, but up until recently there was no requirement for this to be applied to projects financed from the budget.

47. Efforts are underway to strengthen public investment management practices. In 2016, Georgia adopted a resolution on investment projects management (No, 191, April 22, 2016) requiring all capital projects (donor and budget financed) above GEL 5 million to be subject to more robust project appraisal, selection, and post evaluation processes. This includes subjecting projects to an assessment of their economic costs and benefits, although no decision has been made on requirements for their publication. While guidelines and methodology manuals have been approved, they had not been applied to new projects at the time of the fiscal transparency evaluation.

48. General government investment in Georgia is not particularly high in comparison to other countries (Figure 2.5). However, a significant share of public investment is conducted by PCs, and so total public sector investment is higher, at around 5.1 percent of GDP in 2015. There are also several large investment projects in the pipeline, with the authorities planning to almost double nominal general government capital spending over the next four years.

Figure 2.5. General Government Investment, 2015
(Percent of GDP)



Source: Georgian authorities, OECD.

2.2. Orderliness

2.2.1. Fiscal Legislation (Advanced)

49. The Budget Code provides a comprehensive and well-defined framework for budget preparation. It defines the timetable for budget preparation and approval, the content requirements for the main budget documentation, and the procedures for their discussion and approval by Parliament (Part V). Under the Budget Code, the state budget may only be amended at the initiative of the parliament with permission of the government (i.e., parliament approves the budget as a whole). It also sets out the framework for preparation of budgets by local self-governments (Part IV). In addition, the Budget Code defines requirements for in-year reporting on budget execution and audit.

2.2.2. Timeliness of Budget Documents (Advanced)

50. The Constitution and Budget Code require the draft budget to be submitted to Parliament at least three months before the start of the fiscal year and be approved by the start of the fiscal year. The Budget Code further defines the deadlines for submission of the first draft budget and two subsequent drafts. All versions of the draft budget are published and the final budget is published immediately after it is approved by the parliament.

51. The timetable for draft budget submissions defined by the law has been well respected (Table 2.2). During the past five years, the main budget events have always taken place within the timeframe established by the Budget Code.[9]

Table 2.2. Georgia: Dates of Budget Submission and Approval, 2012–16

	Required by	2012 Budget	2013 Budget	2014 Budget	2015 Budget	2016 Budget
1st Submission	Oct 1	Sept 22	Sept 25	Sept 25	Sept 25	Sept 22
2nd Submission	Nov 5	Nov 4	Nov 1	Oct 30	Nov 3	Oct 28
3rd Submission	Nov 30	Nov 30	Nov 27	Nov 28	Nov 28	Nov 27
Final approval by Parliament	3rd Friday of Dec	Dec 9	Dec 20	Dec 11	Dec 12	Dec 11

2.3. Policy Orientation

2.3.1. Fiscal Policy Objectives (Not met)

52. Georgia has legislated numerical fiscal objectives for the main fiscal aggregates. The Economic Liberty Act (2011), which came into force in 2014, defines measurable targets for expenditure, the budget balance and state debt, as follows:

- Expenditure rule: the ratio of expenditure plus the increase in nonfinancial assets of the consolidated budget (central and local government) to GDP should not exceed 30 percent;

[9] In 2016, the November 5 submission of the 2017 draft Budget did not materialize due to the elections.

- Balance rule: the ratio of the consolidated budget deficit to GDP should not exceed 3 percent; and
- State debt rule: the ratio of state debt to GDP should not exceed 60 percent.

53. However, there is no regular reporting on compliance with the fiscal objectives. Although the fiscal aggregates defined in the fiscal rules are detailed in a summary table in an annex to the budget, there is no discussion detailing whether the fiscal projections contained in the budget, are in line with the fiscal objectives. Nor does the government report on whether outturns for expenditure, the budget balance and debt are consistent with the fiscal objectives in the annual budget execution reports or budget documents.

54. The Economic Liberty Act allows higher spending and deficits under certain conditions. If the approved budget is not consistent with the limits on expenditures and deficit, the Government should present a plan for returning below the thresholds defined by the fiscal objectives within two years. Higher spending and deficits are also allowed if either the current year's approved budget was within the thresholds or there is extraordinary spending due to military action and/or economic recession.

55. While debt and deficit rules have been adhered to since their introduction, expenditures have exceeded the legislative limit, albeit by a small margin according to the reported data (Table 2.3). The Economic Liberty Act restricts budget planning but does not clarify what should happen if there is a breach of fiscal rules ex post. The medium-term expenditure projections presented in the budget law have generally been within the expenditure limits since 2014, with only two exceptions. However, expenditure outturns exceeded the limit in both 2014 and 2015. According to the most recent projections, the room for maneuver with respect to the expenditure rule in the near term is minimal. The potential for outcomes to deviate from plans highlights the need for additional transparency on the consistency of government policies with its fiscal objectives, not only in the budget documentation, but also in annual budget execution reports.

56. The fiscal transparency evaluation has identified a number of matters that raise issues in the application of the fiscal rules. These include:

- Government expenditure performed by LEPL using own source revenue is excluded from expenditure (and therefore the expenditure rule), and, any LEPL surplus or deficit is excluded from the fiscal deficit (see principle 2.1.1);
- Reported expenditure is understated by the amount of payments on previous years' invoices (see principle 1.1.3); and
- Lending to PCs, which is accounted for below-the-line, may not always be appropriately reported in circumstances where there is no reasonable expectation of repayment. A similar issue arises with respect to equity injections in PCs (see principle 3.2.2).

Table 2.3. Georgia: Fiscal Policy Objectives and Forecasts
(Percent of GDP)

a. Vintages of Expenditure Rule Forecasts.

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
2014				**30.2**	29.8	29.7	29.6			
2015					29.9	**30.2**	29.6	28.8		
2016						30	28.7	28.5	27.9	
2017							29.9	29.7	29.5	28.9
Outturn	30.7	30.6	29.3	**30.2**	**30.4**					

b. Compliance with Fiscal Objectives

	2014	2015	2016	2017	2018	2019
Expenditure	**30.2**	**30.4**	30	28.7	28.5	27.9
Deficit	-2	-1.1	-0.1	-0.2	-0.8	-0.9
Debt	35.7	41.4	43.9	44.2	44.4	44

Source: MoF.

Note: Expenditure includes expenses plus the acquisition of nonfinancial assets.

57. Addressing the above would have important implications for the fiscal objectives, particularly the expenditure rule. Including LEPL own-financed expenditures and payments of previous year's payables would have increased central government expenditure by 4.3 percentage points to 33.7 percent of GDP. These changes alone would result in general government expenditure exceeding the 30 percent of GDP expenditure rule. Thus, if the government were to expand the coverage of its reports, and tighten its budget accounting, as is recommended in this evaluation, it might need to reconsider its fiscal objectives.

2.3.2. Performance Information (Good)

58. The budget documentation includes information about the main programs and subprograms as well as output-based indicators, but its influence on decision making has so far been limited. The Budget Code introduced a program budget structure that has been applied in all central government spending units since 2012. The preparation of local budgets according the program budget structure began in 2013. Chapter IV of the budget and the detailed program annex specifies the program objectives, expected outcomes and measurable output targets. The annual report on state budget execution includes a detailed discussion on performance against those targets.

2.3.3. Public participation (Basic)

59. Georgia has taken steps to provide more accessible information about the budget to its citizens. A citizen's guide to the state budget has been published since 2013. It includes a description of the budget system as well as a summary of the main budget aggregates and main economic indicators the budget is based on. While the guide includes a wealth of information about the budget and the measures the budget includes, it does not present detailed information on the implications of the budget on the lives of typical citizens.

60. Citizens have the opportunity to participate in budget deliberations through parliamentary committee hearings. Under the rules of procedure of the parliament, individuals, business groups and non-profit organizations may participate in the hearings of the budget and finance committee of the parliament on the draft state budget. They may also submit written comments to the committee on the draft budget. All comments put forward during the hearings are summarized in a report of the committee and submitted to the Chair of Parliament and the government. The Move also conducts an online annual survey "Participate in Budget Planning and Define Priority Directions" where citizens can express their opinions on budget priorities. In 2015, around 4,500 citizens participated in the survey.

2.4. Credibility

2.4.1. Independent Evaluation (Good)

61. The PBO provides regular assessments of the governments macroeconomic and fiscal forecasts. The PBO was established in 1997 and has been independent since 2014. As required under its charter, the PBO produces the following reports:

- Annual macroeconomic forecasts and evaluations of the government's forecasts. Since 2016, the PBO has begun publishing independent macroeconomic forecasts three times a year, and its reports include a comparison with, and evaluation of, the government's published forecasts;
- An opinion on the draft state budget which includes an overview of the government's forecasts and other indicators included in the state budget;
- Monthly, quarterly and annual reports on budget execution, which analyze deviations of revenues and expenditures from the approved budget;
- An annual fiscal policy review and annual review of the public finances of local governments;
- Regular analysis of debt sustainability; and
- Assessments of the fiscal implications of draft legislation, including providing a view on the reliability of costings of measures included in new legislation.

62. While the PBO publishes a large volume of relevant fiscal analysis, it does not publish regular and complete assessments of the government's performance against its fiscal rules. This function is not directly included in its legal mandate, although the PBO has produced a one-off publication on the government's fiscal rules, and provides some limited discussion about fiscal developments in relation to the some of the fiscal rules, primarily the deficit rule, in its publications.

2.4.2. Supplementary budget (Good)

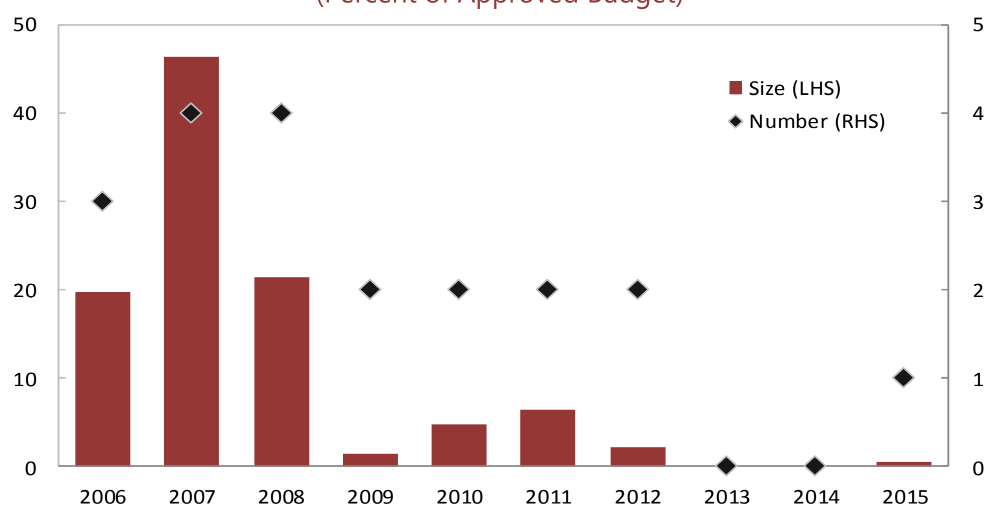
63. **The Budget Code requires parliamentary approval for changes to total budget expenditure, but allows for moderate changes to its composition.** The Budget Code allows for reallocations:

- Between programs and sub-programs of spending institutions with approval from the Move;
- Within an administrative unit up to 5 percent of their approved budget; and
- From unspent ministry budget allocations to expenditures of 'general state significance,' provided these do not exceed the 2 percent budget allocation that applies to the budget Reserve Funds. The Move is required to notify the Budget and Finance Committee of Parliament of these reallocations, which have totaled around 0.8 percent of GDP on average over the past four years.

In addition, allocations from the reserve funds under GEL 100,000 do not require approval of the Parliament.

64. Supplementary budgets were substantial in the period prior to 2008, but have played a much smaller role in recent years (Figure 2.6). Partly reflecting the sizeable revisions to budget revenues, supplementary budgets occurred frequently and were sizeable in the three years prior to 2008, averaging around 30 percent and, in one year were as high as 45 percent of the approved budget. Since that time, supplementary budgets have been used sparingly and have been much more modest in size. There were no supplementary budgets in 2013 and 2014, and only one in 2015, totaling around 0.5 percent of the approved budget.

Figure 2.6. Georgia: Number and Size of Supplementary Budgets
(Percent of Approved Budget)

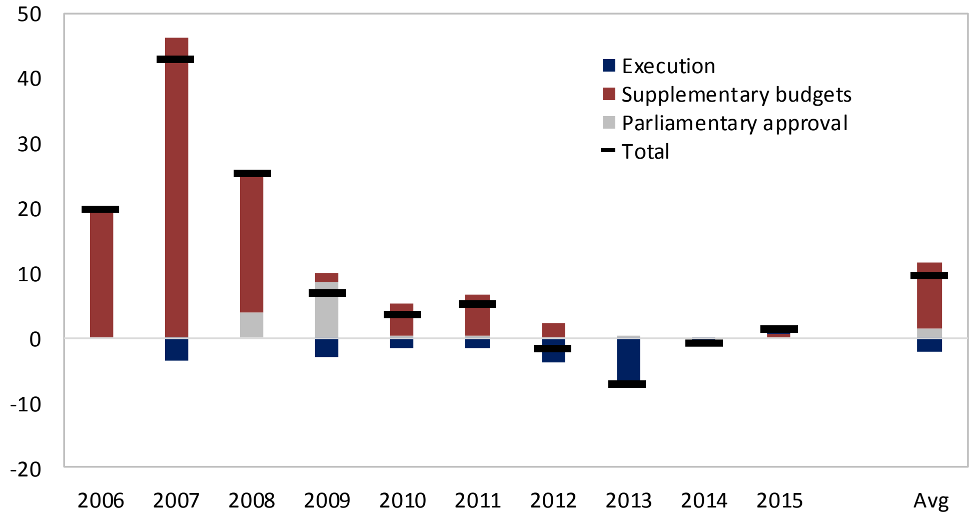


Source: MoF, IMF staff estimates.

65. Supplementary budgets have been the main reason for the deviations between the original spending envisaged by the government and the final outturn (Figure 2.7). As the parliament does not have power to amend the budget without the government's consent, budget amendments have been rare and small. The budget has largely been executed in line with the adjusted budgets, although in 2015 the final expenditure outturn exceeded the approved adjusted budget (including the supplementary budget) by 0.9 percent of approved budget.

Figure 2.7. Georgia: Components of Deviation in Outcome from Approved Budget

(Percent of Approved Budget)



Source: MoF, IMF staff estimates.

2.4.3. Forecast Reconciliation (Not met)

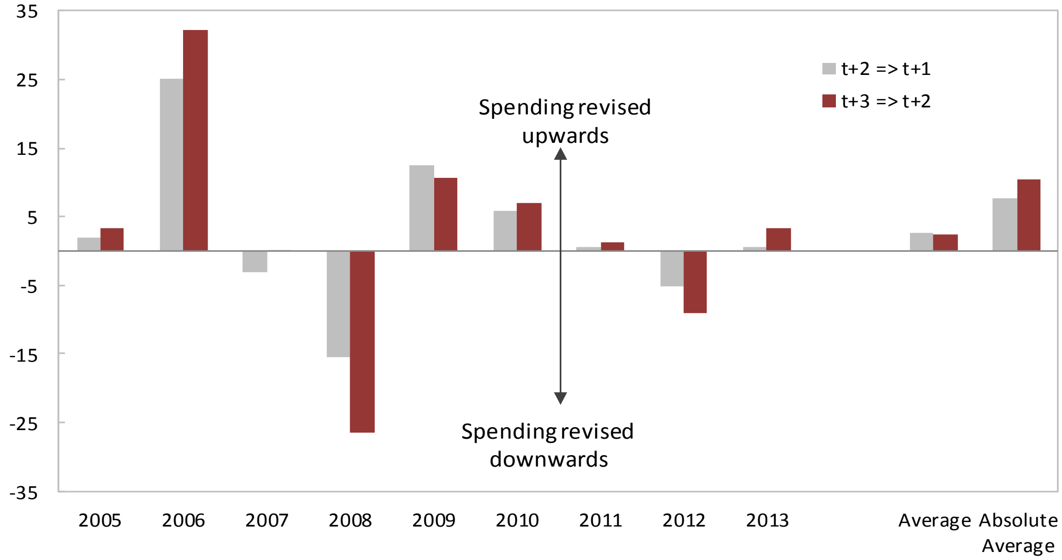
66. The budget documentation does not explain changes between successive forecasts or medium-term plans. There is no explanation of the differences between successive vintages of fiscal forecasts broken down into deviations that are a result of changes to government policies and those resulting from changes to macroeconomic forecasts. Similarly, the government does not publish a detailed reconciliation of deviations in fiscal outturns against plans in its budget execution reports.

67. Expenditure plans have been substantially revised from year to year, reflecting the non-binding nature of existing multi-year expenditure estimates. Between successive fiscal plans, the absolute average of the revisions to the second year's expenditure has been around 8 percent and the third-year expenditure around 10 percent over the sample period (Figure 2.8).[10] Although the revisions have been markedly smaller during the past few years. Including an explanation of the revisions would substantially increase the credibility of the MTBF. Indeed, revisions to medium-term expenditure plans can be consistent with a binding medium-term expenditure framework, provided that revisions are clearly reconciled, subject to pre-defined criteria and/or subject to an aggregate expenditure ceiling that is not revised.

[10] This revision refers, for example, to the difference between the respective 2008 expenditure forecasts made in the 2006 and 2007 Budgets.

Figure 2.8. Georgia: Revisions to Medium-term Plans, 2005-13

(Percent of total expenditure)



Source: IMF staff estimates (years refer to the year when the medium-term plan was made).

2.5. Recommendations

68. Georgia's fiscal forecasting and budgeting practices follow good or advanced practices in many areas. The assessment against the Code, summarized in Table 2.4 shows that the budget includes medium-term forecasts and spending plans, is presented in a timely manner in accordance with the provisions of a clear budget law, and is subject to independent scrutiny by a professionally-staffed parliamentary budget office. Considerable information is also presented on the use of public resources, including by spending program and capital project.

69. However, there is scope to enhance budget comprehensiveness and credibility. A significant proportion of central government revenues and expenditures are not incorporated into the key fiscal aggregates. While numerical fiscal rules have been established to guide medium-term budget planning, there is no reporting on the consistency of budget plans with the fiscal objectives. Further, differences between successive medium-term forecasts are not explained.

70. Based on the above assessment, the evaluation highlights the following priorities for improving transparency of fiscal forecasts and budgets:

- **Recommendation 2.1: Improve the comprehensiveness of the budget.** In the budget documentation, present consolidated fiscal aggregates for central government incorporating own source revenue and related expenditures of LEPL on a gross basis and dividends paid by PCs legally owned, but not actively managed, by the Partnership Fund.

- **Recommendation 2.2: Improve the credibility of the Government's fiscal objective**:

  a. Review the fiscal rules and governance framework in view of other recommendations in this evaluation to expand the coverage of reporting and tighten budget accounting;

  b. Report on performance against each of the fiscal rules in the budget and annual budget execution reports, including reasons for possible deviations and an explanation as to whether government's fiscal plans are in line with the rules; and

  c. Expand the mandate of the PBO to require that it evaluate performance against the government's stated fiscal rules and publish an independent assessment in its fiscal reports.

- **Recommendation 2.3: Improve the credibility of the macroeconomic forecasts and MTBF.** Provide more detailed explanation on details underpinning macroeconomic forecasts and reconciliation of changes to key fiscal aggregates between successive fiscal forecasts and the main drivers.

Table 2.4. Summary Evaluation: Fiscal Forecasting and Budgeting

	Principle	Assessment	Importance	Rec
2.1.1	**Budget Unity**	**Basic:** The budget presents details of most revenues and expenditures on a gross basis, but own-source revenues and related expenses of LEPL are not presented in fiscal aggregates.	**High:** Own source revenues of LEPL are 4.4 percent of GDP.	**2.1**
2.1.2	**Macroeconomic Forecasts**	**Good:** Detailed four-year macroeconomic projections are presented in the budget, but with limited explanation of the key drivers.	**Medium:** Average forecast errors for GDP and inflation for the budget year were -0.6 percent and 1.2 percent over the past decade.	**2.3**
2.1.3	**Medium-term Budget Framework**	**Advanced:** The Budget includes four-year medium-term fiscal projections with spending plans presented by ministry and by program.	**High:** Overspending in medium term plans averaged almost 5 percent of GDP over the past decade, but has been smaller in recent years.	
2.1.4	**Investment Projects**	**Good**: Total obligations are presented in the budget and major projects go through an open and competitive bidding process.	**Medium:** Public investment is high at around 5 percent of GDP, with a number of large projects in the pipeline.	
2.2.1	**Fiscal Legislation**	**Advanced:** The Budget Code defines the timetable for budget preparation and approval, contents of budget documentation and responsibilities of the executive and legislature.	**Low:** Parliament may only revise the budget with agreement from the government and revisions have been limited and small in recent years.	
2.2.2	**Timeliness of Budget Documents**	**Good:** The budget is submitted and published not later than three months before the start of the financial year and approved by the start of the year.	**Low:** Budgets have been routinely presented and approved within the timeframe set by the Budget Code.	
2.3.1	**Fiscal Policy Objectives**	**Not met:** Numerical fiscal rules are enshrined in law, but the government does not report on performance against objectives.	**High**: The expenditure rule has been frequently breached, although by a small margin.	**2.2**
2.3.2	**Performance**	**Good:** Targets are set for outputs to be achieved under each policy program, and are regularly reported against.	**Medium:** There are a large number of output targets, but outcome indicators remain to be defined	
2.3.3	**Public Participation**	**Basic:** A Citizen's Guide presents a summary of the state budget, but with limited detail on its implications for a typical citizen. Citizens can participate in parliamentary budget hearings.	**Medium:** The Budget and 15 annexes include around 900 pages of detailed information.	
2.4.1	**Independent Evaluation**	**Good:** An independent PBO evaluates the credibility of the budget forecasts and their underlying parameters.	**High:** Medium term plans have been frequently revised and breaches of some fiscal objectives have occurred.	**2.2**
2.4.2	**Supplementary Budget**	**Good**: The Budget Code requires parliamentary approval for material changes to total budgeted expenditure, but permits reallocations within a ministry up to 5 percent and areas of state significance up to 2 percent.	**Medium:** Supplementary budgets averaged 30 percent of the approved budget over the three years to 2008, but there has been limited use of them since then.	
2.4.3	**Forecast Reconciliation**	**Not met:** Budget documents do not explain differences between successive vintages of fiscal forecasts.	**High:** Revisions to total expenditure in medium-term plans averaged around 10 percent over the past decade.	**2.3**

III. FISCAL RISKS

71. Governments should disclose, analyze, and manage risks to the public finances and ensure effective coordination of fiscal decision-making across the public sector. This chapter assesses the quality of Georgia's fiscal risk analysis, management and reporting practices against the standards set by three dimensions of the IMF's Fiscal Transparency Code:

- General arrangements for the disclosure and analysis of fiscal risks;
- The reporting and management of risks arising from specific sources, such as government guarantees, public-private partnerships, and the financial sector; and
- Coordination of fiscal decision-making between central government, local governments, and PCs.

72. Disclosure of fiscal risks in Georgia has improved substantially over recent years. The key advance has been the publication of a statement of fiscal risks (SFR), 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, PCs, and the long-term risks to the state associated with power purchase agreements. Table 3.1 lists the various reports published by the government that served the basis for fiscal risk analysis and management in Georgia.

Table 3.1. Georgia: Reports Related to Fiscal Risks

Report	Related Risks and Issues	Author
Analysis of Macroeconomic Risks in the Fiscal Sector, 2016-2020 (SFR)	Macroeconomic risks, Contingent Liabilities	Move
Annual Debt Sustainability Assessment	Debt and macroeconomic risks	Move
NBG Annual Report	Financial Sector Stability	NBG
Performance audit reports into On Lending and Public Debt	Assets and Liabilities	State Audit Office
Annual Fiscal Review	Macroeconomic and Long-term Sustainability	Parliamentary Budget office
Annual Budget Execution Report	Contingency Reserve	Move
Public Debt Statistics and Public Debt Bulletin	Debt management	Move
Quarterly Report on Foreign Financial Resources and Loans	Risks from On-lending	Move

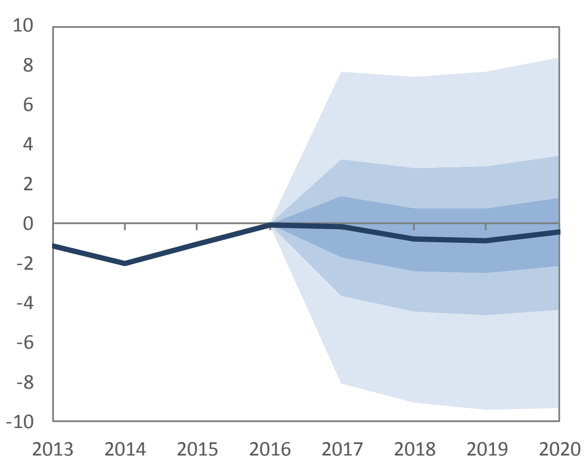
3.1. Disclosure and Analysis

3.1.1. Macroeconomic risks (Advanced)

73. Georgia's budget documentation, which includes the SFR, provides an advanced level of macroeconomic risk analysis. It contains alternative scenario analysis, which show the impact of optimistic, baseline, and pessimistic macroeconomic scenarios on the key fiscal aggregates. These scenarios are based on historical one standard deviation variations of growth and inflation from the baseline scenario, which impact on revenue symmetrically by 0.5 percent of GDP. The pessimistic scenario includes a policy response, with a corresponding reduction in public investment, resulting in a non-varying deficit in the budget year. The budget also publishes a sensitivity analysis of the key fiscal aggregates in response to a broader range of macroeconomic variables, including the interest rate and exchange rates. In addition, the 2017 SFR includes probabilistic fan chart forecasts for GDP growth, inflation, revenues, and fiscal balance, based on the econometric model's standard forecast errors for GDP and inflation (Figure 3.1).

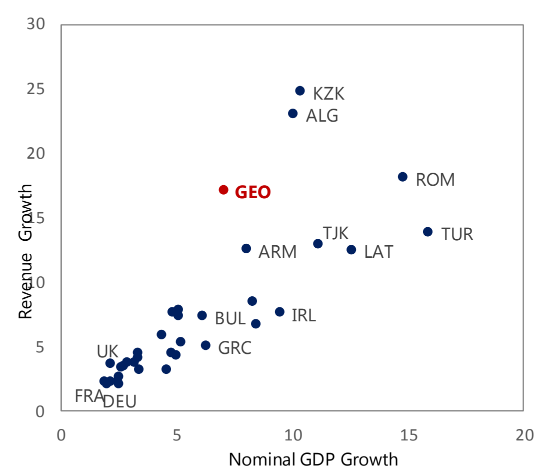
74. This focus on macroeconomic risks is valuable, as Georgia has a relatively volatile economy, and an even more volatile revenue base. Nominal GDP growth volatility is well above average relative to its comparators, while revenue growth is one of the most volatile in the region (Figure 3.2). This, combined with an exchange rate that has recently become more volatile, and instability amongst its major trading partners, mean that the fiscal position is highly exposed to variation from macroeconomic factors.

Figure 3.1. Georgia: Probabilistic Fiscal Deficit Projection (Percent of GDP)



Source: 2017 Fiscal Risk Statement.

Figure 3.2. Volatility of GDP and Revenue (Percent)



Source: IMF WEO database, Oct 2016.
Note: Volatility is measured as the standard deviation of the annual growth rate.

3.1.2. Specific fiscal risks (Advanced)

75. The government publishes an assessment of the main specific risks to public finances. In addition to assessing the impact of alternative macroeconomic scenarios as discussed above, the SFR assesses the performance of PCs and fiscal risks emanating from the sector, and discloses and assesses fiscal risks associated with power purchase agreements (PPAs) that the government and the state-owned Electricity System Commercial Operator (ESCO), has entered into with hydro-power generators. The SFR discloses the magnitude of the fiscal risks and assesses the likelihood of their materialization.

76. While the statement provides a robust assessment of some of the main specific fiscal risks, it is not yet comprehensive. The statement includes extensive information on fiscal risks emanating from the PC sector, but there is no disclosure of other potentially material, though less significant fiscal risks, such as those associated with natural disasters or financial sector exposures. However, these risks are discussed to some extent in other public documents. For example, environmental risks are discussed, but not quantified, in the National Environmental Action Plan 2012–16, and the NBG publishes an assessment of potential risks arising from the financial sector in its annual report.

77. Georgia is exposed to a range of specific fiscal risks, with the maximum gross exposure estimated at around 37 percent of GDP (Table 3.2). This is lower than many other countries for which data is available, primarily due to the absence of explicit financial sector guarantees and state-owned banks. The SFR includes information on 33 percent of GDP of contingent liabilities, while unreported contingent liabilities total around 3 percent of GDP including obligations to provide minimum income guarantees under some PPPs. In addition, exposures arise from natural disaster risks and long-term demographic factors. The estimates in Table 3.2 represents an upper limit. In the event that fiscal risks were to materialize from these sources the impact on public finances could be lower.

Table 3.2. Georgia: Selected Specific Fiscal Risks, Gross Exposure

Specific Fiscal Risk	Magnitude		Reporting
	Billions (GEL)	Percent of GDP	
NonFinancial Public Sector			
Public corporation liabilities	5.3	16.8	Reported in SFR
Public-private partnerships	0.3	1.0	Not reported
Power purchase agreements	6.3	18.8	Partly reported in SFR
Guarantees issued by CG	0.0	0.0	Reported in debt statistics
Financial Sector			
Explicit exposure to financial sector	0	0	Reported by NBG
Contingent events			
Natural disasters	0.05	0.2	Not reported
Long-term Risks			
NPV of pension liabilities (2015-50)	13.2	40	Not reported

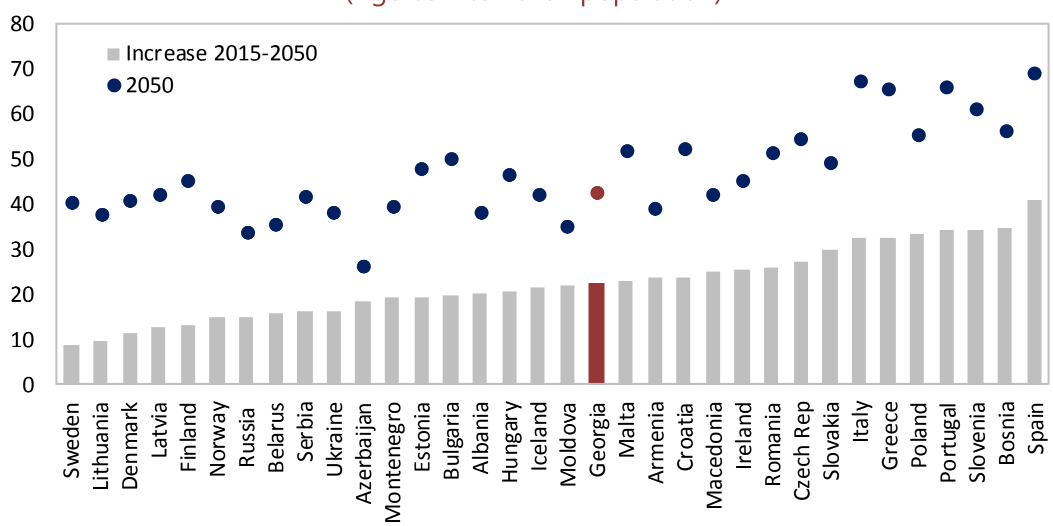
Source: MoF, 2017 SFR, IMF staff estimates.

3.1.3. Long-term sustainability of public finances (Not Met)

78. There is no regular assessment of long-term fiscal sustainability. The government produces a debt sustainability assessment, in line with IMF DSA models, which currently extends out seven years into the future. But this is primarily a test of medium-term debt paths and exposure to macroeconomic shocks. Some one-off assessments of longer-term sustainability have been published, including a PBO assessment of long-term macroeconomic projections in the 2015 Fiscal Review and a MESD study into pension reform. However, these are not regular publications and do not address pressures from other long-term cost factors, such as the health sector.

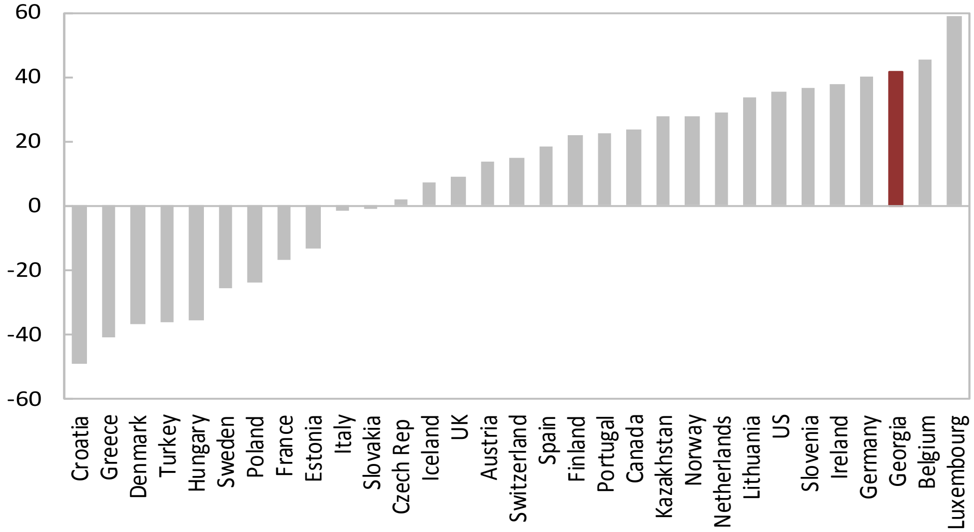
79. While Georgia currently has relatively favorable demographics, it is facing a sharp ageing of the population beginning in middle of the next decade. The current old-age dependency ratio is 20—one person aged 65 or older for every five working age people—one of the lowest among comparator countries. However, beginning in 2025 this ratio is projected to increase sharply, to 43 (or more than two pensioners for every five people of working age) by 2050 (Figure 3.3). Even though Georgia's pension system is based on a universal flat rate, which is currently not indexed, this is still expected to increase pension spending by 3.7 percent of GDP over the period to 2050, based on current policies, which translates to a net present value (NPV) of 40 percent of 2015 GDP (Figure 3.4).

Figure 3.3. Old Age Dependency Ratios
(Age 65+ to 15-64 population)



Source: United Nations.

Figure 3.4. Net Present Value of Pension Expenditure, 2015–50
(percent of 2015 GDP)



Source: IMF Fiscal Monitor.

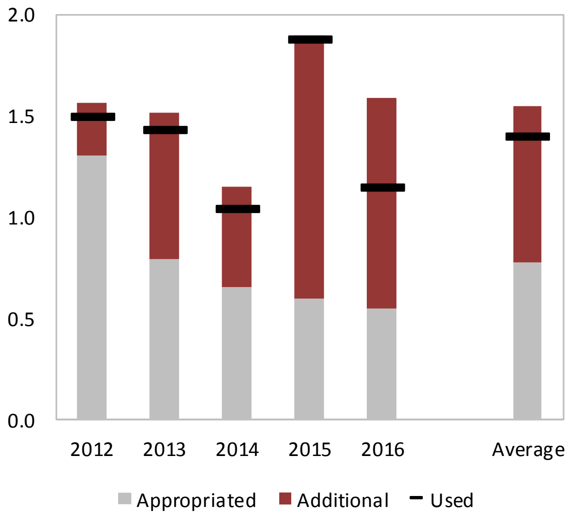
3.2. Fiscal Risk Management

3.2.1. Budgetary contingencies (Basic)

80. Georgia has two main contingency funds capped at two percent of total spending, with frequent, high-quality reporting on their use. These two funds: the Government and the Presidential Reserve funds, are used for contingencies that arise during the course of the year, with their purpose and two percent of spending limit set out in the Budget Code. In addition to the two main funds, there is also a fund to cover costs arising from court decisions against the state, and a Regional Development Fund. While both of these latter funds have elements of contingency reserves—particularly the latter which is in part drawn upon to respond to natural disasters—they are primarily vehicles to pre-fund expected budget expenses that are not defined at the start of the budget year. The reporting on the use of all of these funds is thorough, frequent and timely, with a full list of items funded from the reserves provided in the monthly and quarterly budget execution reports.

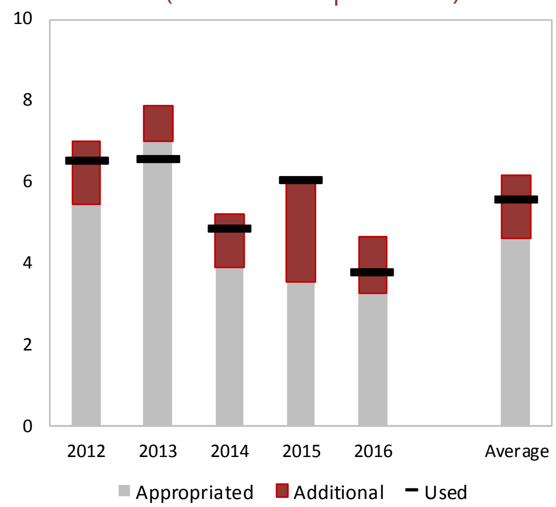
81. There are no transparent access criteria governing the use of the funds, and there is a practice of increasing their allocations over the course of the year. The budget code only requires that the funds are used for purposes that were not envisaged in the original budget, rather than setting in place more rigorous access criteria. Furthermore, there is a tendency to allocate less than the maximum provision of two percent in the original budget, but then allocate underspends from other areas of the budget to top up the funds over the course of the year, resulting in an average overspend of almost 100 percent, or double the original allocation (Figure 3.5). A similar pattern can be seen while assessing all four of the funds in their entirety, albeit to a slightly lesser extent, as the increases to the court action and regional development funds are proportionately not as large (Figure 3.6).

Figure 3.5. Georgia: Use of Main Contingency Funds
(Percent of Expenditure)



Source: MoF.
Note: Includes Government and Presidential Reserve Fund.

Figure 3.6. Georgia: Use of All Contingency Funds
(Percent of Expenditure)



Source: MoF.
Note: Includes Government, President, Regional Development and Court Decision Reserve Funds.

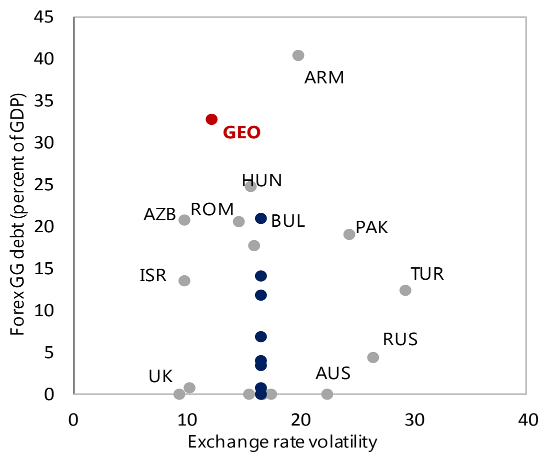
82. These funds can be used to circumvent virement and procurement rules. Under the Budget Code, funds can be reallocated from other areas of the budget to the reserve funds, and then used to fund activities without requiring parliamentary approval at any stage of the process (Art. 31). While this increases budget flexibility, it can also provide an avenue to avoid Parliamentary scrutiny on virements from one program or ministry to another over and above the 5 percent virement limit. This practice is, however, constrained by the two percent contingency reserve spending limit. The funds are also exempt from standard procurement rules, which is particularly relevant for the regional development fund, of which GEL 150 million a year is used to fund investment projects, which represents around one-fifth of budget financed investment expenditure.

3.2.2. Management of assets and liabilities (Good)

83. The government's balance sheet has sizeable assets and liabilities, many of which have significant risk associated with them. The stock of the government's debt is equivalent to 41.6 percent of GDP, all of which is borrowed in accordance with the Law on Public Debt. Of this amount, around 2 percent of GDP relates to obligations the government took on following the end of the Soviet Union, and are spelled out separately under the Law. There are another 1.3 percent of GDP of payables, bringing total reported central government liabilities to 43 percent of GDP. General government financial assets are worth 32.5 percent of GDP and, apart from on-lending, are largely denominated in domestic currency.

84. The government's liabilities are dominated by securities and loans, and the risks surrounding these are high (Figure 3.7). Around three-quarters of the debt portfolio is denominated in foreign currency. While the Lari has been subject to recent volatility, historically it has been relatively stable against the US dollar. Nevertheless, the large share of foreign debt means that even a moderate depreciation can have a significant impact on the value of the debt portfolio. Over the last ten years, the depreciation of the Lari has increased public debt by 8 percent of GDP—almost one-fifth of the 41 percent of GDP of total debt (excluding the historical debts). The maturity of the debt portfolio is also relatively short, leading to rollover risk as debt matures. The bulk of this risk lies on the domestic side, which has an average maturity of three years, while external debt maturity averages nine years. There is also some interest rate risk, with around one-quarter of total debt issued in variable interest rate instruments.

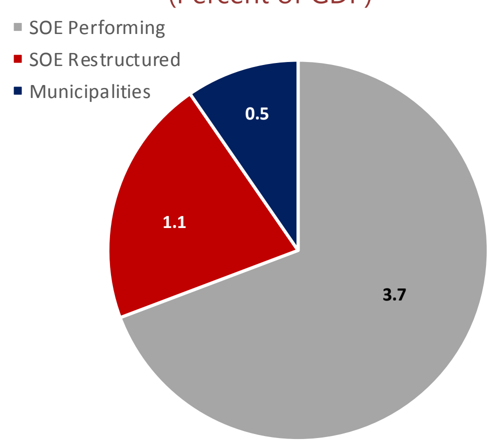
Figure 3.7. Exposure to Forex General Government Debt



Source: FSI, Eurostat, WEO.

Note: Forex debt in 2015, exchange rate volatility is standard deviation/average exchange 2000-2015. Euro area in blue.

Figure 3.8. Georgia: Net-lending Portfolio
(Percent of GDP)



Source: Georgian MoF.

85. There is also some valuation risk surrounding historical debts. These are currently valued at GEL 672 million (2 percent of GDP), the bulk of which relates to banking deposits owned by Georgian residents in a Soviet bank, that were frozen in the early 1990s (GEL 490 million) and down payments on condominiums (GEL 126 million), which the government assumed a liability for in the enactment of the Law on Public Debt in 1995. This historical debt is reported in a transparent manner in the governments public debt statistics. The details of these liabilities are highly uncertain, with severe documentation limitations making the identification of counterparties to the liabilities difficult to disentangle. There is also great uncertainty around the valuation of these liabilities, which have been held constant in Lari terms since 1996, with no interest accrued or indexation applied, resulting in a large decline in the real value of the reported obligation. Uncertainty also surrounds future government decisions on how any compensation mechanism should be determined, with the Commission on Domestic Debt deliberating on this issue since 2004. The public debt bulletin is explicit in its recognition of the uncertainty around the historical debts.

86. The government's financial assets mainly comprise loans and equity in PCs, both of which are subject to valuation risk. While there are some profitable PCs (see 3.3.2), many are performing poorly, and the sector as a whole made a loss of around one percent of GDP in 2015, partly due to foreign exchange losses. The balance sheet values them at 5.7 percent of GDP, which is below the estimated book value of 14.9 percent of GDP. In addition, there is a portfolio of loans that are taken by the government and on-lent mostly to PCs, which totaled 4.8 percent of GDP at the end of October 2016. However, around a fifth of these loans have been restructured or reorganized, by extending grace periods around interest and principal repayments, as the PCs involved have been unable to service them (Figure 3.8).

87. The government improved its assessment and reporting on PCs in the 2017 SFR, and has increased disclosure of the on-lending portfolio. There is detailed discussion of PCs, both overall and for key individual PCs, including the status of their on-lent loans (and the restructuring of a number of the key loans). However, this analysis is yet to be integrated with loan decisions. The Move is also publishing a full list with details on the on-lending portfolio on its website, in response to the SAO's published report discussing the on-lending risks with proposals on how to better manage them.

3.2.3. Guarantees (Good)

88. Loan guarantees are not a significant source of fiscal risk. The government has only one loan guarantee, which has an outstanding value of GEL 5 million (0.02 percent of GDP). Since 1998, no new loan guarantees have been provided by the government.

89. The loan guarantee is disclosed and included in the stock of public debt and new issuance of guarantees are subject to controls. The government reports the maximum value of the guarantee in the budget and in the public debt statistics and bulletins published on the Move website. The government does not discuss the probability of the guarantee being called, but to date it has not been called on to service the loan. Loan guarantees can only be issued by the Minister of Finance (Art. 21 of the Budget Code) and require parliamentary approval (Art. 39 of the Law on Public Debt). The annual budget law also defines the limit for the stock of public debt and guarantees for the budget year (as required under Art. 22 of the Budget Code).

90. Other non-loan guarantees are disclosed, but not quantified, in the SFR. These include a letter of comfort stating an unquantified commitment by the government to provide financial support if necessary to the Partnership Fund and a minimum revenue guarantee to the Gardabani thermal combined cycle power plant.

3.2.4. Public-private partnerships (Not Met)

91. The government does not fully disclose annually its total rights, obligations and other exposures under PPP contracts. It does disclose a number of its key obligations and exposures under PPAs in the SFR, but there remain some gaps. The discussion in the SFR focusses on the PPAs that the government has entered into with hydro power producers, and reports the nominal and NPV of future obligations, as well as some discussion of the risks around them, though not all related contingent liabilities are discussed. There are a number of other PPP contracts, that are not yet covered in the SFR, largely relating to relatively small legacy projects and, two larger projects, one of which is at a very early stage. Apart from these gaps, the SFR meets a basic level of PPP reporting, which could be improved to a good level by disclosing annual obligations over the life of the contracts.

92. Total government gross exposure under PPP and PPA contracts is around 19.8 percent of GDP. However, much this is offset by revenues that are expected to be almost as large, resulting in an estimated net exposure of around 5 percent of GDP (Table 3.3). A new PPP law being prepared envisages a significant expansion in PPP activity, which will increase the importance in high quality assessment, control and monitoring of the sector. The key exposures are:

- **Legacy PPPs**, signed either in the 1990s or in mid 2000s, largely relating to telecommunications, airports and a seaport. These are relatively small, with a total capital stock of around 1 percent of GDP, although total fiscal exposure is lower. No information on these projects is provided.
- **PPAs** whereby mostly ESCO, and in one case the government, guarantees the price, or an amount of power to be purchased from power generators over a long period of time (10-35 years). The government assesses its gross exposure around these payments to be United States Dollar (USD) 8.6 billion (66 percent of 2016 GDP), peaking at 1.1 percent of GDP in 2021, with a NPV of USD 2.1 billion (16 percent of GDP). These payments are anticipated to be largely offset by the sale of the power to distributors, at a price set by the regulator, which is a function of the average weighted price of generation. Based on current arrangements, this would result in an offsetting revenue stream worth 11.6 percent of GDP in NPV terms, with a gap of 0.3 percent of GDP in 2021. However, revenues received are subject to risk around lower prices, either through deregulation of the market, or if the government decides to move away from the current price setting system to avoid increasing consumer prices, which in the baseline scenario will increase by one quarter, as well as exchange rate risk (with payments made in USD, but revenues based in Lari). This exposure and its attendant risks are discussed within the SFR.
- **The Nenskra power plant is one of the largest PPAs and has some unique characteristics that present additional risks.** Although the Nenskra PPA is included in the calculation of gross PPA exposures contained in the SFR, a number of related-risks are not discussed. The main obligation is the government guarantee for a USD internal rate of return (IRR) of 12.5 percent on equity investments, which if not paid for could result in the government terminating the contract, at a total cost of USD 800 million plus the IRR on USD 180 million of equity (6.2 percent of GDP plus the IRR). The guarantee is provided in three levels should project revenues fall short, where the first would see regulated prices adjusted in the year following any shortfall (which would cost consumers, but not government), the second where the Partnership Fund would pay any shortfall, up to a

maximum of USD 54 million (for which it receives a guarantee fee of USD 2.5 million per year from the project), and third, should the government not top up any payments itself, would require the government to buy out the equity in the project (USD 180 million) and assume the debt (USD 620 million). This exposure is subject to exchange rate risk, and is not discussed separately in the SFR. Unlike most other PPAs, the government has also guaranteed against construction and hydrology risks (up to USD 30 million for the former, uncapped for the latter), but this is not discussed separately in the SFR.

- **Gardabani thermal power plant**, for which the government has guaranteed a 12.5 percent IRR in US dollars to the equity investors, currently the Partnership Fund, to 2040, translating to a total gross NPV exposure of USD 308 million (2.4 percent of GDP). The power pricing system for sale to distributors is designed to provide this revenue without cost to the government, though the current formula is falling short by ½ percentage point (delivering an IRR of 12 instead of 12 percent), resulting in a liability of GEL 3 million a year, with an NPV of 0.1 percent of GDP. This exposure is subject to exchange rate risk, and is only generally disclosed in the SFR.
- **Prospective Anaklia deep water port,** whereby the government has a contractual obligation to repay pre-construction design and scoping costs of USD 20 million (0.2 percent of GDP) if the project is cancelled. This is still at an early stage, but if the project goes ahead, would involve a USD 100 million investment by the government, through the Partnership Fund, as well as an additional USD 40 million in land purchase (1.1 percent of GDP). This project was signed in October 2016 and was therefore not included in the 2017 SFR which is based on contracts in place through to the end of 2015.

Table 3.3. Georgia: Summary of PPP Exposures

(Percent of 2016 GDP)

	Project value	NPV exposure		Other risks	Reported
		Gross	Net		
Legacy	0.8	0.8	-	Not known	No
PPA Agreements	66.4	16.2	4.6	Forex, power sale price	FRS
Nenskra PPA	6.2	6.2	-	Forex, power sale price, volume	No
Nenskra specific	-	0.2	-	Construction and hydrology	No
Gardabandi TPP	5.4	2.4	0.1	Forex, domestic power price, volume	Partly in FRS
Anaklia Deep Water Port	4.6	0.2	0.2	Government decision	No
Total	**77.2**	**19.8**	**4.9**		

Source: Fiscal Risk Statement where reported, IMF estimates otherwise.

Note: Net exposure for PPAs is calculated assuming a market price of USD 5 cents. Changes in this assumption would impact on the overall net exposure.

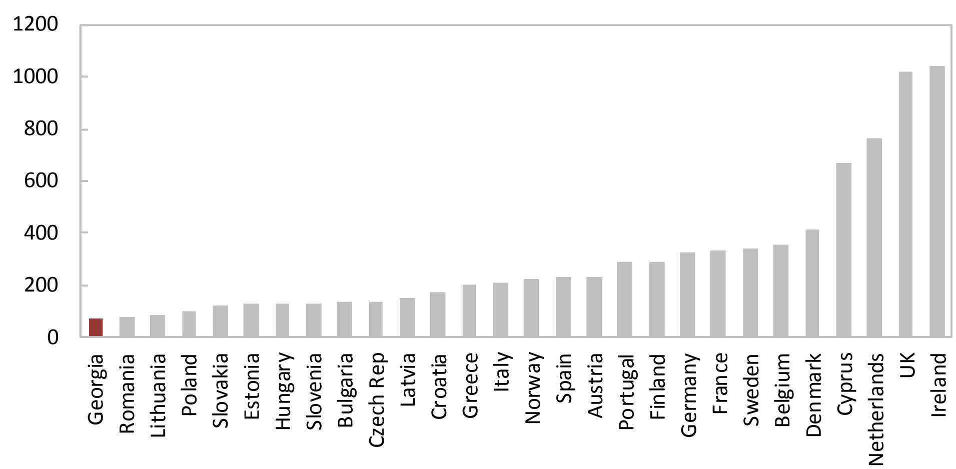
93. Efforts are underway to strengthen the framework for managing fiscal risks associated with PPPs and PPAs. The government has put in place temporary controls on PPAs, including restricting the term and price for new PPAs and limiting the size of new investments based on volume of power generation. A more permanent framework for managing PPPs and PPAs is also being developed, pursuant to a planned new PPP law, which will require that the fiscal risks of PPPs and PPAs are assessed prior to their approval and that a registry be maintained on the government's total fiscal commitments.

3.2.5. Financial sector (Good)

94. **The government does not currently have any explicit liabilities to the financial sector and publishes an annual assessment of the sector's stability.** Other than the Partnership Fund, the government does not own any financial institution and has no guarantees to the sector. The government is preparing to introduce a deposit guarantee scheme, which would bring some direct exposure, and reporting on it should be incorporated into the SFR once it is established. The NBG includes an assessment of financial sector stability in its annual report that provides a good description of financial sector risks, though it is largely backward looking. It also undertakes regular forward looking internal banking sector stress tests, based largely on the methodology used in the 2015 Financial Sector Assessment Program, jointly undertaken with the IMF. These are not currently being published, but the NBG is intending to begin doing so as part of a standalone Financial Stability Report, which would be sufficient to lift Georgia to an advanced level of practice according to the Code.

95. **The financial sector in Georgia is relatively small, at 70 percent of GDP, and well capitalized, though it is particularly exposed to foreign exchange risk (Figure 3.9).** While the banking sector itself does not face a currency mismatch, around 65 percent of its loans to customers are in US dollars, who carry the (largely unhedged—both natural and instrument) exchange rate risk. Thus, any large depreciation could place stress on borrowers and result in an increase in non-performing loans. To address this risk, the NBG places a higher risk weighting (requiring higher amounts of capital to be held against those loans) and requires banks to be more conservative when extending forex loans, and banks have full recourse to customers' assets. Borrowers absorbed the impact of the 36 percent devaluation in 2014, with non-performing loans increasing by ½ a percentage point. Banks are reasonably well capitalized, maintain strong liquidity ratios and are profitable (Table 3.4).

Figure 3.9. Non-equity Liabilities of Financial Sector
(Percent of GDP)



Source: Eurostat, NBG.

96. The government recently announced a policy to reduce foreign exchange risks by de-dollarizing the economy, potentially exposing the public finances to the financial sector. The government announced in the 2017 Budget that US dollar denominated mortgages made prior to 2015 will be converted into GEL at the market exchange rate less an amount of GEL 0.2 which is subsidized from the state budget. While the full financial implications of the new policy are unclear, based on the stock of foreign currency loans to households at January 1, 2015 of GEL 4.1 billion, this could cost the budget a maximum amount of 0.6 percent of GDP, which is greater than the 0.2 percent of GDP allocated in the 2017 Budget.[11]

Table 3.4. Indicators of Banking Sector Stability

	Capital		Asset Quality	Liquidity		Profitability
	Tier 1 Capital	Capital to Assets	NPLs	Loan to Deposit	Liquid Assets	Return on Assets
Georgia	**11.7**	**3.6**	**8.1**	**96.3**	**24.9**	**3.1**
Russia	8.5	8.9	8.3	76.2	26.5	0.2
Germany	15.7	5.9	2.3	85.0	42.8	0.4
Netherlands	16.2	5.6	2.7	-	22.8	0.6
Sweden	21.2	-	1.2	-	9.8	0.8
Lithuania	24.3	13.0	5.8	110.9	-	1.2
Kazakhstan	13.1	10.5	8.0	100.5	21.2	1.6
Slovakia	16.5	11.1	4.9	111.0	34.2	1.3
Austria	13.2	7.4	3.4	85.3	24.8	0.5

Source: NBG and IMF Financial Soundness Indicators.

3.2.6. Natural resources (Not met)

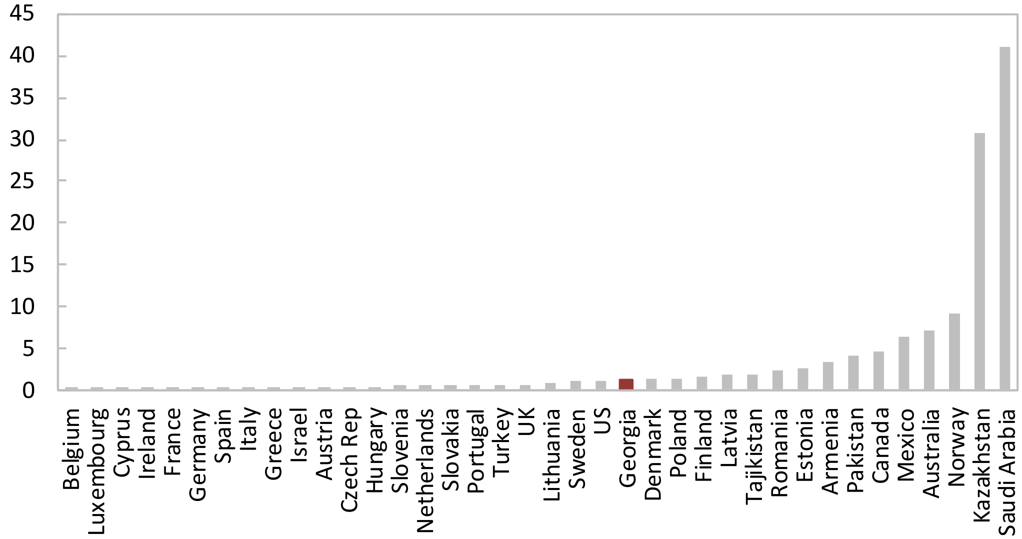
97. The government does not publish any estimates of the value or volume of major natural resources, though these are relatively small in Georgia (Figure 3.10). The budget shows receipts from mineral rents of 0.1 percent of GDP in 2015. The government does have some internal estimates of the value of natural resources, primarily forestry, fishing, and some mining activities, though these assessments are from the Soviet era. Some data on the annual volume of oil, copper and other mineral products are published by the National Statistics Office in the National Accounts. In 2015, exports of ferro alloys were worth 1.6 percent of GDP, at the low end of comparator countries.[12]

[11] There are two reasons why this likely overstates the true figure: (i) not all of loans to households will be in mortgages; and (ii) some of the current stock of loans were entered into prior to January 1, 2015. The latter point is important, as this caps the maximum exposure. This policy only presents a risk to the budget if it is not fully provided for in the 2017 Budget, which was unclear at the time of the evaluation.

[12] Georgia also re-exports copper from Azerbaijan, but there is little value added or revenue from this activity.

Figure 3.10. Natural Resource Rents (2014)

(Percent of GDP)



Source: World Bank World Development Indicators.

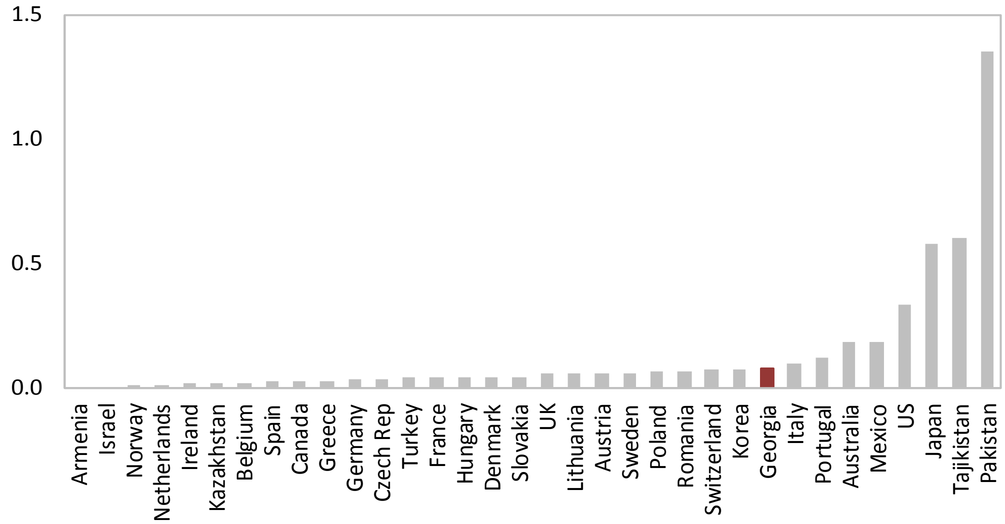
3.2.7. Environmental risks (Basic)

98. Natural disasters and other environmental problems create some risk to the public finances. Flooding, landslides, mudflows, and avalanches are the most common form of environmental risk, with some 50,000 landslides a year presenting a particular risk due the mountainous terrain of the country. In 2015, widespread flooding in Tbilisi led to a number of deaths and created considerable disruption, not least being the escape of wild animals from the zoo into the streets of the city.[13] While not posing a large risk in financial terms, Georgia does sit toward the upper end of the spectrum of comparator countries (Figure 3.11).

99. The government discusses the main risks of natural disasters in qualitative terms and there are some strategies in place to mitigate these. The 2012–16 National Environment Action Plan of Georgia discusses the main natural disaster risks, assesses the likelihood of occurrence and sets out particular steps to be taken to both mitigate and respond to them should they occur. In addition, the Ministry of Environmental Protection and Natural Resources prepares bulletins on hot spots of environmental risk, with advice on actions to be taken. While the government does not currently quantify natural disaster risks, the National Crisis Management Council is preparing a methodology to calculate environmental loss, which will also define ex ante who and how much they should be compensated, to speed up the financial reaction. The Regional Development Fund is used as a contingency to provide assistance during natural disasters, with around GEL 40-50 million (0.2 percent of GDP) per annum spent for this purpose in recent years.

[13] See news reports for a description. The responsibility for the damage was poorly-designed infrastructure that could not cope with the unusually heavy rainfall.

Figure 3.11. Average Annual Damages from Natural Disasters
(Percent of GDP)



Source: World Bank Development Report, 2014.

3.3. Fiscal Coordination

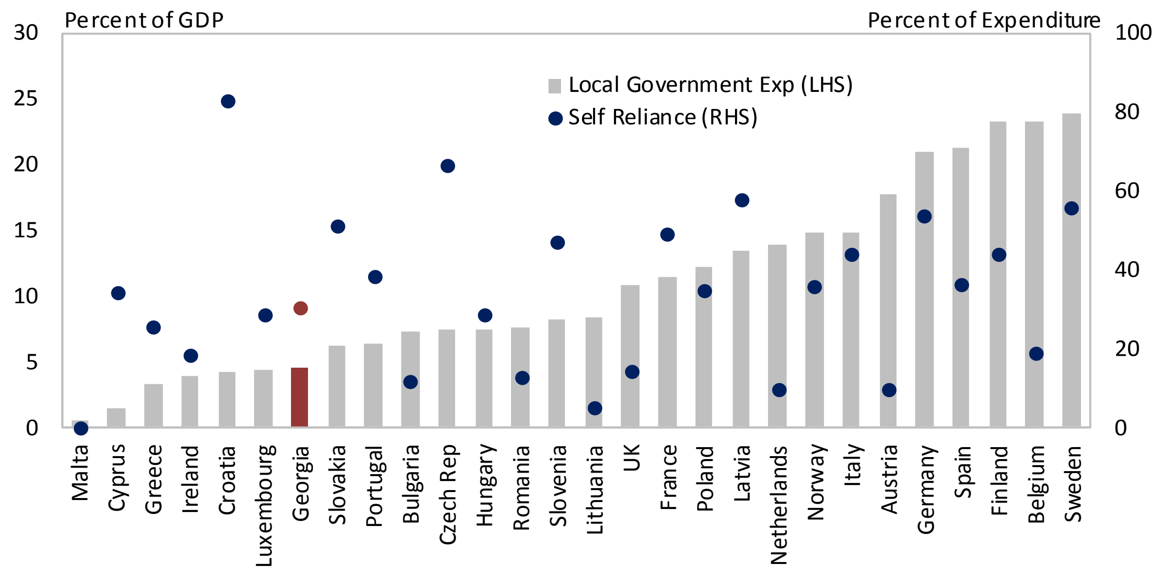
3.3.1. Subnational governments (Not Met)

100. There are no annual summary reports on the financial performance of local government finances, presenting a major gap in the country's fiscal risk assessment. While the government publishes flows for the consolidated general government sector as part of its fiscal statistics, it does not separately report the consolidated flows of local governments. The PBO has published a report on municipal finances, however, this is limited to the flows, with no discussion of municipal stocks. Municipalities prepare annual audited financial statements, but these are not always published and suffer from serious deficiencies, with large gaps in reporting, and major audit qualifications. They are also required to submit regular budget execution reports to their councils according to the timetable set out in the Budget Code. The recent inclusion of municipalities within the treasury single account is a major improvement and will allow much stronger monitoring to be applied.

101. These risks are mitigated by the relative small size of local governments in Georgia and borrowing restrictions that are in place. Local government expenditure is equivalent to only 4.5 percent of GDP, and local governments are highly reliant on central government transfers, with own source revenues making up only 30 percent of their funding (Figure 3.12). There are limits on local government borrowing from non-public entities and borrowing can only take place with the approval of the Move. These rules are largely adhered to, and scattered information on local government debt indicates that it is relatively low, with central government on-lending from international financial institutions forming the largest portion of this, worth only 0.5 percent of GDP, and relatively low liability ratios. Nevertheless, there are some individual municipalities that are running large deficits and liability ratios relative to their own revenues, though these are negligible from an economy-wide perspective (Figure 3.13). In addition, some

PCs controlled by municipalities have taken loans from commercial banks, and require transfers from the municipality to cover their debt servicing, though these appear to be relatively small, and are subject to Move approval. There have been no reports of significant arrears at the municipal sector.

Figure 3.12. Size and Self-Reliance of Sub-National Governments (2014)



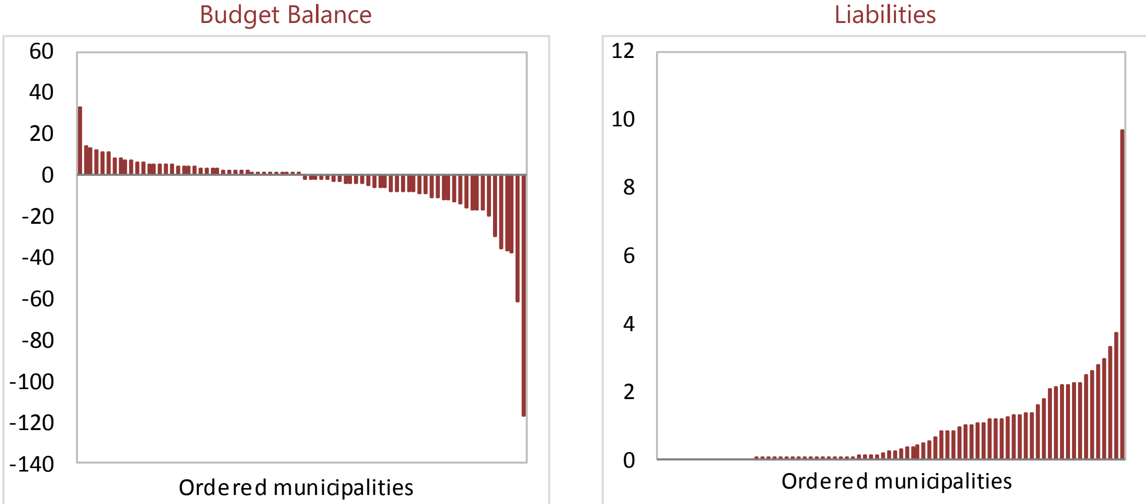
Source: IMF GFS.

Note: Self-reliance is LG own source revenues as a share of total LG expenditure.

102. A number of recent changes to the Local Government Law should improve coordination across levels of government. Although municipalities will maintain their independence, the parliament will be setting targets for the sector overall (such as requiring a 10 percent reduction in administrative costs across the board), as well as aggregate targets consistent with the general government fiscal rules. Municipalities will now have to use the revenue forecasts provided by the central government, rather than the previously overoptimistic forecasts. Furthermore, a new decree allows the central government to withhold capital transfers to municipalities if they do not follow the new rules.

Figure 3.13. Georgia: Municipal Budget Balance and Liabilities

(Percent of revenues)



Source: MoF.

3.3.2. Public corporations (Basic)

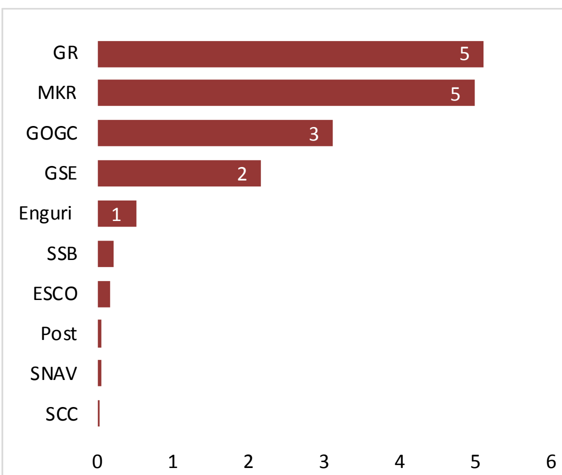
103. Direct transfers between the government and PCs are regularly disclosed, but are not based on a published ownership strategy. Transfers between the government and PCs are disclosed in the budget and SFR. The latter includes information on all direct transfers to PCs (including subsidies, equity injections, and loans), as well as contingent exposures associated with non-debt guarantees (such as letters of comfort). However, there is no published document that outlines the purpose and objectives of state ownership and the criteria under which PCs operate. Dividends are determined by a special commission without reference to a published dividend policy.

104. Detailed information on the financial performance of most PCs is published on an annual basis. The SFR includes aggregated summary income and balance sheet indicators for 65 PCs—representing about three-quarters of the PC sector. The statement also includes a detailed assessment of the financial performance of ten major enterprises including key financial performance and risk ratios. The Move conducts and publishes an assessment of the likelihood of fiscal risks materializing from PCs, which involves assessing each PC according to selected financial ratios and classifying them into different categories based on the degree of risk they pose.

105. Quasi-fiscal activities of PCs are not disclosed. PCs engage in a range of non-commercial activities for public policy purposes, for which they are not compensated. This potentially understates the fiscal deficit. These activities have typically included: the construction of certain facilities for policy purposes; the supply of electricity free of charge to the territory of Abkhazia (estimated cost of GEL 18 million); supply of gas at subsidized rates; and subsidized passenger rail transport (estimated cost of around GEL 30 million). The Move has begun to collect information from PCs on their quasi-fiscal activities in order to disclose them in the 2018 budget SFR and to assess whether there is a continuing need for these and, where there is, to appropriately compensate corporations for them in a transparent manner.

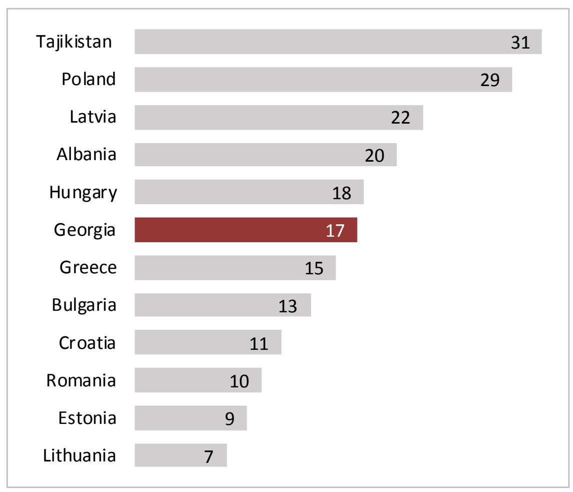
106. PCs in Georgia create fiscal risks. The largest 65 PCs under the central government had aggregate liabilities of 16.8 percent of GDP at the end of 2015, of which around 4.6 percent of GDP are loans owed to the central government. Liabilities are concentrated in four corporations which account for around 90 percent of the liabilities of the sector (Figure 3.14). Although the size of the sector is not large compared to some other emerging European and neighboring countries (Figure 3.15), the financial performance of the sector is weak. About half of all PCs were loss-making in 2015 and the combined losses of these entities totaled 2.3 percent of GDP. Further, around 25 PCs (or around one-third of the sector), with combined liabilities of around 9 percent of GDP in 2015, were found to be experiencing some form of financial difficulty and classified as high risk by the government.[14] The SFR also discloses some contingent liabilities of PCs', with some of them pledging their assets as a guarantee against other entities loans.

Figure 3.14. Georgia: Public Corporation Liabilities
(Percent of GDP)



Source: MoF, IMF staff estimates.
Note: GR=Georgian Rail; MKR= Marabda-Kartsakhi Railway; GOGC=Georgian Oil and Gas Corp.; GSE=State Electric System of Georgia; SSB= State Service Bureau; SNAV= Sakaeronavigation; SCC=State Construction Company.

Figure 3.15. Liabilities of Public Corporations in Select Countries
(Percent of GDP)



Source: Eurostat, MoF, IMF staff estimates.
Note: Data are on an aggregate, not consolidated basis and is as at end-2013 for Albania, end-2014 for Tajikistan and end-2015 for other countries.

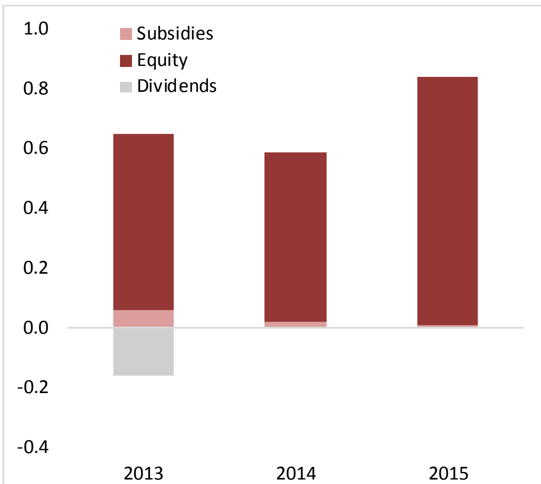
107. The government has provided significant support to PCs in recent years, largely outside budget expenditure appropriations. Government equity injections, totaling GEL 264 million (0.8 percent of GDP) were provided to 25 PCs in 2015 (Figure 3.16). Around one-third of

[14] 2017 State Budget annex "Analysis of Macroeconomic Risks in the Fiscal Sector" provides further details on the basis for this assessment.

these corporations also received an equity injection in each of the two preceding years. In addition, dividends from PCs are often foregone by the government[15] (Figure 3.17).

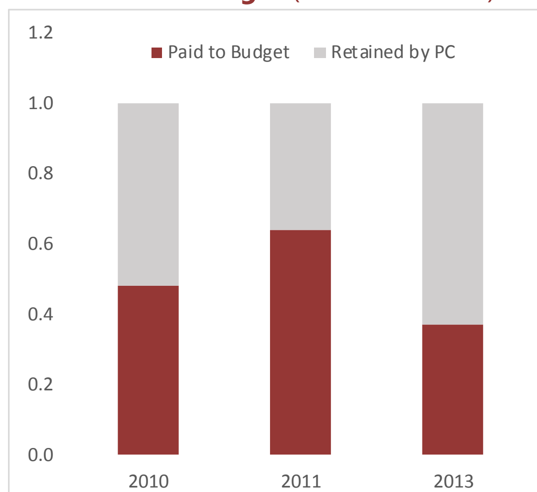
108. The government has been taking steps to restructure the PCs sector. The National Agency for State Property, has been taking actions to liquidate non-viable PCs that are not serving policy objectives and to restructure others, including through mergers with other PCs. As a result, the number of PCs controlled by the Agency has fallen dramatically, from over 1,300 in 2009 to around 137 currently. The government intends to continue this restructuring process.

Figure 3.16. Georgia: Government Support to Public Corporations (Percent of GDP)



Source: MoF.

Figure 3.17. Georgia: Share of Dividends Paid to Budget (Percent of GDP)



Source: State Audit Office.
Note: The commission determining dividends did not meet in 2012 or 2014.

3.4 Recommendations

109. Georgia's fiscal risk disclosure, analysis, and management practices frequently met good or advanced practice when judged against the standards of the Code. As Table 3.5 shows, the disclosure and analysis of general macroeconomic and specific fiscal risks meets the advanced standard. Georgia also pays considerable attention to risks around the government debt liabilities and is in the process of finalizing a debt management strategy.

110. There are some areas where disclosure and the government's control of risks falls short of the Code's standards of good practice. While the government includes an allocation in the budget for contingencies, there is no clear criteria governing its drawdown. There is no regular reporting of long-term fiscal sustainability, although some one-off assessments have

[15] This does not include dividends of the Partnership Fund which are retained for the purposes of investing in commercially viable infrastructure projects.

taken place. In addition, there is scope to further enhance disclosure and strengthen controls over certain types of fiscal risks associated with PPPs, PCs, and local governments.

111. Based on the above assessment, the evaluation highlights the following priorities to strengthen disclosure and management of fiscal risks:

- **Recommendation 3.1: Publish long-term sustainability analysis.** Extend the current DSA to ten-years and incorporate anticipated expansion of public investment, PPPs, and PPAs.
- **Recommendation 3.2: Tighten criteria for drawing on budget contingency provisions.** Amend the existing criteria for drawing on the reserve funds to allow only expenditures demonstrated to be unforeseeable, unavoidable, and unable to be absorbed to be funded from the Presidential and Government Reserve Funds.
- **Recommendation 3.3: Strengthen controls on contingent liabilities.** Continue to provide information on PPAs, PCs and on lending in the SFR, while strengthening controls and assessments on financing activities in these areas by:

    a. Subjecting lending and equity injections to PCs to a transparent test of reasonable expectation of commercial returns on those investments, with those investments failing the test to be treated as subsidies or capital transfers, and therefore falling within the definition of expenditure.

    b. Setting a legislative limit on obligations entered into through PPP and PPA contracts within the annual budget law, with the limit either applying to the total stock of net liabilities, or on a maximum size on the flow of annual gross payments.

- **Recommendation 3.4: Improve reporting on sub-national governments.** Prepare and publish an annual report on sub-national finances, providing key financial information on individual municipalities and publishing an additional statement on the operations of the consolidated local government sector in the GFS reports.

Table 3.5. Summary Evaluation: Fiscal Risks

	Principle	Rating	Importance	Rec
3.1.1	**Macroeconomic Risks**	**Advanced:** Fiscal risk statement has sensitivity and scenario analysis, plus fan charts showing uncertainty from growth and inflation.	**High:** Relatively volatile economy, with a standard deviation of nominal growth and revenue of 7 and 17 percentage points.	
3.1.2	**Specific Fiscal Risks**	**Advanced:** Government publishes a fiscal risk statement that includes discussion and analysis of most of the key fiscal risks.	**Medium:** There are around 37 percent of GDP of specific fiscal risks.	
3.1.3	**Long-term Fiscal Sustainability**	**Not Met:** Long-term fiscal projections or sustainability reports are not regularly published, though one-off analysis has been conducted.	**Medium:** Current favorable demographics are set to deteriorate, leading to a 3.7 percent of GDP increase in pension spending by 2050.	**3.1**
3.2.1	**Budgetary Contingencies**	**Basic:** There is regular reporting on contingency reserves, worth 2 percent of spending, but no clear access criteria.	**High:** Use of Reserve Funds averages 165 percent of original allocation, requiring tops ups through the year.	**3.2**
3.2.2	**Asset and Liability Management**	**Good:** Borrowing is authorized by law, and risks around debt and major financial assets are discussed in the SFR and DSA, but there is no debt management strategy in place.	**Medium:** Central government debt of 41 percent of GDP is at the high end of comparators, and government financial assets total 17 percent of GDP.	
3.2.3	**Guarantees**	**Good:** Guarantee is disclosed in budget and debt statistics and counted in public debt. There is a combined upper limit on public debt and guarantees.	**Low:** There is only one guarantee, with a maximum exposure of 0.02 percent of GDP, though material non-debt guarantee exposures exist.	
3.2.4	**Public-Private Partnerships**	**Not Met:** PPA obligations are reported in SFR, but rights and obligations of a number of legacy PPPs and major PPP projects are not reported.	**High:** NPV of total gross payments for PPPs and PPAs of 19.8 percent of GDP, though for PPAs expected revenues almost offset the payments.	**3.3**
3.2.5	**Financial Sector Exposure**	**Good:** Government has no explicit guarantees to the financial sector and publishes annual financial stability assessments, but stress tests conducted by the NBG are not published.	**Low:** Banking sector is relatively small, with non-equity liabilities of 70 percent of GDP, and a relatively low risk profile. Govt. has no explicit guarantees to financial sector.	
3.2.6	**Natural Resources**	**Not Met:** No estimates of natural resource assets are produced.	**Low:** Natural resource rents are worth 1.6 percent of GDP.	
3.2.7	**Environmental Risks**	**Basic:** Government reports discuss the main environmental risks in qualitative terms, along with mitigating strategies.	**Medium:** Natural disaster are frequent with annual fiscal costs of 0.2 percent of GDP.	
3.3.1	**Sub-national Governments**	**Not met:** Government does not publish reports on local government performance, but they are monitored and they require approval to borrow.	**Medium:** LG spending is one-fifth of total GG, but debt restrictions are largely respected with LG debt only 0.5 percent of GDP and largely in the form of loans on-lent from CG.	**3.4**
3.3.2	**Public Corporations**	**Basic:** SFR includes a summary of the financial position of most PCs, their transactions with government and assesses their performance, but no ownership policy is in place and quasi-fiscal activity is not reported.	**High:** The sector is large with expenditure of 7 percent of GDP, and liabilities of 17 percent (excluding financial PCs). There are also large but unquantified quasi-fiscal activities.	**3.3**

Appendix I. Georgia: Government Fiscal Transparency Action Plan (2017–20)

Recommendation	2017	2018	2019	2020	Responsibility
1.1. Expand the Institutional Coverage of Fiscal Reports					
a. Include LEPL own-source revenues and related expenditures in GFS reports.	Produce a consolidated report of State Budget and LEPL activities as part of the 2018 State Budget Annual Law Package	Make necessary legislative amendments (Liberty Act and Budget Code) as part of recommendation 2.2. Produce an assessment of existing LEPL and create rules for classifying them as general government units or non-general government units, based on international accounting and statistical standards.	Include full LEPL activities in the GFS reports.		MAFD, BD
b. Extend accounting reform to local government and produce an annual consolidated general government sector financial report to cover all general government transactions and stocks in line with international standards.	Design action plan for the gradual implementation of annual financial statements in line with international standards (IPSASs) in subnational governments.	Accounting regulations incorporating selected IPSAS standards are implemented in two Pilot municipalities for the 2018 fiscal year financial statements.	Expanding coverage of the IPSAS based accounting to ten municipalities for the 2019 fiscal year financial statements.	All municipalities prepare IPSAS based annual financial statements. Publish general government consolidated financial report for the fiscal year 2020, prepared in 2021.	Treasury
1.2. Improve the Quality of Fiscal Reports					
a. Ensure all payments of central government units are accurately reflected in cash-based reports.	Ensure payments of prior period invoices are accurately reflected as expenditure in the account of the budget classification item applied in the original budget approval.				BD, Treasury

Recommendation	2017	2018	2019	2020	Responsibility
1.2. Improve the Quality of Fiscal Reports (cont.)					
b. Progressively expand the coverage of the central government balance sheet to include all liabilities and better reflect the value of nonfinancial assets.	Complete stock take of all government obligations under existing PPPs.	Develop an action plan and mechanism for the valuation of existing government property holdings. Develop methodology for estimating pension entitlements of special category civil servant pensions and annual accrual of liabilities based on actuarial studies and disclose.		Recognize pension entitlements for special category civil servant pensions and PPPs in the balance sheet and annual accrual of liabilities in the income statement of annual financial statements. Recognize nonfinancial assets in the central government annual financial statements.	Treasury
c. Include reconciliations of key fiscal aggregates within and across fiscal reports.		Publish reconciliations of the changes in gross debt and net/lending borrowing in fiscal reports and include a discussion of the main differences in coverage and classification between the annual financial statement and other fiscal reports in the annual financial statements.		Include a reconciliation table in the annual financial statements reconciling differences in key fiscal aggregate outcomes for the previous year based on budget classification and the classification in annual financial statements and annual budget execution report.	PDEFD, Treasury, BD
1.3: Strengthen the Integrity of Fiscal Repots					
SAO to commence financial audits of the consolidated central government annual financial statements.				Begin financial audits of the annual consolidated central government financial statement from the 2020 financial year.	SAO

Recommendation	2017	2018	2019	2020	Responsibility
1.4: Enhance Reporting and Control over Tax Expenditures					
Publish an annual estimate on the revenue losses of tax expenditures in an annex to the budget.	Identify data needs, and establish protocols for data collection, and develop methodology for calculation of revenue loss.	Amend tax forms and develop IT systems for data collection.		Publish in an annex to the budget an estimate of revenue foregone from tax expenditures, separately reporting revenue losses from major tax expenditures.	Tax Policy Department
2.1: Improve Budget Comprehensiveness					
Publish consolidated fiscal aggregates encompassing the activities of all central government budget units.	In the 2018 budget, present consolidated fiscal aggregates in an annex incorporating LEPL own source revenue and related expenditure.				BD
2.2: Strengthen Credibility of the Government's Fiscal Objectives					
a. Review and clearly define the fiscal rules and update fiscal governance framework.	Review the existing fiscal rule framework and prepare an action plan of their amendment based on the recommendations of IMF technical assistance.	Amend the fiscal rules and set clear and detailed processes for their compliance.			BD
b. Report performance against each fiscal objective		In the budget and the budget execution reports, provide a statement on the fiscal performance against each fiscal objective, reasons for possible deviations and an explanation as to whether the Government's future fiscal plans are in line with the objectives.			BD

Recommendation	2017	2018	2019	2020	Responsibility
2.3: Improve Credibility of the Macroeconomic Forecasts and MTBF					
Explain changes in successive fiscal forecasts.	Provide more detailed explanation on the details underpinning macroeconomic forecasts and a discussion of how the medium-term fiscal forecasts have changed from the previous year's forecasts.	Publish a reconciliation of fiscal forecast changes separately identifying: (i) macroeconomic; (ii) policy; and (iii) other changes			MAFD, BD, LMs
3.1: Publish Long-term Fiscal Sustainability Analysis					
Extend the timeframe of the current DSA.	Extend the DSA to a ten-year time horizon, incorporating the anticipated expansion of public investment, PPPs and PPAs.	Begin developing long-term demographic models for pensions.		Prepare a long-term (40 year) fiscal sustainability analysis for internal use, with a view to publication over the medium-term.	PDEFD, MAFD
3.2: Tighten Criteria for Drawing on Budget Contingency Funds					
Amend the existing criteria for drawing on the reserve funds.	Develop guidelines for the management of drawdowns from the reserve funds.	Amend legislation to outline clearer rules governing drawdowns from the reserve funds.	Implement new rules and procedures of drawing on the reserve fund in the context of preparations for the 2020 State Budget law.		BD
3.3: Strengthen Reporting and Controls on Contingent Liabilities					
a. Further strengthen reporting on fiscal risks.	Expand the SFR to include all fiscal risks identified in Table 3.2, and include sensitivity analysis for PPAs.				BD, MAFD

Recommendation	2017	2018	2019	2020	Responsibility
3.3: Strengthen Reporting and Controls on Contingent Liabilities (cont.)					
b. Subject on-lending and equity injections to stricter assessments criteria and classification according to GFS criteria.	Develop and approve methodology and guidelines for assessing whether on-lending and equity injections to PCs meet the reasonable commercial return test, in line with GFS criteria.	For the preparation of the 2019 State Budget draft law, apply GFS classification of equity injections and on-lending, according to the reasonable commercial return test, and if not met, these should be treated as subsidies or transfers (i.e., above-the-line expenditure).			BD, PDEFD
c. Set a limit on liabilities from PPA & PPP contracts.	Submit PPP law to the Parliament. Identify and publish all obligations to PPA and PPP contracts on a net and gross basis, on a total and annual flow basis.	Introduce a limit on PPA and PPP obligations within the annual budget law.			MAFD, MESD, Ministry of Energy
3.4: Improve Reporting on Sub-National Governments					
a. Expand GFS reporting to include financial information on the local government subsector.	Include a report on the operations of the consolidated local government sector, along with central and general government GFS reports.				MAFD
b. Publish a regular report on the financial performance of individual municipalities and consolidated local government sector.	Publish a report detailing budget flows and debt stocks of municipalities and autonomous republics.			Expand report to include municipality assets and non-debt liabilities.	BD

Note: The action plan includes those recommendations outlined in the evaluation that fall under the responsibility of government ministries. As such, those recommendations that fall under the responsibility of independent agencies or the Parliament that are referred to in the report have not been not been fully incorporated.

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