

Georgia: Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for Waiver of Performance Criteria, and Request for Rephrasing of Disbursements—Staff Report; and News Briefs on the Executive Board Discussion

In the context of the second review under the Three-Year Arrangement under the Poverty Reduction and Growth Facility, request for waiver of performance criteria, and request for rephrasing of disbursements, the following documents have been released and are included in this package:

- the staff report for the second review under the Three-Year Arrangement under the Poverty Reduction and Growth Facility, request for waiver of performance criteria, and request for rephrasing of disbursements, prepared by a staff team of the IMF, following discussions that ended on **May 1, 2002**, with the officials of Georgia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on June 27, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- News Briefs summarizing the views of the **Executive Board as expressed during its July 12, 2002** discussion of the staff report that completed the review.

The document(s) listed below have been or will be separately released.

Letter of Intent*
Memorandum of Economic and Financial Policies*
Technical Memorandum of Understanding*
Poverty Reduction Strategy Paper—Progress Report
Joint Staff Assessment of the Poverty Reduction Strategy Paper Progress Report

*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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GEORGIA

Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility (PRGF), Request for Waiver of Performance Criteria, and Request for Rephasing of Disbursements

Prepared by European II and Policy Development and Review Departments

Approved by John Dodsworth and Michael T. Hadjimichael

June 27, 2002

- Discussions for the second review of the arrangement under the Poverty Reduction and Growth Facility (PRGF) were held in Tbilisi January 31-February 11 and April 25-May 1, 2002. The staff team comprised Messrs. Owen (head), Mumssen, and Podpiera (EU2), Mr. Fassina (FAD), and Ms. Said (PDR). Mr. Dunn, resident representative, participated in the discussions.
- The mission met with President Shevardnadze, State Minister Jorbenadze, members of the government's economic team, parliamentarians, business people, donor representatives, and the press.
- Georgia's three-year PRGF arrangement was approved on January 12, 2001 (IMF Country Report No. 01/109). The first review and 2001 Article IV consultation were completed on October 26, 2001 (IMF Country Report No. 01/212). Three disbursements of SDR 9 million each were made in January, March, and November 2001.
- Completion of the second review was delayed, mainly because of the need to take adequate measures to underpin higher budgeted tax revenues in 2002. The authorities are now requesting completion of the second review and waivers for non-observance of end-December 2001 performance criteria on tax revenues and expenditure arrears, a structural performance criterion on the adoption of a budget system law, and the continuous performance criterion on external arrears.
- The authorities are requesting a switch from quarterly to semi-annual disbursements and a rephasing of disbursements to finance a higher overall balance of payments deficit in 2002 than initially programmed. A total of SDR 45 million would be disbursed this year in two equal installments. The authorities' Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU) are attached in Appendix III.

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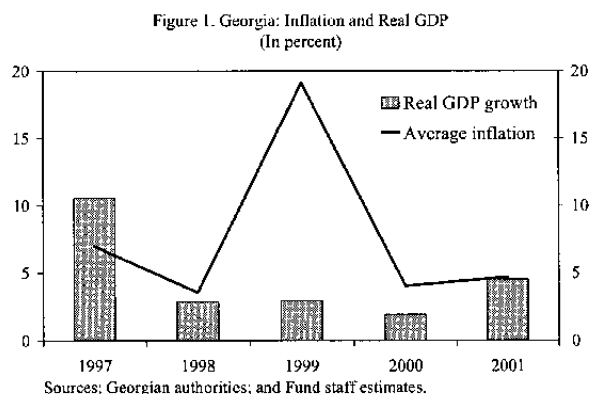
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EXECUTIVE SUMMARY

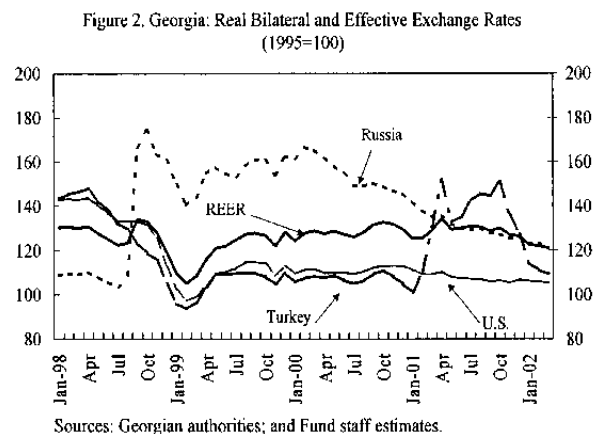
- **Macroeconomic performance remained satisfactory in early 2002, despite a difficult external environment.** Real GDP growth was just under 4 percent in the first quarter of 2002 and inflation increased to 7½ percent in May following a modest exchange rate depreciation prompted by a political crisis last fall. In 2001, GDP growth was 4½ percent and average inflation just below 5 percent. The crisis in neighboring Turkey contributed to a widening of Georgia's current account deficit. International reserves nonetheless grew during 2001, supported by the resumption of lending by the IMF and the World Bank and rescheduling of bilateral debts.
- **Fiscal and monetary policies have been broadly in line with the program, though some fiscal targets were missed at end-December and end-March.** The budget deficit was cut substantially in 2001 and, for the first time in some years, there was no significant net accumulation of expenditure arrears. The 2002 budget aims at further fiscal consolidation and repayment of expenditure arrears, while monetary policy focuses on maintaining low inflation and building up official reserves.
- **A principal objective of the program is to raise fiscal revenues, to finance higher social spending and stronger public institutions needed to achieve long-term growth and poverty reduction.** Following slow progress that contributed to a delay in completing the second review, the authorities have recently taken steps to strengthen tax administration. Several revenue-losing tax code amendments in late 2001 and early 2002 were offset by a tax-raising package in June 2002.
- **The program envisages continued reforms in the fiscal and financial sectors, and an acceleration of progress in other key structural areas.** Georgia's poverty reduction strategy, to be finalized this year, focuses on setting the right environment for private sector growth and reforming the social sector. Some positive steps have been taken on energy sector reform, but the physical and financial state of the energy sector has deteriorated further. Anti-corruption efforts need to be intensified, to strengthen the business environment and prospects for long-term growth.
- **Georgia will continue to rely on concessional external financing.** External debt remains high in relation to official reserves and fiscal revenues. The authorities are likely to ask Paris Club creditors for additional bilateral debt rescheduling on concessional terms to ensure medium-term debt sustainability.
- **The external environment is expected to remain difficult and near-term prospects for foreign direct investment are poor.** The staff now projects a higher overall balance of payments deficit in 2002 and recommends that it be financed through a rephasing of Fund disbursements.

I. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

1. **Economic growth has recovered from the drought-related slowdown in 2000.** Real GDP grew by 4½ percent in 2001, driven by a rebound in agriculture and strong growth in transport and retail trade. The relatively small industrial sector contracted, partly reflecting energy supply interruptions early in the year and partly weak external demand. Energy supply was significantly better this winter, and preliminary data show GDP growth of just under 4 percent in the first quarter of 2002.



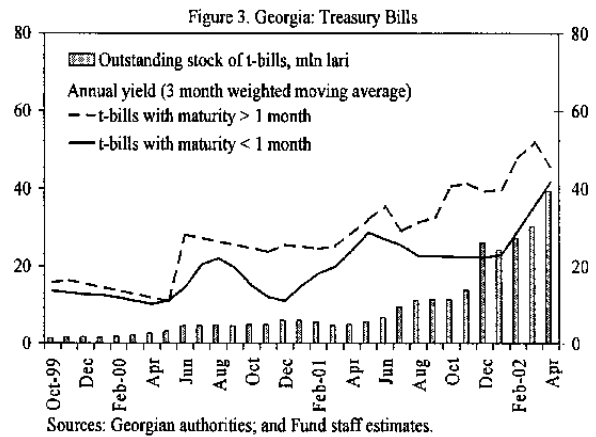
2. **The exchange rate has depreciated and inflation has increased modestly.** After two years of exchange rate stability, the lari depreciated by 6 percent against the U.S. dollar during the last quarter of 2001 and January 2002, partly reflecting a political crisis and government reshuffle in November 2001. The real effective exchange rate depreciated by about 5 percent during the same period. The lari has been relatively stable since February. Inflation picked up in late 2001 and early 2002, reflecting not only the exchange rate depreciation, but also increases in food and utility prices. Consumer prices rose 7½ percent in the 12 months to May 2002.



3. **The economic crisis in Turkey, Georgia's main trading partner next to Russia, contributed to a fall in exports and an increase in the current account deficit in 2001.** Foreign direct investment also fell sharply. Official reserves nonetheless rose substantially in 2001, reflecting renewed lending by the IMF and the World Bank, as well as the Paris Club rescheduling agreed in March 2001. Reserves remain low, however, at about 1¼ months of imports of goods and services in April 2002.

4. **The budget deficit was cut to 2 percent of GDP in 2001, from 4 percent in 2000.** For the first time in years, there was no significant accumulation of expenditure arrears, although the end-December 2001 target on arrears was missed (Table 1). Tax collections fell somewhat short of the end-year program target, and the tax-to-GDP ratio in 2001 was little higher than in the previous year.

5. **Fiscal performance during the first quarter of 2002 was broadly in line with the program** (MEFP, Table 2). There was a minor deviation from the planned repayment of expenditure arrears, partly because of a delay in grant financing. Moreover, tax revenues would have narrowly missed the indicative end-March target if not for a small increase in the stock of advance tax payments. Preliminary data for April and May, however, show that revenues remained broadly in line with program targets, while tax advances fell back to about the end-December level. Treasury bill issuance in April was higher than projected, implying an increase in the cash deficit and higher interest costs to the budget.¹



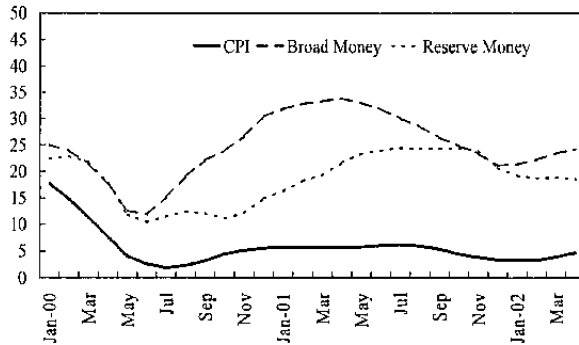
6. **Progress on fiscal reforms has been mixed.** Expenditure control and budgetary management have improved markedly, notwithstanding a delay in adopting a new budget system law (Table 2). By contrast, very little progress was made in tax and customs administration reform during 2001, while changes to the taxation of the energy sector and cars eroded the tax base. However, the government took a number of steps in the first half of 2002 to bolster revenue collection (MEFP, paragraphs 16 and 22). In May 2002, the ministry of revenues was merged with the ministry of finance and a new minister was appointed. Changes in personnel and the structure of the ministry could lead to a temporary lull in implementing further reforms.

7. **Monetary policy has remained on track.** All monetary targets under the program were met at end-December 2001 (Table 1) and end-March 2002 (MEFP, Table 2). Reserve money and broad money growth were consistent with low inflation in the context of a continuing remonetization trend. The economy remained highly dollarized, with 86 percent of all deposits denominated in foreign currency at end-2001.

8. **The central bank's supervisory capacity has been strengthened.** Following the introduction of new asset classifications, international accounting standards, and legislative changes to strengthen the central bank's role in banking supervision in 2001, the National Bank of Georgia (NBG) adopted an analytical framework for resolving insolvent banks (Table 2). The NBG has also introduced a special supervision regime for problem banks. The IMF Safeguards Assessment was completed in January 2002. It highlighted several vulnerabilities in the NBG's internal control areas and proposed appropriate remedies, all of which the NBG agreed to implement (see MEFP, Table 1, for measures included in program conditionality).

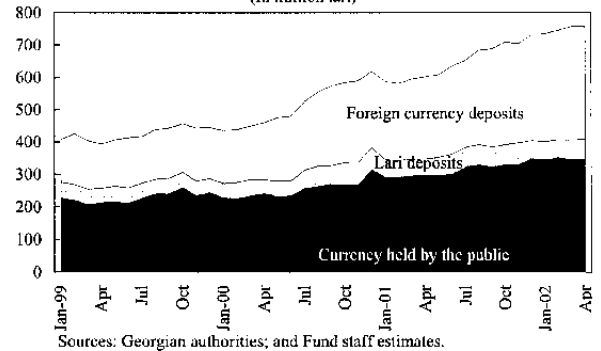
¹ The primary t-bill market is very thin, with highly volatile rates and volumes.

Figure 4. Georgia: Inflation and Monetary Aggregates
(Year-on-year Growth, Six-months Moving Averages)



Sources: Georgian authorities; and Fund staff estimates.

Figure 5. Georgia: Composition of Broad Money
(In million lari)



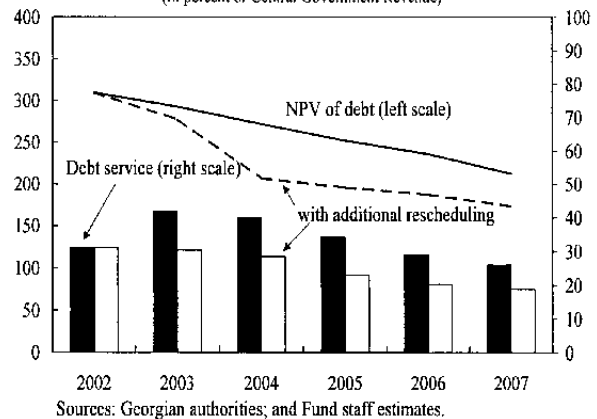
Sources: Georgian authorities; and Fund staff estimates.

9. **The authorities have made progress in implementing the 2001 Paris Club agreement.** This provides for rescheduling maturities due in 2001 and 2002 over 20 years. Georgia has reached agreements on comparable terms with all of its creditors, except China, Turkmenistan and Uzbekistan. Georgia accumulated interest arrears to China from mid-2001 and some minor interest arrears to the United States in late 2001, but was current on all of its scheduled interest obligations as of late June 2002. Georgia has reduced its arrears to Turkmenistan through offset operations involving aircraft services and has agreed to service interest and reduce principal arrears further through sugar, aircraft, and railcar deliveries during 2002.

II. MEDIUM-TERM OUTLOOK AND DEBT SUSTAINABILITY

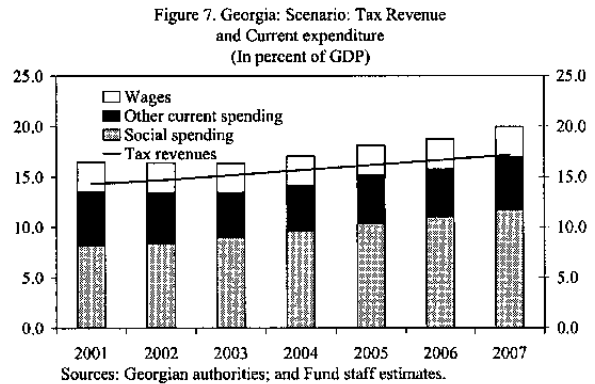
10. **Medium-term debt sustainability will require an increase in tax revenues from their current low level.** Central government revenues excluding grants were only 10¾ percent of GDP in 2001, and the net present value of external debt is currently over 300 percent of central government revenues. External debt service in 2002 is projected at 11½ percent of exports of goods and services, 31 percent of central government revenues, and 61½ percent of gross reserves. In the absence of additional rescheduling these ratios are set to rise sharply in 2003, when the current Paris Club consolidation period expires. An external shock such as a sharp real depreciation or a decline in foreign financing could seriously jeopardize Georgia's solvency. A rescheduling of bilateral debts falling due from 2003 onward, as assumed in Table 3, will be crucial for moving toward debt sustainability.

Figure 6. Georgia: External Debt (Public and Publicly Guaranteed)
(In percent of Central Government Revenue)



Sources: Georgian authorities; and Fund staff estimates.

11. **Low revenues also undermine the prospect for poverty reduction by severely constraining social expenditures** (Table 3). Even with a relatively ambitious medium-term revenue goal, social spending increases over the next five years would only be sufficient to close half the gap between health and education spending in Georgia and other CIS countries, and increase pensions to about half the poverty level.² Some of the reforms envisaged in the authorities' draft poverty reduction strategy paper (PRSP) would require additional concessional financing from abroad.



12. **Establishing conditions conducive to foreign direct investment will be crucial for achieving long-term growth.** Georgia's ability to attract foreign investment has been undermined not only by the recent deterioration in external conditions, but also by home-grown governance problems. Small- and medium-sized private firms are particularly vulnerable to corruption in law enforcement, tax collection, and other public agencies, driving them into the shadow economy. In addition to anti-corruption efforts, the acceleration of structural reforms is particularly urgent in the energy sector.

III. POLICY DISCUSSIONS

13. Policy discussions for the review focused on measures to increase tax collections, to ensure achievement of the 2002 budget revenue target; external risks and growing protectionist pressures; further reforms to strengthen the banking sector; and the need to accelerate energy sector reforms to spur growth and reduce risks to macroeconomic stability.

A. Fiscal Policy

14. **The 2002 budget aims at further fiscal consolidation.** The general government deficit, on a commitment basis, is to be reduced to just over 1 percent of GDP in 2002, from 2 percent in 2001. With the planned clearance of some pre-2001 arrears, this would keep the cash deficit in 2002 at roughly the same level as in 2001. Whereas

Text Table 1. Georgia: General Government (In percent of GDP)

Program	1999	2000	2001	2002
Total revenue and grants	15.4	15.2	16.3	16.9
<i>Of which:</i>				
Tax revenue	13.8	14.2	14.3	14.7
Expenditure and net lending	22.1	19.2	18.2	18.0
Fiscal balance, commitments basis	-6.7	-4.0	-2.0	-1.1
Fiscal balance, cash basis	-5.0	-2.6	-1.6	-1.8

Sources: Georgian authorities; and Fund staff estimates.

² The last Selected Issues paper (Chapter III, IMF Country Report No. 01/211) highlighted the low level of social spending in Georgia.

in 2001 the cash deficit was financed almost entirely from external sources, the deficit in 2002 is projected to be covered in roughly equal parts through net foreign and net domestic borrowing (Table 4). Privatization receipts are expected to increase only slightly, and no major state-owned companies are assumed to be sold this year.

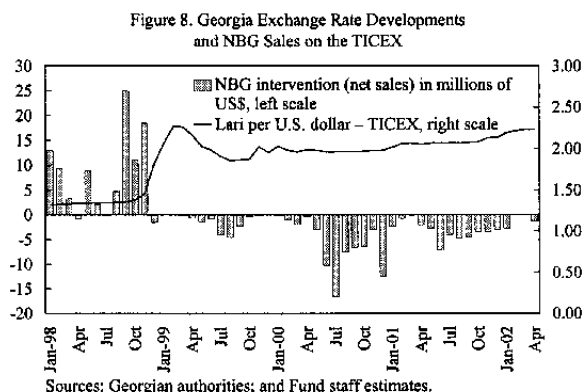
15. Social spending is projected to increase, despite overall expenditure restraint. Non-interest current expenditures are budgeted to decrease to 14 percent of GDP in 2002, from 14¾ percent in 2001, while interest payments are expected to increase. Nevertheless, social sector spending commitments (pensions, poverty benefits, refugee allowances, health care, education, and food) are projected to remain stable at about 8¼ percent of GDP. Arrears clearance in the social sector would amount to an additional ½-¾ percent of GDP, thus raising social spending on a cash basis relative to the 2001 outturn.

16. Staff stressed the need for tax-raising policy and administration measures to underpin the budgeted increase in tax revenues of ½ percent of GDP. The authorities felt that this increase could be achieved through improvements in administration alone. They accepted staff advice, however, that this would not be sufficient, in view of several revenue-losing tax policy changes made in late 2001 and early 2002, including tax concessions to the energy sector and a reduction in the taxation of imported cars. They therefore implemented a package of tax policy measures in June, as a prior action for the review, raising up to ½ percent of GDP in 2002 and one percent in a full year. The package includes the removal of a number of VAT exemptions (raising 0.2 percent of GDP in 2002), increases in non-agricultural land taxes and car fees (0.1 percent) and replacing VAT on bread production with a fixed tax (0.15 percent). A more comprehensive tax reform, originally planned for January 2002, aimed at simplifying the system and broadening the tax base, was shelved due to lack of support from parts of the government and parliament.

B. Monetary and Exchange Rate Policies

17. Monetary policy aims to keep inflation within the 4-6 percent range. Net banking sector credit to the general government is targeted at about ¾ percent of GDP, most of which would come from the NBG and the remainder from treasury bill purchases by commercial banks. Reserve and broad money growth in 2002 are projected to be broadly in line with growth rates in 2001 (Table 5). The authorities and staff agreed that this would be consistent with the NBG's inflation objective, as long as recent trends in remonetization and declining velocity continue. However, given the possibility of short-term fluctuations in money demand and velocity, the NBG will maintain a cautious monetary stance and may aim to keep monetary aggregates below program levels as long as the recent upward trend in inflation persists.

18. **The NBG intends to maintain the floating exchange rate regime, with intervention solely to build up official reserves.** The NBG may make foreign exchange purchases beyond those envisaged under the program, unless the recent upward trend in inflation persists and would thus warrant a more cautious monetary stance. Staff supported this policy, in light of the low level of reserves.



C. External Sector

19. **Georgia's balance of payments is expected to remain weak in 2002.** This is based on an expectation of only modest export growth and a continuing decline in foreign direct investment, as a result of the more difficult global environment. Even with a relatively modest target for international reserves of 1¼ months of imports, the staff projects that there would be a financing gap of about US\$12 million this year without the proposed rephasing of Fund disbursements (Table 6).

Text Table 2. Georgia: Balance of Payments
(In percent of GDP)

	2000	2001	2002
			Program
Exports	17.3	15.5	15.1
Imports	30.8	29.7	29.2
Current Account Balance	-5.4	-6.7	-6.2
Foreign Direct Investment	5.0	3.0	2.5
Reserves, in mths of imports of goods & services	1.0	1.4	1.7

Sources: Georgian authorities; and Fund staff estimates.

20. **Most bilateral creditors have agreed to reschedule Georgia's debts on terms comparable with the 2001 Paris Club agreement.** Negotiations with Georgia's largest creditor, Turkmenistan, are continuing. Georgia paid US\$12 million to Turkmenistan through aircraft services in 2001 and has reached tentative agreements to service interest and reduce principal arrears through further noncash transactions in 2002. These payments exceed scheduled interest due in 2001 and 2002 (about US\$7 million). Uzbekistan has yet to agree to reschedule its US\$1 million in claims. China has indicated its willingness to discuss a restructuring of its US\$2 million in claims.

21. **Debt sustainability remains a serious concern.** The Georgian authorities have indicated that they will request additional debt rescheduling, on concessional terms, from the

Paris Club for 2003 and beyond, when debt service pressures are particularly severe and substantial balance of payments gaps are projected.³

22. **Protectionist pressures have intensified.** A temporary ban on timber exports expired at end-2001, but parliament introduced in December a ban on the export of nonferrous scrap metal, which accounts for about 8 percent of registered exports. The staff argued that such a ban could seriously damage the balance of payments and undermine the rationale for further support under the PRGF arrangement. Parliament reversed the ban in June 2002, as a prior action for the second review. Parliament is also considering government proposals to raise some existing import tariffs and increase the dispersion of tariffs, albeit consistently with Georgia's WTO commitments. The mission reiterated its advice to keep the average tariff rate low and the tariff structure simple.

D. Structural Reforms

23. Structural conditionality under the program covers further fiscal and financial sector reforms and measures to support an acceleration of reforms in the energy sector. (See Box 1 for a discussion of the rationale for Fund structural conditionality and the roles of the Fund and the Bank).

24. **The authorities intend to strengthen the budgetary process and the treasury system.** A new budget system law, reflecting FAD and LEG advice, will significantly strengthen transparency and fiscal accountability. A computer-based system for registration of all expenditure commitments and verification of all expenditures should be in place by end-September. By end-2002, all existing revenue and transit accounts of the ministry of revenues held at the NBG should be closed and replaced by a treasury single revenue account. This will improve cash management and the tax refund mechanism. Customs reform will also be a priority. Following the recent intensification of anti-smuggling measures, the authorities are planning to take additional steps by end-July 2002 (MEFP, paragraph 22).

25. **The banking sector remains fragile, and more needs to be done to strengthen supervision and governance.** Several banks are distressed and the entire sector is exposed to considerable exchange rate and credit risks. Staff urged the NBG to strengthen its supervision of problem banks and to speed up the resolution of insolvent banks. The authorities noted that they had intensified their efforts in this area, highlighting that one politically sensitive problem bank was put into forced administration in late 2001, while staff argued that delays in addressing this problem had been costly. The NBG intends to implement the recently adopted analytical framework for resolving insolvent banks and the procedures for special supervision of problem banks, in line with MAE recommendations. To strengthen

³ Paris Club creditors agreed in March 2001 to consider an extension of the consolidation period in case of a financing need in 2003.

governance and transparency in the sector, the NBG will implement several additional measures during 2002 (MEFP, paragraph 24).

Box 1. Structural Conditionality

Coverage of Structural Conditionality in 2002

Structural conditions are set out in the MEFP, Table 1. Fiscal and financial sector measures are central to the Fund's core macroeconomic objectives. In addition, the authorities have agreed to broaden the coverage of energy sector reforms under the PRGF-supported program, in recognition of the macroeconomic risks arising from low collection rates, frequent power outages, substantial quasi-fiscal deficits and high energy sector debts. Program measures in the energy sector have been designed in close consultation with the World Bank. They are expected to reinforce the efforts of other donors, who currently lack an instrument to apply such conditionality effectively. The World Bank remains in the lead in designing reforms in this sector.

Status of Structural Conditionality from Earlier Programs

All structural measures included in the first year of the current arrangement have been effectively implemented, with the exception of the imposition of a debt surcharge on the electricity tariff and the implementation of a new budget system law (Table 2). The former was rejected by parliament, and a new approach to resolving energy sector debts has been developed, as a prior action for the current review. The latter was delayed by the government crisis last year and the resulting postponement of technical assistance. It is to be completed by end-October 2002, as a structural performance criterion.

Structural Areas Covered by World Bank Lending and Conditionality

The World Bank is in the lead on reforms in the energy and water sectors, the social sector, public administration, and agriculture. Reforms will be supported by the ongoing Structural Reform Support Credit, SAC III, a proposed SAC IV and a SATAC 3, as well as by sector-loans:

- In the energy sector, reforms are aimed at expanding private sector involvement. These reforms are supported by the Electricity Market Support Project, financed by the World Bank, EBRD and KfW. A contract for management of the Tbilisi Water utility is currently being finalized.
- A Public Expenditure Review is underway. It will highlight the need for reforms of public expenditure management to ensure adequate budgetary provisions and more efficient expenditure on health, education, and social safety nets.
- Public administration measures to support the government's anticorruption agenda include reforms in public procurement and licensing, internal audit, the judiciary, civil service, and privatization.
- Key reforms in agriculture include land market development, irrigation, forest conservation, and privatization of the agro-processing industry.

Other Relevant Structural Issues

The World Bank and IMF are supporting the development of Georgia's poverty reduction strategy. The World Bank has prepared a Poverty Update for Georgia. The IMF is providing advice on the medium-term fiscal framework. There are no areas of major macroeconomic relevance without IMF or World Bank involvement.

26. **The authorities plan to accelerate reforms in the energy sector to address its critical condition.**⁴ Reforms will aim to resolve energy debts, introduce private management, and raise collection rates (MEFP, paragraph 25). A strategy for the resolution of energy debts was adopted as a prior action for the second review. It envisages a variety of debt service mechanisms, including use of part of the profit component of the existing electricity tariff. Fund and Bank staff regard it as realistic and a significant step forward. Management contracts have been signed for the wholesale electricity market and electricity transmission and dispatch. State-owned distribution companies outside Tbilisi were recently merged in preparation for eventual privatization or a management contract. The government plans to restrict noncash operations and to improve payments discipline by budgetary organizations and state-owned companies, such that cash collection rates from these consumers would average 70 percent in the second and third quarters of 2002. Reflecting these efforts, cash payments by budgetary organizations rose sharply in the first quarter of 2002.

Text Table 3. Georgia: Electricity Sector Cash Collection Rates
(In percent, period averages)

	2001	2002			
	Actual	Q1 Actual	Q2 Target	Q3 Target	Q4 Target
Wholesale Electricity Market					
Total (excl. Abkhazia)	21	33	40	46	54
Direct customers	23	25	65	75	80
Budgetary organizations	44	64	65	75	85

Sources: Georgian authorities; and Fund staff estimates.

27. **Anti-corruption efforts are focused on fiscal reforms.** The new budget system law and efforts to streamline tax collections are central to the authorities' efforts to increase fiscal transparency. In addition, based on the recommendations of Georgia's anti-corruption council, the government is developing a plan to restructure the top level of government, sharply reduce the number of ministries and staff, and raise salary levels of remaining staff.

28. **The full PRSP should be finalized this year.** The authorities have prepared a progress report. While the staff supports the overall strategy of removing obstacles to private sector growth and reforming the social sector, the current strategy still lacks prioritization and costing of the proposed reforms. These elements are particularly important in Georgia, given the tight fiscal envelope over the medium term. Prioritization would also help focus discussions with nongovernmental organizations and donors. The World Bank's forthcoming

⁴ The latest Selected Issues paper (Chapter VI, IMF Country Report No. 01/211) summarizes the problems of this sector.

public expenditure review focuses on social expenditures. Its recommendations should help improve the tracking and efficiency of poverty-related expenditures. The authorities have initiated their own social impact analysis of the main reforms set out in the PRSP and plan to complete this work by September 2002. No other poverty and social impact analyses are planned at this stage.

IV. PROGRAM MONITORING AND PHASING OF DISBURSEMENTS

29. Program monitoring issues—including prior actions, performance criteria, structural benchmarks, and review conditions—are discussed in the MEFP, paragraphs 28-30, and attachments.

30. Under the program, a disbursement of SDR 9 million would be available upon completion of the second review and a total of SDR 36 million for the year as a whole. However, in order to finance a higher than originally projected overall balance of payments deficit in 2002, the authorities are requesting that SDR 9 million in disbursements (6 percent of quota) be brought forward into 2002, increasing total disbursements to SDR 45 million, while reducing disbursements in 2003 to SDR 36 million. Total access under the PRGF arrangement would remain unchanged. The authorities are also requesting a switch from quarterly to semi-annual disbursements. This would tie disbursements directly to semi-annual reviews and allow a more comprehensive assessment of progress on macroeconomic stabilization and structural reform before each disbursement. Considering the proposed rephasing, this would imply a disbursement of SDR 22½ million following the completion of the second review and another of the same amount following the third review, scheduled for November 2002 (Table 8).

V. STAFF APPRAISAL

31. **Macroeconomic performance has been strong, despite an unfavorable environment.** Growth has been robust, despite weak external demand, particularly from neighboring Turkey. Inflation has remained moderate, albeit a little higher than last year owing mainly to a modest exchange rate depreciation associated with a government crisis last fall. These developments reflect the continued pursuit of sound macroeconomic policies. The staff supports the stance of fiscal policy, as reflected in the 2002 budget, as well as the NBG's maintenance of a cautious monetary policy and the floating exchange rate regime.

32. **The main problem identified in discussions for the review was the slow implementation of reforms in some areas that are central to macroeconomic performance**—tax policy and administration, trade policy, and the energy sector. This reflects substantial disagreement within government, widespread administrative corruption, and resistance from vested interests that are well represented in parliament. Recent steps, including some taken as prior actions for the review, help to reassert government authority and commitment to reforms in these areas. But, with ownership of these reforms only narrowly based, further progress remains uncertain.

33. **Reforms of budgetary management are progressing well, but the pace of revenue reforms has been disappointing.** The staff looks forward to implementation of the new budget system law and further steps to strengthen the treasury. The main problem on the revenue side is weak administration. Continuation of recent progress in tax administration and a strong initiative on customs reform are therefore top priorities. Stronger tax administration cannot, however, compensate fully for frequent revenue-losing policy measures, often implemented at the behest of vested interests. The recent tax package that reduces exemptions represents a positive step in reversing the steady erosion of the tax base, and the staff hopes it will mark a turning point in the direction of tax policy reforms. Staff regrets that the broad tax reform package developed last year, with Fund advice, met with strong opposition and was shelved. The authorities will need to be flexible in developing a broadly-owned, comprehensive reform aimed at simplifying the tax code and encouraging enterprise. The staff would be prepared to support a wide range of approaches consistent with the overall aims of broadening the tax base and steadily raising the tax-to-GDP ratio.

34. **The banking sector remains vulnerable and the NBG will need to make effective use of its new supervisory capacity to deal forcefully with problem banks.** The staff welcomes the authorities' commitment to do this, and to implement further measures this year to strengthen governance and transparency in the banking sector. It will be important to intervene more quickly than in the past in problem banks.

35. **The staff urges the authorities to continue to resist protectionist pressures, which are likely to remain intense.** Interest groups continue to press hard for export bans, import tariffs, and differential taxation to protect domestic enterprises. The recent reversal of a ban on the export of nonferrous scrap metal, in face of strong parliamentary opposition, is an important signal of the government's intention to resist such pressures and fulfill its international commitments to liberal trade, reflected in its membership in the WTO.

36. **Faster progress on energy sector reform is needed to reduce the risks to macroeconomic stability.** The staff particularly regrets tax concessions granted in late 2001 to compensate energy companies for their lack of progress in raising collections and reducing theft. Staff welcomes the development of a strategy to address the debts of the sector, based on the authorities' own preferred approach and not that originally advocated by staff. The authorities are encouraged to actively engage with creditors to implement this strategy. They are also encouraged to maintain recent progress toward introducing private management in the sector. The key, however, will be whether the sector can raise cash collections substantially. The government has a central role in ensuring much higher payments from large state enterprises and the budget.

37. **Medium-term risks remain substantial.** The authorities face a substantial challenge in building broad ownership of reforms in some areas. Sustained efforts to improve governance and fight corruption will be needed to strengthen the business environment and encourage investment. Slow growth of GDP and revenues would constrain the authorities' poverty reduction efforts and increase vulnerabilities associated with high external debts.

Careful costing and prioritization of the poverty reduction strategy will therefore be essential, and many of the more ambitious proposals would require a level of additional concessional financing that currently seems unlikely. The staff supports the authorities' view that further, concessional rescheduling of external debts will be important but stresses the need for strong performance under the program this year—particularly regarding revenues—to justify further assistance.

38. On balance, staff considers that recent strong macroeconomic performance in a difficult external environment and efforts to reestablish the momentum of key structural reforms warrant completion of the second review. In view of the corrective actions taken following nonobservance of some end-December 2001 performance criteria, strong performance that was broadly in line with indicative fiscal and monetary targets for the first quarter of 2002, and the increased balance of payments need, the staff supports the authorities' request for waivers of performance criteria and their request for higher disbursements this year.

Table 1. Georgia: Quantitative Performance Criteria and Indicative Targets, March-December 2001 1/

	Stocks 2/		Cumulative Change from end-March 2001								
	end-Dec. 2000	end-Mar. 2001	end-June 2001			end-Sep. 2001			Performance Criteria		
	Actual	Actual	Target	Adj.T.	Actual	Target	Adj.T.	Actual	end-Dec. 2001		
									Target	Adj.T.	Actual
(In millions of lari)											
1. Quantitative targets 3/											
Floor on general govt. tax revenue (including special funds) 4/	851.5	202.7	232.7	232.7	238.6	492.5	492.5	493.5	760.3	760.3	748.7
Ceiling on cash deficit of the general govt. (CDGG) 5/	153.6	3.4	58.7	50.0	21.6	52.2	65.6	45.6	87.4	112.2	105.7
Ceiling on domestic expenditure arrears of the general govt.	n.a.	37.1	-10.0	-10.0	-11.6	-33.3	-33.3	-24.7	-43.3	-43.3	-25.8
Ceiling on net credit of the banking system to the general govt. (NCG) 6/ 7/	738.1	719.2	37.8	37.8	14.2	47.1	41.5	21.9	19.1	17.4	5.4
Ceiling on net domestic assets (NDA) of the NBG 6/	820.1	815.7	23.5	23.5	15.5	28.1	22.5	-0.4	-12.5	-14.3	-15.9
(In millions of U.S. dollars)											
Floor on total net international reserves (NIR) of the NBG 8/	-214.4	-228.2	2.3	2.3	4.3	8.5	11.3	22.9	32.8	32.9	43.2
Ceiling on contracting or guaranteeing											
A. short-term external debt (less than one year)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
B. nonconcessional medium- and long-term external debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(In millions of lari)											
2. Indicative targets											
Reserve money	391.2	359.3	28.1	28.1	24.1	45.2	45.2	45.4	53.2	53.2	70.6
Cigarette and petroleum revenues	100.5	24.9	31.1	31.1	28.4	71.4	71.4	55.9	111.7	111.7	85.2
Cumulative Change from end-March 2001											
			end-June 2001			end-Sep. 2001			end-Dec. 2001		
(In millions of U.S. dollars)											
3. Adjusters											
A. Net foreign-currency non-project financing 8/											
Projection						-0.8			-3.9		23.7
Outturn						-0.8			-1.1		23.8
Adjustment to NIR target						0.0			2.8		0.1
(In millions of lari)											
B. Net external non-project financing of the general govt. 6/											
Projection						-1.5			-7.8		36.3
Outturn						-1.5			-2.2		38.1
Adjustment to NDA and NCG targets						0.0			-5.6		-1.8
C. External project financing minus grants for debt operations 5/											
Projection						24.6			25.6		40.5
Outturn						15.9			38.9		65.3
Adjustment to cash deficit target						-8.8			13.4		24.7

Sources: Fund staff estimates.

1/ Section 1 shows performance relative to quantitative targets and performance criteria for end-December 2001, based on cumulative changes from end-March 2001. Some ceilings and floors are subject to adjustment, as indicated in footnotes 5, 6, and 8, based on deviations from projections of external financing, shown in Section 3. Continuous performance criteria are described in paragraph 53 of the MEF (Georgia Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, December 6, 2000).

2/ Year-to-date flows for tax revenues, cash deficit, expenditure arrears, and cigarette and oil revenues.

3/ Based upon accounting exchange rates 2 lari/US\$ and 1.35 US\$/SDR.

4/ Special state funds include the Pension, Employment, and Road Funds. Privatization receipts are excluded.

5/ As described in the TMU (IMF Country Report No. 01/212), the program target on the cash deficit is adjusted for deviations from projected disbursements of external project finance minus grants for debt operations (Section 3C). The ceiling for the cash deficit of the general government for the end of a month will be adjusted upward (downward) by the full amount of the cumulative excess (shortfall) of external project financing minus grants for debt operations, subject to a cap on cumulative upward adjustment of lari 80

6/ As described in the TMU (IMF Country Report No. 01/212), program targets on NCG and NDA are adjusted for deviations from projected net external non-project financing of the general government (Section 3B), defined as the sum of all foreign-currency privatization receipts and World Bank SAC&ESAC disbursements, minus external amortization payments by the general government (net of debt reduction grants). The ceilings for NCG and NDA will be adjusted upward (downward) by the full amount of the cumulative shortfall (excess) of net external non-project financing, subject to a cap on cumulative upward adjustment of lari 40 million.

7/ The stock excludes the recapitalization bond issued by the government to cover NBG losses in 1998.

8/ As described in the TMU (IMF Country Report No. 01/212), the program target on NIR is adjusted for deviations from projected net foreign-currency non-project financing (Section 3A), defined as the sum of foreign-currency privatization receipts and World Bank SAC&ESAC disbursements, minus foreign-currency amortization by the general government and the NBG (net of debt reduction grants). The floor on NIR will be adjusted downward (upward) by the full amount of the cumulative shortfall in net foreign-currency non-project financing, subject to a cap on downward adjustment of US\$32.5 million.

Table 2. Georgia: Past Structural Benchmarks and Performance Criteria

	Date Due	Status
Fiscal Measures		
1. Adoption of code of conduct for tax and customs officials.	April 1, 2001	Adopted as a prior action for the first review.
2. Implement simplified VAT refund system and monitor refunds claimed and paid.	April 1, 2001	VAT fraud monitoring unit established. Tax code changes adopted to facilitate identification of fraudulent claims.
3. Amend legislation and regulations to strengthen control on procedures for granting customs exemptions.	July 1, 2001	Implemented through regulations and transfer of responsibility for granting of exemptions to the ministry of finance.
4. Audit the stock of expenditure arrears	July 1, 2001	Completed in August 2001.
5. Introduce commitments recording for contracts over lari 5,000 and strengthen commitments control.	July 1, 2001	Implemented, except for utilities and embassies.
6. Apply standard expenditure control procedures to off-budget accounts outside the treasury.	Jan. 1, 2002	Implemented in the context of the 2002 budget.
7. Adopt new budget system law (performance criterion).	Feb 28, 2002	Delayed. Structural performance criterion for end-October 2002.
Financial Sector Measures		
8. Issue new asset classification regulations for commercial banks.	Dec. 31, 2000	Implemented in January 2001.
9. Issue conflict of interest regulation for banks.	Mar. 31, 2001	Done. Regulations issued in May 2001.
10. Amend legislation to establish primacy of banking law in bank-related matters.	June 30, 2001	Done as a prior action for the first review.
11. Implement IAS in commercial banks comprising 80 percent of total banking sector assets.	Sep. 30, 2001	Banks have been submitting their monthly reports in IAS since February 2001.
12. Adopt an analytical framework for the resolution of insolvent banks.	Dec 31, 2001	Completed in March 2002.
Energy Sector Measures		
11. Impose debt surcharge of 0.3–0.7 tetri/kWh on the electricity tariff.	June 1, 2001	Not implemented. A strategy for the resolution of energy debts was completed in June 2002, as a prior action for the second review.

Table 3. Georgia: Macroeconomic Framework 1999–2007

	1999	2000	2001	2002	2003	2004	2005	2006	2007	
	Actuals		Prelim.			Program Scenario 1/				
(Percent change)										
Output, prices, money, and external trade										
Real GDP	3.0	1.9	4.5	3.5	4.0	4.0	4.0	4.0	4.0	
Consumer price index (average)	19.1	4.0	4.7	6.0	5.0	5.0	5.0	5.0	5.0	
Broad money (M3, lari)	20.7	39.0	18.5	18.8	14.7	15.0	15.3	15.7	16.1	
Exports (US\$)	-0.3	10.6	-6.0	3.0	6.2	5.2	6.1	6.2	6.4	
Imports (US\$) 2/	-11.8	-8.7	1.9	3.3	10.1	6.3	1.1	0.8	3.9	
(In percent of GDP)										
General government										
Total revenues and grants	15.4	15.2	16.3	16.9	17.2	18.0	18.3	19.0	19.6	
Tax revenues	13.8	14.2	14.3	14.7	15.2	15.7	16.2	16.7	17.2	
Non-tax revenues	0.8	0.8	1.3	1.1	1.1	1.2	1.4	1.5	1.7	
Grants	0.9	0.3	0.7	1.1	0.9	1.0	0.8	0.8	0.8	
Expenditures and net lending	22.1	19.2	18.2	18.0	18.2	19.0	20.0	20.3	21.5	
Current expenditure (incl. budget contingency)	20.0	18.2	16.5	16.4	16.3	17.1	18.1	18.7	20.0	
non-interest	17.2	15.2	14.7	14.1	14.4	15.4	16.7	17.3	18.6	
interest	2.8	3.0	1.8	2.3	2.0	1.7	1.5	1.4	1.4	
Capital expenditure and net lending	2.1	1.0	1.7	1.6	1.9	1.9	1.9	1.6	1.5	
Overall balance (commitment basis)	-6.7	-4.0	-2.0	-1.1	-1.0	-1.0	-1.7	-1.4	-1.8	
Overall balance (cash basis)	-5.0	-2.6	-1.6	-1.8	-1.6	-1.8	-2.5	-2.3	-1.8	
Financing	5.0	2.6	1.6	1.8	1.6	1.8	2.5	2.3	1.8	
Privatization	0.9	0.3	0.1	0.3	0.4	0.4	0.4	0.3	0.3	
Domestic financing	2.3	2.2	-0.4	0.8	0.2	0.1	0.4	0.6	0.3	
External financing (net)	1.7	0.0	1.9	0.8	1.0	1.2	1.6	1.4	1.2	
Disbursements (incl. in-kind)	2.9	1.1	2.4	1.9	2.2	2.4	2.3	2.0	1.9	
Amortization 3/	-1.2	-1.1	-4.1	-4.9	-2.6	-2.5	-1.9	-1.6	-1.5	
Debt rescheduling 3/	...	...	3.6	3.8	1.3	1.3	1.2	1.0	0.8
Saving and investment										
Investment	19.2	18.2	18.5	17.0	19.7	20.6	19.1	17.9	17.6	
Non-government sector 2/	17.1	17.1	16.7	15.4	17.8	18.7	17.2	16.3	16.1	
Of which: FDI	2.2	5.0	3.0	2.5	5.2	6.1	4.6	3.3	2.6	
Gross domestic saving	10.8	12.8	11.8	10.8	11.7	12.3	11.8	12.4	13.3	
Non-government sector	15.3	15.8	12.0	10.3	10.8	11.4	11.7	12.2	13.6	
Current account deficit 2/	8.5	5.4	6.7	6.2	8.0	8.3	7.2	5.5	4.3	
(In millions of U.S. dollars; unless otherwise indicated)										
Gross official reserves of the NBG	132	109	161	193	228	257	274	291	317	
(in months of imports of goods and services)	1.2	1.0	1.4	1.7	1.8	1.9	2.0	2.1	2.2	
Balance of payments gap 3/	0.0	0.0	0.0	0.0	12.5	48.8	44.9	35.4	21.7	
External debt, public and guaranteed 3/										
External debt stock	1,676	1,590	1,646	1,715	1,757	1,619	1,682	1,731	1,769	
<i>memo: without additional rescheduling</i>	1,676	1,590	1,646	1,715	1,789	1,861	1,924	1,973	2,011	
NPV of external debt	...	1,130	1,130	1,180	1,167	968	1,018	1,079	1,107	
as percent of 3-year av. exports of goods & services	...	135.5	121.9	115.3	111.9	88.3	87.6	87.8	84.3	
as percent of central govt. revenues, excl. grants	...	362.9	329.0	309.5	277.8	207.0	196.0	187.4	173.5	
External debt service, total	108	113	71	118	128	133	119	116	120	
<i>memo: without additional rescheduling</i>	108	113	71	118	176	187	177	167	166	
as percent of exports of goods and services	14.6	10.8	7.1	11.5	11.6	11.5	9.7	8.9	8.5	
as percent of central government revenues, excl. grants	37.9	36.2	20.6	31.0	30.4	28.5	22.9	20.2	18.9	
as percent of official reserves	81.6	102.9	43.9	61.4	55.9	51.9	43.4	40.0	37.9	
Memorandum items:										
Nominal GDP (in millions of lari)	5,666	6,016	6,655	7,264	7,932	8,662	9,458	10,329	11,279	
Exchange rate, average (Lari/US\$)	2.02	1.98	2.07	...	...	...	...	...	...
Real exchange rate against the US\$, average, percent change	-19.6	2.9	-2.9	0.8	0.2	0.8	0.5	0.5	0.5	
M3-velocity	n.a.	9.7	9.1	8.3	7.9	7.5	7.1	6.7	6.3	
Social sector expenditure commitments (percent of GDP)	n.a.	8.3	8.2	8.3	9.0	9.6	10.3	11.0	11.7	
Social sector spending, cash basis (percent of GDP)	n.a.	6.9	8.1	9.0	9.6	10.4	11.1	11.9	11.7	

Sources: Georgian authorities; and Fund staff estimates.

1/ The program scenario assumes net repayment of budgetary arrears of lari 320 million from 2002 to 2006, continued access to concessional external financing, and additional debt rescheduling.

2/ Large oil and gas pipeline projects are projected to increase investment and the current account deficit substantially in 2003–05.

3/ Based on 2001 Paris Club agreement, which reschedules 2001/02 maturities over 20 years, and assuming additional flow and stock rescheduling under Naples terms in 2003 and 2004. Data prior to 2002 are shown on a cash basis. Principal arrears to Turkmenistan are assumed to be amortized over 10 years. Remaining balance of payments gaps are assumed to be closed through exceptional financing.

Table 4. Georgia: General Government Operations: 2000-02

	2000		2001		2002		2002				
	Actuals		Actuals		Program		QI Prog.	QI Act.	QII Prog.	QIII Prog.	QIV Prog.
	mln lari	% GDP	mln lari	% GDP	mln lari	% GDP	million lari				
Total revenue and grants (excl. privat.)	913.3	15.2	1,081.9	16.3	1,225.3	16.9	279.2	274.2	305.5	316.9	323.6
Total Revenue	897.1	14.9	1,036.0	15.6	1,147.9	15.8	268.2	273.2	279.3	296.9	303.5
Tax revenue	706.6	11.7	795.6	12.0	890.2	12.3	186.8	190.4	222.8	237.5	243.1
Taxes on income	108.2	1.8	135.8	2.0	147.4	2.0	30.9	28.9	36.9	39.3	40.2
Taxes on profits	79.7	1.3	66.6	1.0	72.6	1.0	15.2	14.9	18.2	19.4	19.8
VAT	289.8	4.8	357.3	5.4	386.1	5.3	81.0	86.2	96.6	103.0	105.4
Customs duties	53.1	0.9	55.5	0.8	63.6	0.9	13.3	13.5	15.9	17.0	17.4
Excises	90.2	1.5	89.9	1.4	108.6	1.5	22.8	21.5	27.2	29.0	29.7
Other taxes	85.7	1.4	90.6	1.4	111.9	1.5	23.5	25.6	28.0	29.9	30.6
Nontax revenue	45.6	0.8	84.5	1.3	82.2	1.1	44.6	45.8	12.6	12.6	12.6
NBG Profit transfers	0.0	0.0	20.0	0.3	32.0	0.4	32.0	35.0	0.0	0.0	0.0
Extrabudgetary revenue 1/	144.8	2.4	155.9	2.3	175.5	2.4	36.8	36.9	43.9	46.8	47.9
Grants	16.2	0.3	45.9	0.7	77.4	1.1	11.0	1.0	26.2	20.1	20.1
Total expenditure and net lending	1,155.9	19.2	1,211.9	18.2	1,306.0	18.0	299.1	307.5	319.0	334.0	353.9
Current expenditure	1,094.2	18.2	1,095.7	16.5	1,179.8	16.2	267.5	273.0	287.4	302.4	322.4
Wages and salaries 1/	180.1	3.0	168.7	2.5	173.8	2.4	43.5	44.9	43.5	43.5	43.5
Goods and services	132.2	2.2	132.5	2.0	214.5	3.0	36.8	32.1	54.2	57.8	65.6
Transfers and subsidies 2/	166.7	2.8	136.9	2.1	96.8	1.3	24.2	31.7	24.2	24.2	24.2
Interest payments	178.4	3.0	117.5	1.8	168.6	2.3	44.1	40.7	30.8	38.2	55.4
Domestic	87.7	1.5	66.2	1.0	75.1	1.0	18.1	17.7	18.3	19.0	19.7
External	90.7	1.5	51.3	0.8	93.5	1.3	26.0	22.9	12.6	19.2	35.7
Extrabudgetary expenditures 3/	203.7	3.4	235.0	3.5	251.3	3.5	62.8	60.1	62.8	62.8	62.8
Pension Fund	174.0	2.9	197.8	3.0	209.1	2.9	52.3	52.3	52.3	52.3	52.3
Employment Fund	5.2	0.1	5.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Road Fund	24.5	0.4	32.1	0.5	42.2	0.6	10.6	7.8	10.6	10.6	10.6
Local government expenditures 4/	233.1	3.9	305.0	4.6	274.8	3.8	56.1	63.6	71.9	75.9	70.9
Capital expenditure	30.2	0.5	71.9	1.1	110.4	1.5	27.6	24.5	27.6	27.6	27.6
Of which: Foreign financed	25.4	0.4	69.1	1.0	95.1	1.3	23.8	23.5	23.8	23.8	23.8
Net lending	31.6	0.5	44.3	0.7	5.8	0.1	1.5	10.0	1.5	1.5	1.5
Of which: Foreign financed	34.7	0.6	33.1	0.5	14.8	0.2	3.7	7.7	3.7	3.7	3.7
Budget contingency	0.0	0.0	0.0	0.0	10.0	0.1	2.5	0.0	2.5	2.5	2.5
Overall balance (commitments)	-242.6	-4.0	-130.0	-2.0	-80.7	-1.1	-19.9	-33.3	-13.5	-17.1	-30.3
Adjustment to cash basis	89.0	1.5	20.9	0.3	-49.0	-0.7	-7.0	2.3	-14.0	-13.0	-15.0
Net change in expenditure arrears (-, reduction)	84.0	1.4	12.7	0.2	-49.0	-0.7	-7.0	1.0	-14.0	-13.0	-15.0
External interest	0.0	0.0	0.1	0.0	0.0	0.0	0.0	4.0	0.0	0.0	0.0
Domestic expenditure	84.0	1.4	12.6	0.2	-49.0	-0.7	-7.0	-3.0	-14.0	-13.0	-15.0
TMU Definition	n.a.	n.a.	11.3	0.2	-45.0	-0.6	-5.0	-3.0	-14.0	-13.0	-13.0
Net other cash balancing	5.0	0.1	8.2	0.1	0.0	0.0	0.0	1.4	0.0	0.0	0.0
Overall balance (cash)	-153.6	-2.6	-109.1	-1.6	-129.7	-1.8	-26.9	-31.0	-27.5	-30.1	-45.3
Total financing	153.6	2.6	109.1	1.6	129.7	1.8	26.9	31.0	27.5	30.1	45.3
Privatization	19.1	0.3	5.6	0.1	20.0	0.3	3.0	1.7	3.0	6.0	8.0
Domestic	133.0	2.2	-25.3	-0.4	55.0	0.8	3.5	-0.4	10.5	14.0	27.0
NBG 5/	136.9	2.3	-15.0	-0.2	40.0	0.6	0.5	-8.5	4.0	11.5	24.0
Commercial banks (t-bills and deposits)	-1.5	0.0	1.5	0.0	10.0	0.1	2.0	4.3	5.0	1.0	2.0
Commercial banks (other)	-13.1	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nonbank (t-bills and other)	10.7	0.2	-11.8	-0.2	5.0	0.1	1.0	3.7	1.5	1.5	1.0
External	1.6	0.0	128.8	1.9	54.8	0.8	20.4	29.7	14.0	10.1	10.3
Disbursements	68.6	1.1	162.4	2.4	140.1	1.9	24.8	30.5	38.4	38.4	38.4
Memorandum items:											
Tax revenue, program definition	851.5	14.2	951.5	14.3	1,065.7	14.7	223.6	227.4	266.7	284.3	291.0
Cigarette tax revenue	38.6	0.6	30.3	0.5	41.0	0.6	8.6	8.3	10.3	10.9	11.2
Gasoline and petroleum tax revenue	61.8	1.0	79.7	1.2	103.3	1.4	21.7	21.0	25.9	27.6	28.2
Nominal GDP (millions of lari)	6,015.5		6,654.6		7,263.5						

Sources: Georgian authorities; and Fund staff estimates.

1/ Exclude payroll to SSF and to EF (2000 and 2001) or employment programs (2002).

2/ Exclude transfers from Central Budget to Local Budgets, to SSF and to EF (2000 and 2001) or employment programs (2002).

3/ Include transfers and payroll from Central Budgets and payroll from Local Budgets.

4/ Include transfers from Central Budget. Exclude payroll to SSF and to EF (2000 and 2001) or employment programs (2002).

5/ Excluding for 2001 recapitalization transfers (28.1 million lari)

Table 5. Georgia: Accounts of the National Bank of Georgia and Monetary Survey, 1999–2002 1/
(End-of-period stocks; In millions of lari, unless otherwise indicated)

	1999	2000	2001		2002					
	Dec. Actual	Dec. Actual	Actual (1) 8/	Actual (2) 8/	Target	Mar. Adj.Target	Actual	Jun. Target	Sep. Target	Dec. Target
Accounts of the National Bank of Georgia										
Net foreign assets 2/	-440.3	-409.4	-339.6	-366.5	-378.3	-379.8	-377.8	-356.5	-337.7	-356.2
Gold	1.0	1.0	1.1	1.1	1.2	1.2	1.2	1.2	1.2	1.2
Foreign exchange reserves (including BIS account) 3/ 4/	255.5	216.1	331.8	347.8	318.0	316.4	322.4	387.6	392.4	414.2
Use of Fund resources 4/	-617.4	-549.8	-591.4	-629.2	-615.3	-615.3	-615.2	-663.2	-649.2	-689.5
Other foreign liabilities (net)	-79.5	-76.6	-81.0	-86.2	-82.1	-82.1	-86.2	-82.1	-82.1	-82.1
Net domestic assets	748.8	800.6	769.4	796.4	821.2	816.2	810.6	819.2	822.9	839.8
Net claims on general government 5/	687.5	782.2	739.1	739.1	739.6	734.6	730.7	743.6	755.1	779.1
Loans	709.2	802.5	767.6	767.6	767.6	762.6	767.6	769.6	781.1	802.6
Deposits	-21.7	-20.3	-28.5	-28.5	-28.0	-28.0	-37.0	-26.0	-26.0	-23.5
Claims on rest of economy	80.9	77.9	78.3	83.3	83.3	83.3	82.2	83.3	83.3	83.3
Claims on banks	1.9	4.0	0.7	0.7	1.2	1.2	0.5	2.3	3.3	4.4
Other items, net 5/	-21.4	-63.5	-48.7	-26.7	-2.9	-2.9	-2.8	-9.9	-18.8	-26.9
Reserve money (RM)	308.5	391.2	429.9	429.9	442.9	...	432.8	462.7	485.2	483.6
Currency in circulation (M0)	259.8	329.2	365.7	365.7	376.3	...	361.6	391.7	409.1	406.2
Required reserves	29.7	38.9	53.3	53.3	58.2	...	57.6	62.1	66.5	67.7
Balances on banks' correspondent a/cs	19.0	23.1	10.9	10.9	8.3	...	13.5	8.9	9.5	9.7
Memorandum items:										
Growth of reserve money (in percent, relative to end of previous year)	18.8	26.8	9.9	9.9	3.0	...	0.7	7.6	12.9	12.5
Foreign exchange reserves (in mlns of U.S. dollars) 3/ 4/	132.4	109.4	161.1	161.1	147.9	147.2	149.9	180.3	182.5	192.6
Monetary Survey										
Net foreign assets 2/	-446.6	-422.2	-335.9	-362.6	-374.4	-375.9	-393.7	-352.6	-333.9	-352.4
Net domestic assets	891.2	1,040.5	1,068.3	1,095.1	1,145.1	1,140.1	1,151.1	1,167.0	1,197.5	1,222.8
Domestic credit	1,080.9	1,282.8	1,296.9	1,319.6	1,345.3	1,340.3	1,325.5	1,374.2	1,413.6	1,447.0
Net claims on general government	685.7	766.2	724.6	724.6	727.1	722.1	720.5	736.1	748.6	774.6
Public borrowings from DMBs	13.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Credit to the rest of the economy	395.2	516.6	572.3	595.0	618.2	618.2	605.0	638.1	665.0	672.4
Other items, net	-189.7	-242.4	-228.6	-224.5	-200.2	-200.2	-174.4	-207.2	-216.1	-224.3
Broad money (M3)	444.6	618.2	732.4	732.4	770.7	...	757.4	814.4	863.6	870.4
Broad money, excl. forex deposits (M2)	286.1	382.1	403.8	403.8	420.2	...	406.1	446.8	476.7	483.6
Currency held by the public	244.0	315.0	348.9	348.9	354.6	...	346.3	370.6	388.4	386.8
Total deposit liabilities	200.6	303.2	383.6	383.6	416.0	...	411.1	443.8	475.2	483.6
Memorandum items:										
Growth of broad money (in percent, relative to end of previous year)	20.6	39.1	18.5	18.5	5.2	...	3.4	11.2	17.9	18.8
Growth of credit to the rest of the economy (in percent)	34.5	30.7	10.8	15.2	3.9	...	1.7	7.3	11.8	13.0
M3 multiplier 6/	1.4	1.6	1.7	1.7	1.7	...	1.7	1.8	1.8	1.8
M3 velocity 7/	13.7	10.8	9.8	9.8	8.1	...	8.6	8.5	8.5	9.0
Foreign exchange deposits in percent of total deposits	79.0	77.9	85.7	85.7	84.2	...	85.5	82.8	81.4	80.0

Sources: National Bank of Georgia; and Fund staff estimates.

1/ Quarterly patterns reflect the expected timing for disbursements of World Bank and EU disbursements.

2/ Data for 1999, 2000 and 2001 are at actual exchange rates, unless indicated otherwise. Net international reserves in 2002 are valued at the program rate of 2.15 lari/US\$, US\$/SDR of 1.28 and US\$/Euro of 0.90.

3/ Includes SDR holdings and foreign currency account with BIS which is used for debt service payments.

4/ Assumes replasing of IMF disbursements proposed at the second review under the PRGF.

5/ In 1999, a lari 70 million government bond was issued to recapitalize the NBG for losses from revaluation of its net international reserves. In 2000, lari 42 million was repaid and the remainder in March 2001.

The bond raises government liabilities and is offset by an entry in OIN.

6/ M3 divided by reserve money (RM).

7/ Annualized quarterly GDP divided by end-period M3. Estimated for 2002.

8/ Data under (1) are evaluated at actual exchange rates and data under (2) at program rates for 2002.

Table 6. Georgia: Summary Medium-Term Balance of Payments, 1998-2007

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
	Act. 1/	Act. 1/	Act. 1/	Act. 1/			Projection			
(In million of U.S. dollars)										
Current account balance (including transfers)	-388.5	-238.0	-164.7	-214.5	-210.0	-287.2	-321.8	-300.9	-245.9	-206.0
Trade balance	-685.4	-549.3	-409.2	-458.3	-474.7	-542.2	-582.8	-560.7	-532.5	-536.9
Exports (total)	478.3	477.0	527.7	496.0	510.9	542.5	570.7	605.2	642.4	683.3
Imports 2/ (total)	-1,163.7	-1,026.3	-937.0	-954.3	-985.6	-1,084.7	-1,153.5	-1,165.9	-1,174.9	-1,220.2
Services (net)	86.3	135.7	124.4	107.9	110.6	101.4	96.7	102.4	119.7	154.1
Nonfactor services, credit	242.1	261.6	516.2	502.9	517.9	558.3	590.2	619.1	660.4	728.2
Nonfactor services, debit	-273.2	-247.3	-406.1	-397.2	-412.3	-455.3	-485.1	-501.6	-518.3	-545.2
Factor services, credit	193.3	206.1	88.7	70.3	75.0	79.9	85.1	90.2	95.2	100.6
Factor services, debit	-75.9	-84.7	-74.3	-68.2	-69.9	-81.4	-93.5	-105.2	-117.6	-129.6
Interest payments	-42.2	-47.1	-47.6	-49.3	-53.7	-51.5	-56.5	-62.4	-70.4	-78.7
Transfers	210.7	175.6	120.1	136.0	154.1	153.5	164.4	157.4	166.8	176.9
Capital account	247.9	79.2	86.2	106.0	85.5	256.0	299.9	274.0	227.3	207.0
Medium- and long-term loans	30.0	1.5	-74.5	-11.1	-30.7	45.2	48.6	65.4	72.0	69.6
Disbursements	111.9	95.5	35.0	117.2	143.0	155.5	175.6	187.8	194.9	210.8
World Bank	73.5	58.4	18.5	64.2	59.0	63.7	66.2	49.4	21.4	5.0
EBRD	8.8	4.2	6.2	1.8	29.0	40.0	25.0	0.0	0.0	0.0
IFAD	1.1	1.1	0.9	0.8	2.2	3.8	3.5	0.6	0.0	0.0
Bilateral	28.4	12.1	9.5	12.5	7.9	13.2	23.6	14.3	0.0	0.0
Other (including commercial & uncommitted)	0.0	19.7	4.4	38.0	44.8	34.8	57.3	123.6	173.5	205.8
Amortization	-81.9	-94.0	-109.5	-128.3	-173.7	-110.3	-126.9	-122.4	-122.8	-141.2
Foreign direct investment	221.0	61.7	152.6	96.1	85.8	189.1	238.1	192.3	145.6	125.3
Other (incl. commercial banks)	-3.1	16.0	8.0	21.0	30.5	21.6	13.2	16.4	9.7	12.2
Errors and omissions	15.9	94.2	14.0	21.5	-	-	-	-	-	-
Overall Balance	-124.6	-64.6	-64.6	-86.9	-124.4	-31.5	-22.0	-26.8	-18.9	1.0
Financing	124.6	64.6	64.6	86.9	124.4	19.0	-26.9	-18.1	-16.5	-22.7
Use of Fund resources, net	36.2	23.8	-25.9	19.1	28.0	5.8	-47.4	-50.0	-42.8	-36.1
Of which: purchases/disbursements	37.2	45.3	0.0	34.4	57.6	46.1	0.0	0.0	0.0	0.0
Of which: repurchases/repayments	1.0	21.5	25.9	15.3	29.6	40.3	47.4	50.0	42.8	36.1
Increase in reserves (-)	54.9	-14.0	23.0	-51.7	-31.5	-35.4	-28.9	-17.3	-16.8	-26.5
Change in arrears (+, increase) 2/	-93.8	54.8	67.6	5.3	-184.8	0.0	0.0	0.0	0.0	0.0
Debt and arrears rescheduling 3/	4.6	0.0	0.0	114.3	312.7	48.6	49.4	49.2	43.1	39.8
Rescheduling based on March 2001 Paris Club	...	...	...	114.3	127.9	0.0	0.0	0.0	0.0	0.0
Rescheduling of arrears 2/	...	...	...	0.0	184.8	0.0	0.0	0.0	0.0	0.0
Assumed additional Paris Club rescheduling	...	...	...	0.0	0.0	48.6	49.4	49.2	43.1	39.8
Macroeconomic support from the EU	122.7	...	...	...	...	...	...	...	...	...
Financing gap	...	...	...	...	0.0	12.5	48.8	44.9	35.4	21.7
Memo: without IMF rephasing or additional rescheduling	...	...	...	...	12.0	49.1	98.2	94.1	78.5	61.5
Memorandum items										
Current account deficit, including transfers										
(In percent of GDP)	-10.7	-8.5	-5.4	-6.7	-6.2	-8.0	-8.3	-7.2	-5.5	-4.3
Gross international reserves	118.4	132.4	109.4	161.1	192.6	228.0	256.9	274.2	291.0	317.5
(in months of imports of goods and services)	1.0	1.2	1.0	1.4	1.7	1.8	1.9	2.0	2.1	2.2
Debt service (after 2001 Paris Club rescheduling)	91.5	107.9	115.4	78.7	129.1	202.1	230.8	234.8	236.1	256.0
(In percent of GNFS exports)	12.7	14.6	11.1	7.9	12.6	18.4	19.9	19.2	18.1	18.1
External debt	1,629.4	1,701.3	1,612.7	1,704.1	1,830.5	1,943.7	2,056.3	2,168.2	2,274.0	2,368.9
(in percent of GDP)	45.0	60.7	53.0	53.1	54.2	53.9	53.1	52.2	51.1	49.7

Sources: Georgian Statistics Department, National Bank of Georgia, and Fund staff estimates.

1/ From 2000 onwards, the current account is based on a new series estimated by the NBS, which is not consistent with the series used for the original program and not consistent with data prior to 2000.

2/ It is assumed that the stock of arrears to Turkmenistan will be rescheduled over 10 years in 2002.

3/ Paris Club creditors agreed in March 2001 to reschedule principal falling due in 2001 through 2002 over 20 years, with a 3-year grace period. Additional rescheduling terms assumed here are based on Naples flow terms in 2003 and a stock-of-debt operation in 2004.

Table 7. Georgia: Indicators of Fund Credit, 1999–2009
(In million of SDRs, unless otherwise indicated)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
			Projections								
Outstanding Fund Credit	233.3	213.7	228.7	250.5	255.1	218.1	179.0	145.6	117.4	89.0	60.8
In percent of:											
Exports of goods and nonfactor services	43.2	27.0	29.1	31.2	29.7	24.0	18.7	14.3	10.6	7.6	4.9
Total public debt	18.7	17.5	17.1	17.5	16.8	13.6	10.6	8.2	6.3	4.7	3.1
Gross official reserves	240.9	257.5	180.7	166.5	143.2	108.7	83.6	64.0	47.3	33.6	21.3
GDP	11.4	9.3	9.1	9.5	9.1	7.2	5.5	4.2	3.2	2.2	1.4
Quota	155.2	142.2	152.1	166.7	169.7	145.1	119.1	96.9	78.1	59.2	40.4
Total obligations	19.3	23.2	14.9	25.1	33.5	38.6	40.2	34.2	28.8	28.9	28.6
In percent of:											
Quota	12.8	15.4	9.9	16.7	22.3	25.7	26.8	22.8	19.2	19.2	19.1
Exports of goods and nonfactor services	3.6	2.9	1.9	3.1	3.9	4.3	4.2	3.4	2.6	2.5	2.3
Total public debt	15.7	15.3	9.6	12.3	20.9	21.2	21.7	18.5	14.4	12.6	10.6
Gross official reserves	19.9	28.0	11.7	16.6	18.8	19.2	18.7	15.1	11.6	10.9	10.0
GDP	0.9	1.0	0.6	0.9	1.2	1.3	1.2	1.0	0.8	0.7	0.7
1. Principal	15.7	19.7	12.0	23.1	31.5	37.0	39.0	33.4	28.2	28.4	28.3
a. GRA Repurchases	15.7	19.7	9.3	9.3	9.3	9.3	4.6	0.0	0.0	0.0	0.0
b. PRGF/ESAF Repayments	0.0	0.0	2.8	13.9	22.2	27.8	34.4	33.4	28.2	28.4	28.3
2. Charges and interest	3.6	3.5	2.8	2.0	2.0	1.6	1.2	0.8	0.7	0.5	0.4
Obligations from existing drawings	19.3	23.2	14.9	25.0	33.2	38.2	39.8	33.8	24.4	16.0	10.4
(In percent of quota)	12.8	15.4	9.9	16.6	22.1	25.4	26.5	22.5	16.2	10.6	6.9
1. Principal	15.7	19.7	12.0	23.1	31.5	37.0	39.0	33.4	24.1	15.8	10.3
a. GRA Repurchases	15.7	19.7	9.3	9.3	9.3	9.3	4.6	0.0	0.0	0.0	0.0
b. PRGF/ESAF Repayments	0.0	0.0	2.8	13.9	22.2	27.8	34.4	33.4	24.1	15.8	10.3
2. Charges and interest	3.6	3.5	2.8	1.9	1.7	1.2	0.7	0.4	0.3	0.2	0.1
Obligations from prospective drawings			0.0	0.1	0.3	0.4	0.4	0.4	4.4	13.0	18.3
(In percent of quota)			0.0	0.1	0.2	0.3	0.3	0.3	3.0	8.6	12.2
1. Principal			0.0	0.0	0.0	0.0	0.0	0.0	4.1	12.6	18.0
a. GRA Repurchases			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
b. PRGF/ESAF Repayments			0.0	0.0	0.0	0.0	0.0	0.0	4.1	12.6	18.0
2. Charges and interest			0.0	0.1	0.3	0.4	0.4	0.4	0.4	0.4	0.3

Sources: Georgia authorities; and Fund staff estimates.

Table 8. Georgia: Disbursements Under the Three-year PRGF-Supported Arrangement

Actuals for 2001 and Program Based on First Review (IMF Country Report No. 01/212)				Proposed Rephasing for 2002/03			
Loan	Disbursement	Based on	Amount	Loan	Disbursement	Based on	Amount
1	Jan 2001	Approval of PRGF	SDR 9 million				
2	Mar 2001	Dec 2000 PCs	SDR 9 million				
3	Nov 2001	Mar 2001 PCs and first review	SDR 9 million				
4	Mar 2002	Dec 2001 PCs and second review	SDR 9 million	4	July 2002	Dec 2001 PCs and second review	SDR 22.5 million
5	Jun 2002	Mar 2002 PCs and third review	SDR 9 million	...	...	...	...
6	Sep 2002	Jun 2002 PCs	SDR 9 million	...	...	...	...
7	Dec 2002	Sep 2002 PCs and fourth review	SDR 9 million	5	Nov 2002	Sep 2002 PCs and third review	SDR 22.5 million
8	Mar 2003	Dec 2002 PCs	SDR 9 million	6	May 2003	Mar 2003 PCs and fourth review	SDR 18 million
9	Jun 2003	Mar 2003 PCs and fifth review	SDR 9 million	...	...	...	...
10	Sep 2003	Jun 2003 PCs	SDR 9 million	...	...	...	...
11	Dec 2003	Sep 2003 PCs and sixth review	SDR 9 million	...	...	...	...
12	Dec 2003	Sep 2003 PCs and sixth review	SDR 9 million	7	Nov 2003	Sep 2003 PCs and fifth review	SDR 18 million
<i>Memorandum items:</i>							
Loans, in millions of SDR			108.0	Loans, in millions of SDR			108.0
2001			27.0	2001			27.0
2002			36.0	2002			45.0
2003			45.0	2003			36.0

GEORGIA: FUND RELATIONS

(As of May 31, 2002)

I. Membership Status: Joined 05/05/1992; Article VIII

II. General Resources Account:	SDR Million	Percent of Quota
Quota	150.30	100.00
Fund holdings of currency	180.36	120.00
Reserve position in Fund	0.01	0.01

III. SDR Department:	SDR Million	Percent of Allocation
Holdings	0.56	N/A

IV. Outstanding Purchases and Loans:	SDR Million	Percent of Quota
Systemic transformation	30.06	20.00
ESAF/PRGF arrangements	190.73	126.90

V. Financial Arrangements:

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR million)</u>	<u>Amount Drawn SDR Million)</u>
PRGF	1/12/01	1/11/04	108.00	27.00
ESAF	2/28/96	8/13/99	172.05	172.05
Stand-by	6/28/95	2/28/96	72.15	22.20

VI. Projected Obligations to Fund: (SDR million; based on existing use of resources and present holdings of SDRs):

	<u>Overdue</u>	<u>Forthcoming</u>				
	<u>8/31/01</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Principal	0.0	15.30	31.5	37.0	39.0	33.40
Charges/interest	<u>0.0</u>	<u>1.60</u>	<u>1.5</u>	<u>1.1</u>	<u>0.6</u>	<u>0.40</u>
Total	0.0	16.90	33.0	38.1	39.6	33.8

VII. Safeguards Assessments:

Under the Fund's safeguards assessment policy, the National Bank of Georgia was subject to a full safeguards assessment with respect to the PRGF arrangement that was approved on January 12, 2001 and is scheduled to expire on January 11, 2004. The assessment found that safeguards at the NBG may not be generally adequate to safeguard resources. The assessment noted several vulnerabilities where recommendations were proposed, and NBG has made substantial progress in implementing the proposed recommendations.

VIII. Exchange Arrangements:

The currency of Georgia is the lari, which became the sole legal tender in October 2, 1995. The lari replaced the coupon, which was introduced in April 1993. Since April 29, 1993, the Tbilisi Interbank Currency Exchange (TICEX), established by the NBG and a group of commercial banks, has conducted periodic auctions to determine the exchange rate of the domestic currency. On June 14, 1993, the NBG authorized the establishment of foreign exchange bureaus that are allowed to buy and sell foreign currency bank notes.

The frequency of the TICEX auctions was increased from weekly to twice weekly in late September 1994, to thrice weekly in April 1995, and to daily from January 1, 1996.

From September 1994 until December 7, 1998 intervention was a major factor in the evolution of the exchange rate. However, the difference between the TICEX rates and those at foreign exchange bureaus has become smaller over time. Since December 7, 1998, the NBG has only intervened to purchase foreign exchange, to bolster the international reserves. From May 1, 2001, foreign exchange transactions can be made by electronically.

IX. Article IV Consultation:

- (a) Georgia is on a 12-month consultation cycle.
- (b) The 2001 Article IV consultation was concluded on October 26, 2001.

X. FSAP Participation:

Two FSAP missions visited Tbilisi during May 1-15, 2001 and July 24-August 7, 2001.

XI. Technical Assistance:

See Table 1 of this Appendix.

XII. Resident Representative:

The fourth resident representative, Mr. Dunn, took up his post on August 16, 2001, replacing Mr. Lane. Mr. Lane took up the post as resident representative on April 10, 1999, replacing Mr. Monroe. Mr. Monroe took up his post as resident representative on November 23, 1996, replacing Mr. Wang.

XIII. National Bank of Georgia:

Ms. Vance, MAE peripatetic banking supervision advisor to the NBG, commenced a series of visits to Tbilisi at the end of September 1997. Mr. Nielsen, an MAE advisor, provided technical assistance to the NBG during May 1998. Mr. Viksnins was an MAE peripatetic advisor to the NBG president starting in October 4, 1999. Mr. Fish was resident advisor on banking supervision from August 10, 1999 to January 31, 2002. Mr. Bernard Thompson provided peripatetic technical assistance in accounting and internal audit in March and August 2000.

XIV. Ministry of Finance Resident Advisors:

The late Mr. Sharma was an FAD resident advisor and assisted the authorities in the development of a Treasury. He assumed duties on May 1, 1997. Mr. Sainsbury, an FAD advisor, assisted the Ministry of Finance from June 1998 to November 1999. Mr. Chaturvedi is FAD resident advisor to assist the authorities in continuing the development of the Treasury and the Treasury Single Account, in revising the legislative framework, expenditure control systems, and budgeting issues. He assumed duties on June 1, 2001 for a one year assignment. His assignment has been extended for one year. Mr. Welling is FAD peripatetic advisor to assist the State Customs Department in preparing and introducing measures for the custom reform and modernization program. A series of two-month visits have been scheduled. Two visits took place in February-March and July-August 2001. The third visit is expected in 2003, depending on progress achieved in introducing reforms.

Table 1. Georgia: Fund Technical Assistance Missions, 2001-02

Subject	Type of Mission	Timing	Counterpart
Fiscal Affairs Department (FAD)			
Public Expenditure Management	Assessment of Treasury system and preparing work plan for the resident advisor	Jun. 12-19, 2001	Ministry of Finance
Public Expenditure Management	Review of the draft Budget System Law	Mar. 14-Apr. 02, 2002	Ministry of Finance
Monetary and Exchange Affairs Department (MAE)			
Banking, foreign exchange reserve management, monetary programming, and research	Advisory	Feb. 26-Mar. 8, 2001	National Bank of Georgia
Payment Systems, Bank Supervision and Resolution, Internal Audit, Foreign reserve Management, and Research	Advisory	Oct. 23-Nov. 6, 2001	National Bank of Georgia
Payment Systems and Bank Resolution	Advisory	Mar. 11-19, 2002	National Bank of Georgia
Statistics Department (STA)			
National Accounts	Follow-up assistance	Mar. 26-Apr. 6, 2001	State Department of Statistics
Balance of Payments Statistics	Follow-up Assistance	February 13-27, 2002	State Department of Statistics
Money and Banking	Follow-up Assistance	March 2-15, 2002	National Bank of Georgia
Legal Department (LEG)			
Tax Code	Follow-up Assistance	Jan. 28-Feb. 9, 2001	Ministry of Finance, Tax Inspectorate of Georgia
Tax Code	Follow-up Assistance	Jul. 13-24, 2001	Ministry of Finance, Tax Inspectorate of Georgia

GEORGIA: RELATIONS WITH THE WORLD BANK

(As of May 31, 2002)

1. Georgia joined the World Bank in August 1992 and the International Development Association (IDA) in August 1993. As of end-March 2002, the World Bank approved 24 investment and technical assistance credits and five adjustment operations, all with standard IDA terms, totaling US\$649.8 million. A resident mission was opened in Tbilisi in August 1996.
2. A third Structural Adjustment Credit (SAC III) and an Energy Sector Adjustment Credit (ESAC), equivalent to US\$60 million and US\$25 million, respectively, were approved by the World Bank Executive Board on June 29, 1999. SAC III supports the government's reform program, including strengthening fiscal performance, ensuring budgetary provisions for core social expenditures, improving the legal and regulatory framework for the private sector, and completing the process of privatization and market liberalization. Key reform objectives of the ESAC include, enhancing financial sustainability and management of the energy sector, privatization, and increasing the poverty benefit for the socially most vulnerable. The first tranches of SAC III (US\$20 million) and ESAC (US\$12.3 million) were released on July 27, 1999. The second tranches of US\$18.4 million (SACIII) and US\$11.3 million (ESAC) were disbursed respectively on December 27, 2001 and December 28, 2001.
3. On August 28, 2001, a Supplemental Credit (US\$2.7 million) to the Health Project was approved to allow the Government of Georgia complete activities that have already been initiated under the existing Health Project, and move closer towards the achievement of its development objectives for the health sector. An Irrigation and Drainage Community Development project (US\$27 million) was approved on June 28, 2001 to revitalize the irrigation and drainage sub-sectors and to develop the institutional foundation for the sub-sector's long-term sustainability for the benefit of increased crop production, and subsequent improvement in farm family incomes. On May 3, 2001 an Electricity Market Support project (US\$27.4 million) was approved to improve reliability and efficiency of electricity supply, and improve financial and corporate management in the wholesale electricity market. An Education project (US\$25.9 million) was approved on March 20, 2001, as the first phase of a 12-year program that seeks to improve the quality of primary and general secondary education, and develop the policy and institutional framework for education in Georgia. On March 13, 2001 an Energy Transit Institution Building project (US\$9.6 million) was approved to enhance Georgia's capacity to negotiate and implement oil and gas transit agreements in a manner that maximizes economic benefits and minimizes social and environmental costs.
4. Georgia joined IFC in 1995. To date IFC has approved eight projects in Georgia with a total commitment of approximately US\$81.6 million. IFC has disbursed a US\$ 30 million loan to Tbilisi electricity distributor AES TELASI to strengthen its electricity distribution network and to install new meters to improve collections. Currently IFC has three investments in the banking sector: (i) a US\$3 million credit line and a US\$0.86 million

equity investment in TBC Bank; (ii) a US\$0.78 million equity investment in the Microfinance Bank of Georgia; (iii) a US\$3 million credit line to the Bank of Georgia. The credit line to TBC supports the small and medium size enterprises, and mortgage-based financing, and that of the Bank of Georgia - mortgage-based financing for renovation and acquisition of both residential and commercial real estate. Apart from those projects, IFC committed approximately US\$30 million of investment in Azeri Early Oil to support the Georgian section of the oil pipeline and the Supsa oil terminal.

5. IFC has included Georgia in the list of countries covered by the Private Enterprise Partnership, and is currently contemplating new technical assistance initiatives in Georgia, including leasing and corporate governance. IFC team provides advisory services to the Government of Georgia on (i) privatization of electricity distribution and generation outside Tbilisi, and (ii) hiring private firms to manage transmission network, system dispatch, and the wholesale electricity market.

6. The Foreign Investment Advisory Service (FIAS), a joint facility of IFC and the World Bank, carried out an assessment of Georgia's investment climate in November 2001. It has also assisted the Government with the legislation on foreign direct investment and establishment of an investment promotion agency.

7. **Progress in Implementation:** Progress under the Bank-supported structural reform program, SAC III, has been slow. This reflects Georgia's relatively unstable political setting during much of the past two years. The project was approved in June 1999. The second tranche was released in December 2001 upon fulfillment of specific conditions, and the third (and last) tranche, is still pending. The program includes measures to: (i) strengthen fiscal management while ensuring budgetary provisions for health, education and social protection; (ii) improve the regulatory framework for private sector development; (iii) complete the process of privatization and market liberalization.

- In the area of **fiscal management**, progress has been made in reorganizing and downsizing the Ministry of Finance, and new procurement rules have been adopted and are increasingly being enforced by spending units. Overall budget execution has improved since mid-2000. Notably, the share of the social sectors in total government expenditures have been kept within agreed targets, and poverty benefits have remained current during this period while past arrears have been fully cleared. In addition, progress has been made in implementing the hospital restructuring program, e.g., a severance policy has been adopted and the privatization process of two facilities has begun.
- In the area of **privatization**, the strategy and regulatory framework for the restructuring of Poti Port and the telecommunications sector, have been established. The process to concession two berths of Poti Port has been initiated, but the privatization process for the telecommunications sector has to be re-launched due to

low investor interest during the first tender. Most non-infrastructure companies slated for privatization have been sold or placed under liquidation.

- On **regulatory reform**, the Government has conducted a number of reviews of the business environment in consultation with the private sector. In light of this, it has revised the licensing law and has begun simplifying the procedures for the certification of goods and services. The adoption of an appropriate legal framework for the sale and leasing of urban land has created conditions for the emergence of secondary land market.
- Of the eight conditions for third tranche release, most have been met or are on track for completion. However, there remain a few outstanding actions specifically in the area of licensing reform.

World Bank Contact: Peter Nicholas, Acting Country Director, 458-0420

GEORGIA RELATIONS WITH THE EBRD

(As of April 1, 2002)

8. As of April 1, 2002, the European Bank for Reconstruction and Development (EBRD) had signed 15 investments in Georgia with cumulative commitments totaling \$198 million.¹ The EBRD's first operation, a power rehabilitation project, was signed in December 1994. Since then, the pace and composition of portfolio growth has varied significantly from year to year. Two large public sector projects were signed at the end of 1998, and four private sector projects were signed in 1999-2000. The ratio of private sector projects in the portfolio now stands at 59.5 percent.

9. Recent projects in the **power sector** include a government-guaranteed loan, signed in December 1998, to rehabilitate hydropower generation and transmission capabilities, as well as a loan to Tbilisi's privatized electricity distribution company AES-Telasi, signed in December 1999, to help strengthen and expand the electricity distribution network, install power meters, and reduce power transmission losses.

10. In the **transport sector**, a government-guaranteed loan to Georgian National Railways was signed in December 1998, to finance a program of infrastructure improvements on the Georgian section of the South-Caucasian railway line. In March 2002 the Bank signed a loan of \$11.6 million with the JSC Channel Energy Poti Port Ltd. The project consists of building and operating a new oil terminal in the Port of Poti which will be able to serve the growing demand for export of oil products and derivatives from Central Asia and Azerbaijan to Africa, Europe and United States.

11. Recent projects in the **financial sector** include a convertible loan to Bank of Georgia, signed in June 1998, for on-lending to small and medium-sized enterprises, and a capital increase of \$6.1 million for MicroFinance Bank of Georgia, signed in October 2001, to encourage the development of micro and small enterprises. The EBRD has also issued guarantees under its trade facilitation program.

12. In the **industrial sector**, the EBRD signed private-sector loan projects with Ksani Glass Bottling Plant and Georgian Wine & Spirits, and an investment to develop the offshore Chirag oil field in 1999. In May 2000, it signed loans to Frontera Caucasus Corporation, to support the commercial development of oil production in eastern Georgia.

13. The EBRD has provided **technical assistance** through 56 operations, with a total commitment of \$8 million.

¹ Evaluated at an exchange rate of \$0.88 per euro.

Table I. Projects Signed by the EBRD

Project Name	Date of Agreement	Commitment Amount, US\$ millions 1/
Public Sector Projects		
Power Rehabilitation Project	December 1994	18
Tbilisi Airport Refurbishment	July 1995	11
Enguri Hydro Power Plant	December 1998	39
Trans-Caucasian Rail Link Project	December 1998	20
Private Sector Projects		
IBSB Georgia	September 1996	1
Georgia SME Credit Line (TBC Bank, TbilComBank, TbilcreditBank, Tbiluniversalbanki, Intellectbank)	December 1996–November 1997	12
Borjomi	June 1997	10
United Georgian Bank	November 1997	10
Bank of Georgia Convertible loan	July 1998	7
Ksani Glass Packaging Factory	May 1999	9
Regional trade facilitation program (Bank of Georgia, TBC Bank, United Georgian Bank)	July 1999-December 2000	5
Georgian Wines & Spirits	September 1999	5
AES-Telasi	December 1999	30
Microfinance Bank	March 2000	10
JSC Channel Energy Poti Port	March 2002	12
Total		198

1/ US\$ amounts calculated at an exchange rate of 0.88 U.S. dollars per euro, as of end-December 2001.

June 27, 2002

Dear Mr. Köhler:

Georgia has made progress in implementing the comprehensive economic reform program supported under the PRGF arrangement. Macroeconomic stability has been maintained, despite a deterioration in the external environment. There have also been some important reforms in the fiscal area and in the financial sector, although much more remains to be done.

In the attached Memorandum of Economic and Financial Policies, we set out our main macroeconomic objectives and structural reform initiatives for 2002, which are consistent with our medium-term policy objectives described in the draft Poverty Reduction Strategy Paper (PRSP). At the center of the program is the aim to increase fiscal revenue collection, in order to move towards levels of social spending and institutional reforms that could support long-term growth and poverty reduction. We will continue to improve expenditure management and strengthen banking supervision. We are also committed to accelerating reforms in the energy sector, further efforts in the fight against corruption, and improving the business environment.

In support of this program, Georgia requests the completion of the second review under the PRGF arrangement, following the implementation of measures set out in Table 1 (Section A). For reasons discussed further below, we also request a change in the frequency and phasing of disbursements and waivers for non-observance of end-December 2001 performance criteria on tax revenue and expenditure arrears, the end-February 2002 performance criterion on the adoption of a budget system law, and the continuous performance criterion on external arrears.

I am confident that the measures described below are adequate to achieve the broad objectives of the program. The government and the National Bank of Georgia (NBG) will take any other measures that may become appropriate for this purpose. The government will continue to consult regularly with the Fund concerning additional measures that may become appropriate and will provide the Fund with such information as the Fund requests in connection with the progress of Georgia in implementing the policies and reaching the objectives of the program supported under the PRGF arrangement. Georgia will conduct discussions with the Fund for the third review of its program under the PRGF arrangement before November 2002.

Yours truly,

/s/

Eduard Shevardnadze

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2002

A. Introduction

1. This memorandum sets out the economic and financial policy objectives of the Georgian authorities for 2002 and beyond. The policies to achieve these objectives are the basis for the second review under the 3-year program supported under the PRGF arrangement that was approved by the Executive Board of the IMF on January 12, 2001. The first review under the program was completed on October 26, 2001.

2. Georgia has made progress in implementing the economic program supported under the PRGF. Notable achievements include higher GDP growth and lower inflation than originally envisaged, an increase in international reserves, no significant net accumulation of social expenditure arrears in 2001, financial sector and public expenditure management reforms, and an agreement with Paris Club creditors on debt rescheduling.

3. However, progress was slow in some key areas. There has not yet been a sustained improvement in tax revenue collections, due to slow reforms of the tax and customs administration and frequent tax code amendments that have narrowed the tax base. Regional and political instability in Georgia, as well as a poor investment climate, have undermined the prospect for foreign investment. Despite recent initiatives, corruption remains a very serious problem. The serious situation in the energy sector constitutes a significant risk to macroeconomic stability and growth. The weakness of the Turkish economy has reduced export opportunities. Poverty remains widespread and the low level of fiscal revenues has hindered progress in addressing this problem.

4. Removing these constraints will be critical for achieving long-term economic growth and poverty reduction, as set out in the draft PRSP. In 2002, we will therefore prioritize our program on the following objectives:

- to maintain a stable macroeconomic environment, supported by a prudent monetary policy, including a build-up of official reserves, and further fiscal consolidation;
- to raise fiscal revenue by accelerating administrative reforms in the tax and customs areas, as well as through tax policy measures;
- to make further progress in improving budgetary expenditure management;
- to conclude bilateral debt rescheduling agreements with China, Turkmenistan and Uzbekistan on terms comparable with the Paris Club agreement in March 2001;
- to strengthen the financial system by making progress in implementing the recommendations of the recent FSAP and safeguards assessment;

- to accelerate structural reforms, in particular in the energy sector, and improve the business environment by making progress in the fight against corruption;
- to finalize a full poverty reduction strategy (PRSP) in consultation with civil society and the international community, focused on growth-enhancing strategies and appropriate social sector reforms.

5. We discuss these objectives in more detail below. In addition, we have reached understandings with Fund staff on a set of macroeconomic targets and structural benchmarks (Tables 1 and 2), subject to the specifications set out in the attached Technical Memorandum of Understanding (TMU).

B. Performance Under the Program

6. Real GDP growth was 4½ percent in 2001, reflecting a rebound in agriculture and strong growth in transport and retail trade. The industrial sector continued to shrink in 2001, partly due to energy supply problems early in the year. Inflation was 3½ percent at the end of 2001, below program projections. The exchange rate depreciated modestly, reflecting economic problems in Turkey and the dismissal of the Georgian government in late 2001.

7. Fiscal performance was uneven in 2001. Very low tax collections in the first quarter of 2001 and lower than expected external financing necessitated a revision to the program and a budget amendment in October 2001. Tax collections recovered from May onwards, although the end-December performance criterion was missed by a small margin. The performance criterion on arrears was also missed, although for the year as a whole the budget did not incur significant social expenditure arrears on a net basis, which was an important improvement over previous years. The fiscal deficit on a commitments basis fell from 4 percent of GDP in 2000 to 2 percent in 2001, and the end-December 2001 performance criterion on the cash deficit was observed.

8. Monetary policy in 2001 was in line with the revised program, and end-December monetary performance criteria were met. Reserve money growth exceeded program projections somewhat, reflecting a faster than expected accumulation of foreign exchange reserves by the NBG. Official reserves rose from US\$109 million at the end of 2000, to US\$161 million at the end of 2001, or 1½ months of imports of goods and services. Broad money grew by 18½ percent as the process of remonetization continued.

9. The balance of payments was negatively affected by weak demand from Turkey and the downturn in the world economy. The trade deficit widened in 2001, reflecting a decline in exports, and foreign direct investment was substantially lower than in the previous year. In March 2001, the Paris Club agreed to reschedule Georgia's bilateral debts falling due in 2001 and 2002 over 20 years, with a 3-year grace period and a graduated repayment schedule. All bilateral creditors except China, Turkmenistan and Uzbekistan have agreed to reschedule Georgia's debts on comparable terms. There was a delay in external interest payments to

China from mid-2001 and to the USA in late 2001, constituting a breach of the continuous performance criterion on external arrears. These arrears have now been cleared.

10. Structural reform implementation was slower than expected in 2001. While good progress was made in improving fiscal expenditure management, there was virtually no improvement in the revenue-raising agencies. Smuggling, tax evasion, and corruption remain widespread. Two anti-corruption decrees were issued in 2001 and their implementation is being monitored by a specially appointed council. While the supervisory capacity of the NBG was strengthened in 2001, the banking system remains too small to make a major contribution to financing Georgia's investment needs. There has been very little progress in reforming the energy sector in the last two years and much remains to be done in the agricultural sector.

C. Medium-Term Objectives

11. At the center of our medium-term economic program is a sustained increase in tax collections, with the tax-to-GDP ratio increasing by about ½ percentage point of GDP each year. This will require strengthening administration in the revenue-raising agencies, fighting corruption and smuggling, and policy reforms aimed at simplifying the tax system and broadening the tax base. The additional fiscal resources will be channeled primarily into the social sector, targeted at poverty reduction.

12. Current levels of public expenditure are too low to finance the social spending and strengthening of public institutions that are required to support long-term growth and poverty reduction. In addition to increased tax collections, assistance from donors and multilateral lenders will continue to be required to support structural reforms and investments in infrastructure, with a focus on health, education, agriculture, and the energy sector. We will also request additional debt rescheduling under the Paris Club, on concessional terms, to help finance projected balance of payments gaps and ensure medium-term debt sustainability. The limited capacity of the state to assume further debts will constrain the size of fiscal deficits over the medium term.

13. Improvements in governance and the investment climate will be necessary to achieve the target of at least 4 percent average GDP growth per year. Foreign direct investment and concessional project loans will be crucial to supplement limited domestic savings, in order to achieve the necessary scale and quality of investment. We will continue our policy of not assuming any new nonconcessional external debt. Monetary policy will continue to focus on maintaining low inflation and gradually building official reserves. This set of policies should ensure that the net present value of external debt falls to sustainable levels within the next 4-6 years.

D. Macroeconomic Prospects for 2002

14. Growth prospects for 2002 are constrained by weaknesses in the world economy. The program is based on a cautious assumption of 3½ percent real GDP growth. Export growth is assumed to be modest, reflecting a subdued recovery in external demand. The recent

downturn in foreign direct investment is expected persist throughout 2002. End-year inflation is targeted at 4-6 percent.

15. Macroeconomic performance during the first quarter of 2002 was in line with the program. GDP grew by an estimated 3¼ percent compared with the first quarter of the previous year. Inflation accelerated somewhat, to 7½ percent in the 12 months to May 2002, partly reflecting a modest exchange rate depreciation in late 2001 and early 2002. Fiscal and monetary performance in the first quarter of 2002 was broadly in line with the quantitative targets agreed with the Fund mission (Table 2), although a small planned repayment of old expenditure arrears was not fully made, partly due to a delay in grant financing.

E. Fiscal Policy in 2002

16. The budget for 2002 is based on an increase in the tax-to-GDP ratio for the general government, from 14¼ percent in 2001 to 14¾ percent in 2002. In support of this goal, we are implementing a comprehensive set of tax and customs administration measures aimed at strengthening the revenue-raising agencies, discussed below. In addition, as a prior action for completion of the second review, we have implemented a number of tax policy measures, reducing exemptions under the VAT and profit tax, reversing recent cuts in land taxes and car fees, and replacing the VAT on bread with a fixed tax.

17. The deficit of the general government on a commitment basis is to be reduced from 2 percent of GDP in 2001 to about 1 percent in 2002. Social expenditures will be protected, in line with our poverty reduction strategy, including through the clearance of some pre-2001 social arrears amounting to ½ - ¾ percent of GDP. Overall, social spending on a cash basis is budgeted to increase from 8 percent of GDP in 2001 to 9 percent in 2002. The cash deficit is projected at about 1¾ percent of GDP.

F. Monetary Policy in 2002

18. The monetary program for 2002 focuses on maintaining low inflation and strengthening the foreign reserve position of the NBG. It envisages net banking sector credit to the general government of about ¾ percent of GDP, reserve money growth of about 12½ percent and broad money growth of about 19 percent. Assuming a continuation of the recent trend in remonetization and decline in money velocity, this would be consistent with our inflation objective in the 4-6 percent range. Foreign exchange purchases by the NBG are projected at about US\$23 million. There should be a modest improvement in net international reserves of the NBG and gross reserves should cover about 1¾ months of imports of goods and services by end-2002. If market conditions permit additional purchases, the NBG would be willing to exceed the monetary growth targets somewhat, as long as the inflation outlook remains broadly in line with the program. The NBG will maintain the floating exchange rate regime and refrain from foreign exchange sales aimed at supporting the lari.

G. External Policies in 2002

19. Exports and foreign direct investment are expected to turn out weaker than assumed at the time of the first review under the PRGF arrangement. We therefore request that a projected financing gap of about US\$12 million be closed through a rephasing of IMF disbursements.

20. We will continue to work with China, Turkmenistan and Uzbekistan to reach debt rescheduling agreements as soon as possible, on terms comparable with the Paris Club agreement. Since the agreement, Georgia has cleared US\$12 million in arrears to Turkmenistan through non-cash operations, although Turkmenistan has not yet agreed to reschedule debt maturities on Paris Club terms. We will remain current on all scheduled interest to all creditors.

21. We will continue to maintain a liberal foreign trade regime, in line with our WTO commitments. Given the potentially serious consequences for the balance of payments, we have not renewed a temporary ban on timber exports that expired at the end of 2001 and, as a prior action for the completion of the second review, have recently reversed a temporary ban on the export of non-ferrous scrap metals. We will strongly resist any pressures to impose other restrictions on exports.

H. Structural Reforms in 2002

Fiscal reforms

22. In order to strengthen the tax and customs administration, we have implemented a comprehensive set of measures in early 2002 and will take further steps this year. In particular, we:

- a) have extended the coverage of the large taxpayers inspectorate to all large taxpayers, in line with IMF technical assistance recommendations, as a prior action for the completion of the second review;
- b) have made progress in establishing a valuation database and training customs officers for shipment inspections;
- c) have adopted new regulations on the registration of taxpayers and have initiated the revision of the taxpayers data base;
- d) have adopted tax code amendments that strengthen the enforcement of tax arrears collection, as specified in the attached TMU, as a prior action for the completion of the second review;
- e) are implementing measures to reduce smuggling of tobacco and petroleum products, by:

- centralizing the supply of tobacco excise stamps,
 - establishing a special depository for smuggled goods,
 - developing a draft cooperation agreement with neighboring customs services,
 - making receipts from cash registers mandatory, and
 - introducing special invoices or VAT forms for wholesale supply of tobacco and oil products;
- f) will adopt a decree extending the status of customs zones to international airports, seaports, railways, and pipelines and will unify under the state customs department all customs functions that are currently carried out by other authorities, including the special legion, by end-July 2002;
- g) will implement the Automated System for Customs Data (ASYCUDA) module to improve customs control of transit operations, by end-June 2002;
- h) will establish a treasury single revenue account at the NBG and adopt a new tax refund system, in line with IMF technical assistance recommendations, and will close all existing transit accounts by end-December 2002.

23. The budgetary process and expenditure control have been strengthened since the beginning of 2001, including through the closure of sub-treasury accounts at the ministries of defense and interior, an audit of expenditure arrears, the introduction of commitment recording for large purchases, and the application of standard expenditure control procedures to off-budget accounts outside the treasury. However, the adoption of a budget system law, originally a performance criterion for end-February 2002, has been delayed. During the remainder of this year, we will:

- a) prepare monthly expenditure plans for major spending categories, from April 2002 onwards;
- b) adopt, by end-October 2002, a budget systems law, prepared by the ministry of finance in consultation with IMF technical assistance, as specified in the attached TMU;
- c) establish full commitment control for all payments by the treasury for ministries and line agencies, by end-September 2002.

Financial sector reforms

24. The NBG's supervisory capacity was strengthened significantly in 2001, including through the issuance of new asset classification rules for banks, the implementation of IAS accounting rules in the banking sector, and the establishment of the primacy of bank law in

bank-related matters. We will accelerate the resolution of insolvent banks and tighten supervision of problem banks. Specifically, in order to strengthen banking supervision and enhance transparency in the financial sector, we:

- a) have adopted and published an analytical framework for the resolution of insolvent banks, in line with IMF technical assistance recommendations, and have introduced procedures for special supervision of banks that are identified as likely to have their licenses revoked;
- b) will adopt regulations to establish the “fit and proper” criteria for bank managers, as well as legislation and regulations to establish such criteria for bank owners, by end-September 2002;
- c) will adopt a law on money laundering, reflecting FSAP recommendations, by end-December 2002;
- d) will implement the measures summarized in Table 1 of the IMF Safeguard Assessment Report dated January 24, 2002, by end-December 2002.

Energy sector reforms

25. The energy sector is affected by low collections, high debts, corruption, and a lack of investment. The government has been working with the World Bank and other organizations on reforms that would expand private sector participation in the sector. After the privatization of electricity distribution in Tbilisi and three power plants, it has been difficult to attract other investors. As an alternative, we have introduced a private management contract for the wholesale electricity market, as well as for transmission and dispatch. Combined with our efforts to restrict non-cash operations and to improve payments discipline by budgetary entities and state-owned companies, this approach should help raise total cash collections at the wholesale level from about 20 percent in 2001 to at least 50 percent in the second half 2002. At the same time we are planning to expand financial support to the most vulnerable parts of the population to ensure the affordability of basic utility services, including through increased allowances to refugees and clearance of social arrears, both provided for in the 2002 budget. We are also working to ensure the proper management and the eventual resolution of old energy debts, and to reduce theft and corruption. As part of the overall reform effort, we:

- a) have adopted a strategy for the resolution of old energy debts (as specified in the attached TMU) in consultation with the World Bank, as a prior action for the completion of the second review;
- b) have made legal and administrative changes to ensure that core physical assets are not transferred without an open privatization process;

- c) have merged regional distribution companies to prepare for a future management contract or privatization;
- d) will make operational a management contract for transmission and dispatch by end-July 2002, financed under the Electricity Market Support Project led by the World Bank;
- e) will raise cash collection rates from the general government and from direct customers of the wholesale electricity market (predominantly large state-owned enterprises) to at least 70 percent on average in the 6 months to end-September 2002;
- f) will develop and adopt legal amendments to strengthen enforcement provisions against electricity theft, in consultation with the World Bank, by end-December 2002.

Poverty reduction strategy

26. Our poverty reduction strategy, set out in a draft PRSP, focuses on improvements in the business environment to stimulate long-term growth and on social sector reforms to provide adequate social spending and an equitable distribution of resources. Given the low fiscal revenue base, the scope for an increase in pro-poor spending is limited this year, but we have included in the 2002 budget a significant repayment of social arrears. The PRSP will lay out the medium-term path towards achieving a sustainable social safety net. In addition, we will continue to work with the World Bank and others to support the development of the private sector, including through land reform. We aim to complete a full PRSP, including priority measures and their impact on the medium-term budgetary framework, this year.

Public sector reform and anti-corruption efforts

27. While the above reforms, especially in the fiscal area, should go some way toward strengthening governance, we will make additional efforts to combat corruption at all levels of government. The anti-corruption council will continue to monitor progress in implementing decrees No. 95 and No. 758. In addition, the government intends to develop a plan for a comprehensive restructuring of the public administration, aimed at improving the efficiency of government structures. Anti-corruption initiatives should support improvements in the business environment. Open and transparent government will be crucial for attracting urgently needed foreign direct investment.

I. Program Monitoring

28. Table 1, Section A, lists the measures that have been implemented as prior actions for completion of the second review under the PRGF arrangement. Sections B and C list further structural measures we plan to take during the remainder of the year. Quantitative targets for 2002 are shown in Table 2.

29. We propose a change in the frequency of reviews and disbursements under the PRGF-supported arrangement, so that for the remainder of the program there would only be two disbursements per year, following the completion of reviews. In addition, given the projected balance of payments gap this year, described in paragraph 19 above, we request a re-phasing of IMF loans, raising total disbursements in 2002 to SDR 45 million, while keeping total access under the 3-year arrangement unchanged. The third review, scheduled to be completed by November 2002, will require meeting macroeconomic performance criteria shown in Table 2 at the end of September 2002 and structural performance criteria shown in Table 1 by end-October 2002. The third review will assess progress on structural benchmarks listed in Table 1, as well as on:

- a) addressing the problem of advance tax payments;
- b) the application of the new analytical framework and special supervision regime for resolving problem banks;
- c) the effectiveness of measures to raise overall energy sector collections at the wholesale level;
- d) recent anti-corruption initiatives.

30. Macroeconomic performance will continue to be measured by the same quantitative indicators (Table 2), subject to the attached TMU. Disbursements under the PRGF arrangement will continue to be subject to the continuous performance criteria specified in paragraph 53 of the Memorandum of Economic and Financial Policies attached to the letter dated December 6, 2000 (Georgia Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, December 6, 2000).

Table 1. Prior Actions, Structural Performance Criteria and Benchmarks for 2002

Description	Effective Date
A. Prior Actions for the Second Review	
1. Measures in support of the execution of the 2002 budget: <ul style="list-style-type: none"> i. extending the coverage of the large taxpayers inspectorate to all large taxpayers; ii. adoption of stronger enforcement provisions in the tax code; iii. adoption of tax policy measures raising about ½ percent of GDP (paragraph 16). 	
2. Adoption of a strategy to resolve the debts of the energy sector.	
3. Removal of the ban on exports of non-ferrous scrap metal.	
B. Structural Performance Criteria for the 2002 Program	
4. Adoption by parliament of the budget system law, as defined in the attached TMU.	<i>By end-October</i>
5. Reorganization of NBG functions to strengthen internal controls, as recommended in the IMF Safeguards Assessment Report dated January 24, 2002 (Chapter VII) and defined in the attached TMU.	<i>By end-December</i>
C. Structural Benchmarks for the 2002 Program	
6. Adoption of a decree extending the status of customs zones to international airports, seaports, railways, and pipelines; unification under the state customs department of all customs functions that are currently carried out by other authorities, including by the special legion.	<i>By end-July</i>
7. Implementation of a private management contract for transmission and dispatch of electricity.	<i>By end-July</i>
8. Establishing full commitment control for all payments by the treasury for state ministries and line agencies.	<i>By end-September</i>
9. Adoption of regulations relating to the “fit and proper” criteria for bank managers, as well as legislation and regulations for bank owners.	<i>By end-September</i>
10. Increasing cash collections for electricity consumption by the general government and direct customers of the wholesale electricity market to at least 70 percent on average, in the 6 months to end-September 2002.	<i>By end-September</i>
11. Introduction of a treasury single revenue account at the NBG and closure of transit accounts.	<i>By end-December</i>

Table 2. Georgia: Quantitative Performance Criteria and Indicative Targets, January-December 2002 1/

	Stocks 2/ end-Dec 2001	Cumulative change from end-December 2001					
	Actual	Mar 2002			Jun 2002	Sep 2002	Dec 2002
		Indicative Targets	Adj.T.	Actual	Indicative Targets	Perform. Criteria	Indicative Targets
(In millions of lari)							
I. Quantitative targets 3/							
Floor on general govt. tax revenue (including special funds) 4/	951.5	223.6	223.6	227.4	490.4	774.7	1065.7
Ceiling on cash deficit of the general govt. 5/	109.1	26.9	30.9	31.0	54.3	84.4	129.7
Ceiling on domestic expenditure arrears of the general govt.	11.3	-5.0	-5.0	-3.0	-19.0	-32.0	-45.0
Ceiling on net credit of the banking system to the general govt. (NCG) 6/	724.6	2.5	-2.5	-4.1	11.5	24.0	50.0
Ceiling on net domestic assets (NDA) of the NBG 6/	796.4	24.8	19.8	14.3	22.9	26.5	43.4
(In millions of U.S. dollars)							
Floor on total net international reserves (NIR) of the NBG 7/	-170.5	-5.5	-6.2	-5.3	4.7	13.4	4.8
Ceiling on contracting or guaranteeing							
A. short-term external debt (less than one year)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
B. nonconcessional medium- and long-term external debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(In millions of lari)							
2. Indicative targets							
Reserve money	429.9	13.0	13.0	2.9	32.8	55.3	53.7
Cigarette and petroleum revenues	110.1	30.3	30.3	29.3	66.4	104.9	144.3
Cumulative change from end-December 2001							
(In millions of U.S. dollars)							
3. Adjusters							
A. Net foreign-currency non-project flows 7/							
Projection			-3.3		1.9	0.9	-7.7
Outturn			-4.1		n.a.	n.a.	n.a.
Adjustment to NIR target			-0.7		n.a.	n.a.	n.a.
(In millions of lari)							
B. Net external non-project flows to the budget 6/							
Projection			-24.3		-26.4	-41.9	-73.7
Outturn			-19.3		n.a.	n.a.	n.a.
Adjustment to NDA and NCG targets			-5.0		n.a.	n.a.	n.a.
C. External project financing minus non-project grants plus external interest payments 5/							
Projection			44.7		60.7	89.6	134.9
Outturn			48.7		0.0	0.0	0.0
Adjustment to cash deficit target			4.0		n.a.	n.a.	n.a.

Sources: Fund staff estimates.

1/ Section I of this table shows quantitative targets for 2002, based on cumulative changes from end-December 2001. Some ceilings and floors are subject to possible adjustment, as indicated in footnotes 5, 6, and 8, based on deviations from projections of external financing, reported in Section 3 of the table. Indicative targets are shown in Section 2. Continuous performance criteria are described in paragraph 53 of the MEFP (Georgia Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, December 6, 2000).

2/ Year-to-date flows for tax revenues, cash deficit, expenditure arrears, and cigarette and oil revenues.

3/ Based upon accounting exchange rates of 2.15 lari/US\$, 1.28 US\$/SDR, and 0.90 US\$/euro.

4/ Special state funds include the Pension, Employment, and Road Funds. Privatization receipts are excluded.

5/ As described in the TMU, the program target on the cash deficit is adjusted for deviations from projected disbursements of external project finance minus non-project grants plus external interest payments (Section 3C). The ceiling for the cash deficit of the general government for the end of a month is adjusted upward (downward) by the full amount of the cumulative excess (shortfall) of external project financing minus non-project grants plus external interest payments, subject to a cap on cumulative upward adjustment of lari 80 million.

6/ As described in the TMU, program targets on NCG and NDA are adjusted for deviations from projected net external non-project flows to the budget (Section 3B), defined as the sum of all foreign-currency privatization receipts, World Bank SAC disbursements and non-project grants, minus external debt service by the general government. The ceilings for NCG and NDA will be adjusted upward (downward) by the full amount of the cumulative shortfall (excess) of net external non-project flows, subject to a cap on cumulative upward adjustment of lari 25 million.

7/ As described in the TMU, the program target on NIR is adjusted for deviations from projected net foreign-currency non-project flows (Section 3A), defined as the sum of foreign-currency privatization receipts, World Bank SAC disbursements and non-project grants, minus foreign-currency debt service by the general government and the NBG. The floor on NIR is adjusted downward (upward) by the full amount of the cumulative shortfall in net foreign-currency non-project flows, subject to a cap on downward adjustment of US\$20 million.

INTERNATIONAL MONETARY FUND

GEORGIA

Technical Memorandum of Understanding (TMU)

June 27, 2002

1. This memorandum sets out the understandings between the Georgian authorities and the IMF staff regarding the definitions of quantitative and structural performance criteria and indicative targets for the arrangement supported under the Poverty Reduction and Growth Facility (PRGF) reported in Tables 1 and 2 of the Memorandum of Economic and Financial Policies (MEFP), attached to the Letter dated June 27, 2002, as well as respective reporting requirements. It also provides definitions and reporting requirements for the continuous performance criteria described in paragraph 53 of the MEFP attached to the Letter dated December 6, 2000.

2. The quantitative performance criteria (ceilings and floors) and indicative targets listed in Table 2, Sections 1 and 2, of the MEFP are defined as cumulative changes from end-December 2001. Some floors and ceilings are adjusted by cumulative deviations of certain external financing flows from projections (Table 2, Section 3), converted at an accounting exchange rate of lari 2.15 per U.S. dollar.¹ The program relies on adjusters that are symmetric and allow the substitution of net external non-project financing for net domestic credit to government (and net domestic assets of the NBG). However, any resulting increases in net domestic credit to government and net domestic assets of the NBG are subject to a cap. The program also allows for an automatic adjustment to the cash deficit target in case of deviations of external project financing from expectations, subject to a cap on upward adjustment.

3. While the adjustment mechanism is designed to accommodate unanticipated, temporary fluctuations in external financing, the caps imply that significant shortfalls in financing will require policy changes, including tighter fiscal policy, which would need to be considered in the context of a program review.

¹ For instance, if a disbursement of \$10 million originally projected to accrue in the first quarter is delayed until the second quarter of 2002, then an adjuster of \$10 million (lari 21.5 million) would apply to end-March targets, but not to end-June, when net external financing would have returned—on a cumulative basis—to the originally projected level. In practice, this means that a delay in external financing inflows can be compensated temporarily by higher domestic credit, but not permanently, implying a repayment to the NBG once the delayed disbursement accrues.

**QUANTITATIVE PERFORMANCE CRITERIA, INDICATIVE TARGETS, AND CONTINUOUS
PERFORMANCE CRITERIA: DEFINITIONS AND REPORTING STANDARDS**

A. Floor on Tax Revenues

4. **Definition:** Tax revenues are defined as total tax collections by the State Tax Department and the State Customs Department, including tax revenues from the central government, local governments, and extrabudgetary funds. The tax revenues are recorded when these are paid into the treasury's revenue account(s) in the National Bank of Georgia (NBG). The tax revenues exclude the amounts retained by the revenue agencies for bonus payments.
5. **Adjustment clauses:** Once a change is made in accounting practices so that the bonus payments to the revenue agencies are included in the treasury's revenue account(s), the revenue targets will be adjusted upward by the applicable bonus share.
6. **Supporting material:** The Ministry of Finance (treasury) will provide data showing a detailed breakdown of tax revenues paid into the NBG revenue accounts (form 412) on a monthly basis within two weeks of the end of each month. The local budget department in the Ministry of Finance will provide additional information on revenue collections of local governments. The authorities will also provide data on any offset transactions on a monthly basis.

B. Indicative Target for Revenues from Cigarettes and Petroleum

7. **Definition:** This is defined as the total of customs duties, excise duties, and VAT collected by the State Tax Department and the State Customs Department on the domestic production and imports of cigarettes and petroleum products.
8. **Adjustment clauses:** None.
9. **Supporting material:** The Ministry of Finance will provide data with a break-down into the main categories of products on a monthly basis within two weeks of the end of each month.

C. Ceiling on Expenditure Arrears

10. **Definition:** Expenditure arrears are defined as a subset of arrears incurred by the general government on the following expenditure items: wages and salaries; pensions; health programs and invalid NGO programs; family allowances; stipend and food compensations; refugee allowances; transfers to SMIC; and transfers to the employment fund. Once sufficient progress is made on introducing commitments recording in the treasury, the measurement of arrears will be strengthened by applying the following principles for recording expenditure arrears: (a) the goods and services have been received; (b) these have been certified to conform to the order of the contract; (c) the bill for payment has been received; and (d) the due-for-payment date has passed and the bill has remained unpaid

beyond the normal or agreed period of credit. Until then, the net change in arrears will be estimated as the difference between actual cash spending and the monthly cash limits issued to spending units prior to the beginning of the month.

11. **Adjustment clauses:** None.

12. **Supporting material:** The Ministry of Finance (treasury) will provide monthly data, with a detailed break-down by economic and organizational category, on cash spending and commitments made by the central government, and/or cash limits issued to the spending units. The information on cash limits and spending commitments will be provided within two weeks from the beginning of each month. The information on cash spending will be provided within four weeks of the end of each month. The local budget department in the Ministry of Finance will provide information on monthly spending by the local budgets, and the extrabudgetary funds will provide information, through the Ministry of Finance, on their monthly expenditures.

D. Ceiling on the Cash Deficit of the General Government

13. **Definition:** The cash deficit of the general government will be measured from “below-the-line,” equal to the total financing (domestic and external, plus privatization proceeds) received by the general government.² Privatization receipts consist of all gross proceeds received by the central and local governments. Domestic financing consists of all bank and non-bank financing to the general government. External financing is defined as the total of disbursements, macroeconomic support, net change in arrears, minus amortization. Disbursements include all project financing (capital expenditure and net lending) and balance of payments support (excluding grants) received by the budget. Amortization includes all external debt-related payments of principal; amortization to external creditors via third parties is accounted for at the time and in the amount of payment by the budget to the third party, rather than at the time of recognition of amortization by the external creditor.

14. **Adjustment clauses:** The ceiling will be adjusted to reflect cumulative deviations from program assumptions on **external project financing** for capital expenditure or net lending minus non-project grants plus external interest payments (see Table 2, Section 3). The ceiling at the end of a quarter will be adjusted upward (downward) by the full amount of the cumulative excess (shortfall) of external project financing minus non-project grants plus external interest payments. There will be a cap on cumulative upward adjustment of lari 80 million.

15. **Supporting material:** Data on privatization receipts will be provided by the Ministry of Finance (treasury) on a monthly basis within two weeks of the end of each month. The

² Modest differences between the recorded financing and the cash deficit, calculated as expenditures plus net lending minus revenues and grants, can be attributed to check-float and smaller errors and omissions.

data will be consistent with the revenue account(s) in the NBG (form 412). Data on domestic financing (bank and non-bank) will be provided by the NBG. Until further improvements in the NBG accounts, the treasury will provide information on Ministry of Finance guaranteed loans (including guaranteed amount, principal repayment schedule, and actual principal and interest payments). Data on external project financing and non-project grants will be provided by the Ministry of Finance in a table on project and grant disbursements by creditor, on a monthly basis within two weeks of the end of each month.

E. Ceiling on Net Credit of the Banking System to the General Government

16. **Definition:** Net credit of the banking system to the general government includes net credit to the general government from the NBG and the deposit money banks. General government is defined in this context as the central government, local government, and extrabudgetary funds. Credit to the government includes: all loans to the general government, all treasury bills issued by the general government (including those purchased by the central bank), as well as all government-guaranteed loans from the banking system to other entities. Net credit to the government is credit to the government less deposits of the general government in the banking system. In addition, any accrued government interest obligations to the NBG would be reflected in net credit to the government. Government bonds issued to cover NBG losses are excluded from net credit to the government.

17. **Adjustment clauses:** The ceiling on net credit of the banking system to the general government will be adjusted to reflect cumulative deviations from program assumptions on **net external non-project flows to the budget** (see Table 2, Section 3), which is defined as the sum of all foreign-currency denominated privatization receipts, disbursements under the World Bank's SAC program, and non-projects grants, minus external amortization and interest payments by the general government. Amortization and interest payments are recorded at the time and in the amount of actual debt-related payments made by the general government. The ceiling at the end of a quarter will be adjusted upward (downward) by the full amount of the cumulative shortfall (excess) of net external non-project flows, subject to a cap on cumulative upward adjustment of lari 25 million.

18. **Supporting material:** The NBG will provide the monetary survey on a monthly basis within two weeks of the end of each month. The NBG will also provide information on the activities of the treasury bill market. The necessary information on net external non-project flows will be provided in a table on the NBG's foreign exchange flows (which includes details on inflows, outflows, and net international reserves) on a monthly basis within a week of the end of each month. The Ministry of Finance will provide additional information on the repayment of principal and interest on government-guaranteed loans from commercial banks on a monthly basis.

F. Ceiling on Net Domestic Assets of the NBG

19. **Definition:** Net domestic assets of the NBG are defined as the difference between net foreign assets and reserve money. Net domestic assets include net claims on government

(including loans and treasury bills purchased by the NBG, accrued government interest obligations to the NBG, less deposits of the government with the NBG.), claims on banks, claims on the rest of the economy (including the KfW loan), and other items net (including the NBG capital accounts, net unclassified assets, counterpart funds and exchange rate revaluation).

20. **Adjustment clauses:** The ceiling on net domestic assets of the NBG will be adjusted to reflect cumulative deviations from program assumptions on **net external non-project flows** (see Table 2, Section 3), which is defined as the sum of all foreign-currency denominated privatization receipts, disbursements under the World Bank's SAC program, and non-project grants, minus external amortization and interest payments by the general government. Amortization and interest payments are recorded at the time and in the amount of actual debt-related payments made by the general government. The ceiling at the end of a quarter will be adjusted upward (downward) by the full amount of the cumulative shortfall (excess) of net external non-project flows, subject to a cap on cumulative upward adjustment of lari 25 million.

21. **Supporting material:** The NBG will provide data on its balance sheet, which includes data on its net domestic assets, on a monthly basis within one week of the end of each month. The necessary information on net external non-project flows will be provided in a table on the NBG's foreign exchange flows (which includes details on inflows, outflows, and net international reserves) on a monthly basis within one week of the end of each month.

G. Floor on Net International Reserves of the National Bank of Georgia (NBG)

22. **Definition:** Net international reserves (NIR) of the NBG in U.S. dollars are calculated on the basis of assets and liabilities of the NBG, using program assumptions of bilateral exchange rates (2.15 lari per U.S. dollar, 1.28 U.S. dollar per SDR, and 0.90 U.S. dollar per euro). Gross reserves of the NBG are defined as liquid, convertible currency claims of the NBG on nonresidents that are readily available. Pledged or otherwise encumbered assets, including but not limited to assets used as collateral (or guarantee for third party external liabilities) are excluded from reserve assets. Reserve liabilities include the use of Fund resources and any other liabilities of the NBG. The stock of NIR in period t is calculated as the stock of NIR in period $(t-1)$ plus the net inflow of foreign exchange in period t , the change in the value of gold stock at market prices in period t , and the change in the stock of liabilities to the IMF and other creditors in period t .

23. **Adjustment clauses:** The floor of net international reserves will be adjusted to reflect cumulative deviations from program assumptions on **net foreign-currency non-project flows** (see Table 2, Section 3), which is defined as the sum of all foreign-currency denominated privatization receipts, disbursements under the World Bank's SAC program, and non-projects grants, minus external amortization and interest payments made in foreign currency by the general government and NBG. Amortization and interest payments are recorded at the time and in the amount of actual debt-related payments made. For a shortfall (excess) of net foreign-currency non-project flows, the floor on NIR will be adjusted

downward (upward) by the full amount, subject to a cap on cumulative downward adjustment of US\$20 million.

24. **Supporting material:** Data on net international reserves and data on net foreign-currency non-project financing will be provided in a table on the NBG's foreign exchange flows (which includes details of inflows, outflows, and net international reserves) on a monthly basis within the week following the end of the month.

H. Ceiling on Contracting or Guaranteeing New Non-Concessional Medium- and Long-Term External Debt by the Public Sector (with original maturity of 1 year or more)

25. **Definition:** The public sector consists of the central government, the National Bank of Georgia (NBG), and local authorities. Non-concessional external loans are defined as loans from lenders other than the IMF with a grant element of less than 35 percent of the value of the loan. The grant element is to be calculated by using currency-specific discount rates reported by the OECD (CIRRs).³ For maturities of less than 15 years, the grant element will be calculated based on six-month averages of commercial interest rates. For maturities longer than 15 years, the grant element will be calculated based on 10-year averages. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85) August 24, 2000) but also to commitments contracted or guaranteed for which value has not been received.⁴ Previously contracted non-concessional external debt that has been rescheduled

³ An electronic spreadsheet file that shows the relevant discount rates reported by the OECD (CIRRs) will be provided on a periodic basis by Fund staff.

⁴ The definition of debt set forth in No. 9 of the guidelines reads as follows: "(a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the

(continued)

shall be excluded from the definition of "new debt" for the purposes of this performance criterion.

26. **Adjustment clauses:** None.

27. **Supporting material:** Details of all new commitments and government guarantees for external borrowing, with detailed explanations, will be provided by the Ministry of Finance on a monthly basis within two weeks of the end of each month.

I. Ceiling on Contracting or Guaranteeing Short-Term External Debt by the Public Sector (with original maturity of less than 1 year)

28. **Definition:** The public sector consists of the central government, the National Bank of Georgia (NBG), and local authorities. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85) August 24, 2000), see footnote for Section H, but also to commitments contracted or guaranteed for which value has not been received.

29. **Adjustment clauses:** None.

30. **Supporting material:** Details of all new commitments and government guarantees for external borrowing, with detailed explanations to be provided by the Ministry of Finance on a monthly basis within two weeks of the end of each month.

J. Non-Accumulation of External Arrears

31. **Definition:** During the period of the arrangement, the general government and the NBG will not accumulate any new external payment arrears. Official arrears on external debt service obligations include any non-payment of interest and/or principal *in full and on time* falling due to all creditors, including the Fund, the World Bank, and other official creditors.

32. **Adjustment clauses:** None.

property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property. (b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.”

33. **Supporting material:** Details of official arrears accumulated on interest and principal payments to creditors will be reported within one week from the date of the missed payment.

K. Non-Introduction of Exchange and Trade Restrictions

34. **Definition:** During the period of the arrangement the general government and the NBG will not impose or intensify restrictions on payments and transfers for current international transactions; will not introduce multiple currency practices; will not conclude bilateral payments agreements that are inconsistent with Article VIII; and will not impose or intensify import restrictions for balance of payments purposes.

35. **Adjustment clauses:** None.

36. **Supporting material:** The government and NBG will inform the Fund about any changes to the exchange and trade regime.

L. Indicative Target for Reserve Money

37. **Definition:** Reserve money is defined as currency in circulation and required reserves of deposit money banks and balances on banks' correspondent accounts.

38. **Adjustment clauses:** None.

Supporting material: The central bank balance sheet is to be transmitted on a monthly basis, within one week of the end of the month.

M. Target for Cash Collection Rate from Direct Customers of the Wholesale Electricity Market

39. **Definition:** Cash collection rate is defined as the ratio of all cash payments received in a given time period to the lari billed amount in the same time period. Direct customers of the Wholesale Electricity Market are defined as all customers receiving electricity through the Wholesale Electricity Market excluding the electricity distribution companies. For comparability purposes, the data will separately include the delivered, billed and collected amounts from all transactions originated from direct contracts concluded after February 1, 2002 by any current or former member of the Wholesale Electricity Market.

40. **Adjustment clauses:** None.

41. **Supporting material:** The Ministry of Fuel and Energy will provide both aggregated data on electricity delivery, billing and collection amounts as well as a breakdown into payments by all individual customers of the Wholesale Electricity Market and individual transactions based on direct contracts described in the definition above. The total payments received from each customer of the WEM as well as payments originating from the direct contracts will be broken down into cash and offset payments. Subsidies paid in cash by

donors to the WEM should be included in the cash component of payments. Monthly data will be reported, within [three weeks] of the end of each month.

N. Target for Cash Collection Rate from the General Government

42. **Definition:** Cash collection rate is defined as the ratio of all cash payments received by electricity distribution companies in a given time period to the lari billed amount in the same time period. General government is defined as all organizations that are principally financed from the local or state budgets.

43. **Adjustment clauses:** None.

44. **Supporting material:** The Ministry of Fuel and Energy will provide data on electricity delivery, billing and total collection amounts and a breakdown into cash and offset payments by organizations financed by local and state budgets (separate data for local and central budgetary organizations). This data will be reported for each electricity distribution company and as an aggregate. Monthly data will be reported, within [three weeks] of the end of each month.

O. Adoption of a strategy to resolve the debts of the energy sector

45. **Definition:** The strategy to resolve the debts of the energy sector should be set out in a strategy paper, to be adopted by the government. The strategy should address both internal and external debts of the energy sector (electricity and gas). The strategy - to be developed in consultation with the World Bank - should ensure that core physical assets cannot be swapped for debts without government approval and can be privatized only to qualified investors through an open and transparent privatization process. The strategy paper should (a) identify and quantify internal and external debts, with detailed information on creditors, debtors, loan terms, and guarantees, as well as any previous approaches to debt resolution, (b) suggest a resolution mechanism for each type of debt, with detailed information on financing sources, (c) provide a timetable for action by each responsible agency, (d) provide a projection of debt levels and required payments for each type of debt, (e) provide an analysis of the fiscal impact of the proposed strategy.

P. Extending the Coverage of the Large Taxpayer Inspectorate to all Large Taxpayers

46. **Definition:** A large taxpayer is any taxpayers, legal or physical person, whose annual turnover or annual gross income is above lari 2,500,000 or whose tax liabilities, accrued over one fiscal year, are above lari 200,000 lari. The registration of any taxpayer fulfilling the above mentioned criteria is to be mandatory and provided by the law.

Q. Extending the Status of Customs Zones to International Airports, Seaports, Railways, and Pipelines

47. **Definition:** To give airports, seaports, railways and pipelines the status of customs zones means that customs officers will have access to, and control of, appropriate parts of

these sites. The customs zone at the international airport includes the tarmac, the “airside” passenger areas, the temporary stores and warehouses for uncleared import and export cargo, and the duty-free shop. With respect to the railway system and pipelines, only those necessary for adequate customs control of uncleared goods (including those in through-transit, that is the access points) should be considered customs zones.

R. Adoption of Stronger Enforcement Provisions in the Tax Code

48. **Definition:** Adoption of a law on tax lien, establishing the government’s interest in the whole property of every tax debtor and allowing the government to administratively liquidate its interest in the property of tax debtors; adoption of a law enabling administrative collection of tax liabilities by employees of a government’s tax department; implementation of a case prioritizing system to address administrative collection of tax liabilities; creation of a reporting system to measure results of administrative collection of tax liabilities and suggest areas of improvement; organization of training courses for tax liability collectors and liability collection managers.

S. Adoption of a Budget System Law

49. **Definition:** A budget system law that provides a sound legal framework for budget preparation, presentation and approval; budget execution; government borrowing and debt; and budget accounting, inspection, and auditing; should include the following: (a) a comprehensive coverage of the budget (coverage has to include: all the levels of government; all stages of the budget process, from budget preparation to budget execution and reporting; and all inflows and outflows of resources); (b) the establishment of a consolidated fund into which all inflows of resources shall flow and from which all outflow take place following due process of law; (c) a medium-term macroeconomic framework and a medium-term fiscal framework, which covers at least one year following the budget year. (d) a budget circular that indicates a hard budget ceiling both for the aggregate budget (overall spending envelope) and a resource envelope for the line ministries; (e) the submission by the government to parliament of a quarterly review on the status of budget execution; (f) publishing the draft budget; (g) a revision of the budget following the approval of any normative act affecting the receipts or payments approved in the annual budget. The revision of the budget has to be approved by the time of the next quarterly budget review.

T. Reorganization of NBG Functions to Strengthen Internal Controls

50. **Definition:** This includes the restructuring of foreign exchange operations to provide for clear and effective separation of control over front office, back office, and risk management activities, including the establishment of an independent middle office, as elaborated in Chapter VII of the IMF’s Safeguards Assessment Report dated January 24, 2002. It also includes the establishment of an NBG-wide accounting function under a single point of control and responsibility that oversees all of the bank’s accounting processes, and developing a financial controller role within the bank, as elaborated in Chapter VII of the IMF’s Safeguards Assessment Report dated January 24, 2002.

NEWS  BRIEF

FOR IMMEDIATE RELEASE

News Brief No. 02/67
FOR IMMEDIATE RELEASE
July 12, 2002

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

**IMF Completes Second Review of Georgia's PRGF Program and
Approves In Principle US\$30 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) today completed its second review of Georgia's economic performance under the program supported under a three-year Poverty Reduction and Growth Facility (PRGF) arrangement. The Board also approved Georgia's request of a switch from quarterly to semi-annual disbursements and a rephrasing of disbursements. The completion of the review will enable Georgia to draw an amount equivalent to SDR 22.5 million (about US\$30 million) from the IMF.

The Board's decision will become effective after the World Bank's review of the progress on the development of Georgia's full Poverty Reduction Strategy Paper (PRSP).

Georgia's arrangement under the PRGF was approved on January 12, 2001, in an amount equivalent to SDR 108 million (about US\$144 million--see Press Release No. 01/4). So far, Georgia has drawn SDR 27 million (about US\$36 million).

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs will in time be based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a PRSP. This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual

interest rate of 0.5 percent, and are repayable over 10 years with a 5 ½-year grace period on principal payments.

Following the Executive Board discussion, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, said:

"The Georgian authorities have moved forward in implementing their three-year economic program; economic growth has been robust, despite a difficult external environment; and inflation remained moderate. The authorities' program for 2002 provides a coherent framework for supporting economic stability and growth. The budget envisages further deficit reduction, while a rise in tax revenue will help safeguard an increase in social spending (on a cash basis) in a context of overall expenditure restraint. The authorities' continued commitment to a prudent monetary policy and a floating exchange rate regime is welcome.

"Going forward, a determined effort to press through critical reforms will be essential to achieve the program's medium-term objectives of ensuring debt sustainability, of creating a favorable business and investment climate, and of making significant inroads into poverty. Recent reforms in the fiscal area have strengthened expenditure management and revenue administration, while the tax package adopted in June 2002 removes several exemptions and reverses the steady erosion of the tax base seen in recent years. Further strengthening the tax and customs administration and enhancing the efficiency of the tax system will, however, be crucial to achieve a level of revenue collection that is consistent with debt sustainability, while creating room for priority spending aimed at reducing poverty.

"On structural reforms, progress will be particularly important in the energy and financial sectors. Implementation of the government's recently adopted energy debt strategy will be a significant step forward to move the sector toward financial viability. The authorities are committed to continuing to work closely with the World Bank and other agencies to raise cash collection rates in the energy sector and to improve the sector's efficiency. In the financial sector, the central bank is encouraged to make effective use of its new supervisory capacity to deal expeditiously with identified problem banks, and to move ahead with measures that will improve governance and transparency in the banking system.

"The authorities intend to finalize their poverty reduction strategy in the near future, in consultation with civil society. The strategy's focus on setting favorable conditions for private sector growth, supported by fiscal

and social sector reforms, is welcome. The Executive Board considers that progress in developing the strategy provides a sound basis for continued concessional assistance from the Fund. Going forward, it will be important to ensure adequate prioritization and costing of the measures contained in the strategy. The authorities are encouraged to intensify their efforts to improve governance in a wide range of areas that are critical to creating a sound business and investment environment.

“In view of the satisfactory macroeconomic performance and recent progress on structural reforms in some critical areas, the Executive Board completed the second review under the arrangement and granted waivers for the nonobservance of a number of performance criteria. Strong performance under the program will continue to be needed to address the difficult economic challenges facing Georgia, and to mobilize support that will help Georgia achieve medium-term debt sustainability,” Mr. Sugisaki said.

NEWS  BRIEF

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IMF Completes Second Review of Georgia's PRGF Arrangement

The Executive Board of the International Monetary Fund (IMF) has completed the second review of Georgia's performance under the Poverty Reduction and Growth Facility (PRGF) arrangement.

The final decision of the IMF Executive Board was contingent on a decision by the Executive Board of the World Bank on July 19, 2002 (see News Brief No. 02/67). That decision concluded that the Poverty Reduction Strategy Paper for Georgia is satisfactory and provides a sound basis for continued access to International Development Association adjustment lending.

The completion of the second review enables Georgia to draw an amount equivalent to SDR 22.5 million (about US\$30 million) from the IMF.

Georgia's arrangement under the PRGF was approved on January 12, 2001, in an amount equivalent to SDR 108 million (about US\$144 million—see Press Release No. 01/4). So far, Georgia has drawn SDR 27 million (about US\$36 million).