

INTERNATIONAL MONETARY FUND AND INTERNATIONAL DEVELOPMENT ASSOCIATION

GEORGIA

Joint Staff Assessment of the Interim Poverty Reduction Strategy Paper

Prepared by the Staffs of the International Monetary Fund and
The International Development Association

December 4, 2000

1. The Government of Georgia is developing a comprehensive and participatory plan for reducing poverty, which it is calling a *Poverty Reduction and Economic Growth Program* (PREGP). This title reflects the central role the Government sees growth as having in generating the employment and public revenues necessary for sustained poverty reduction. The Interim Document (I-PREGP) summarizes where Georgia stands in developing that plan, and provides an analysis of poverty and the Government's policies to reduce it. The document also outlines the existing and future consultation process. The I-PREGP indicates the broad direction of policy and institutional reform, and points the direction for an integrated treatment of these issues in the full PREGP, which is expected to be completed in 2001.
2. The Government has been enthusiastic in developing the I-PREGP, and has conducted the process in an open manner and given it wide publicity. The document is based on the submissions of six working groups, five formed specially for the purpose, and one -- the anti-corruption working group -- created by separate Presidential Decree. The groups discussed their work through open meetings attended by civil society and the media. The diversity of inputs partly explains why the document goes well beyond the suggested minimum scope for an I-PRSP.
3. The staffs of the Fund and the Bank assisted the authorities by commenting on the drafts of the I-PREGP, and, in addition, a number of other donors (including EU, UNDP and USAID) participated in the meetings of the working groups, other government meetings, and a major workshop. The UN, EU, DFID and USAID amongst others have expressed interest in providing further support to the preparation of the full PREGP.

Poverty Data and Factors

4. The I-PREGP contains a useful discussion of poverty data and trends, based on a system -- unique among low-income countries in Europe and Central Asia -- of continuous household surveys. However, additional analysis is required in order to get a more elaborated picture of the vulnerable groups of the population. The I-PREGP uses the poverty data quite well in Chapter 1, and we look forward to a full PREGP that uses the data more broadly, including to: (i) underpin prioritization between and within sectors;

(ii) analyze the causes of poverty, and the links between growth and poverty reduction; and (iii) identify the most vulnerable segments of the population. This would involve more thorough analysis and disaggregation of the household survey data, consistent use of a well-defined poverty-line, and better definition of the monitoring indicators by which progress would be measured. Bank staff will assist this process through the forthcoming Poverty Profile update.

Poverty Reduction Strategy

5. The I-PREGP is a very wide-ranging document, and reflects an evolving strategy with which the staffs of the IMF and World Bank are broadly in agreement. As indicated above, the strategy identifies economic growth as the main engine of poverty reduction, yet recognizes the need for a new focus and priority to reforms in social sectors. It generally endorses a free-market strategy to achieve sustainable growth, with a key emphasis on support to domestic and foreign private investment; and it also recognizes, more convincingly than any prior policy statement had done, that good governance and the fight against corruption are essential elements of the Government's economic strategy, while also highlighting their role in promoting social development. Against this background, we would like to highlight the following notable features:

- **Macroeconomic Stability.** The Government is committed to maintaining price stability and a floating exchange rate as a precondition for growth. To achieve this, the authorities have indicated that they will continue to pursue a prudent monetary policy which will limit credit to the Government and aim to increase international reserves. Their objective is to achieve solid growth of the order of 4.5 percent, and a reduction in inflation to 4 percent by 2003. The I-PREGP also indicates the Government's intention to seek a restructuring of Georgia's foreign debt, and its commitment to timely debt-servicing.
- **Fiscal Management.** Bank and Fund staff fully support the Government's aims to raise revenue and reduce the budget deficit, and to improve financial management and accountability. This is important for supporting a prudent monetary policy, for reducing unnecessary administrative burdens on the private sector, and for increasing budgetary resources available for efficient investment in human capital. The I-PREGP rightly stresses the impact on the poor of arrears in social sector spending, wages, and pension and benefit payments. It notes that the August 2000 data shows combined arrears at 3.25 percent of GDP, with a government target for 2001 of 2 percent of GDP, and complete elimination by end-2003. The Government plans to strengthen control of budgetary expenditures, including adoption of a new budget law, better accounting standards for budgetary institutions, an improved treasury system, and more streamlined and less corrupt tax and customs administration.
- **Governance.** Achieving improvements in government administration will be crucial for achieving all the Government's major goals. We thus welcome the emphasis the document puts on governance, and especially on the National Anti-Corruption Program which has the strong backing of President Shevardnadze. Corruption, particularly administrative corruption, has been a major constraint to

Georgia's economic growth and poverty alleviation. Political will to tackle corruption has often been lacking, and this new high-level initiative is a very positive sign. The I-PREGP identifies the need to address corruption in a broad range of sectors and areas and in a systemic way, especially in the functioning of public institutions. It is also consistent with the free-market strategy of the Government, underlining the need to strengthen the foundations of a market economy, for example in its emphasis on judicial reform.

- **Liberalization and privatization.** The Bank and the IMF staff support the continuing commitment to market liberalization and privatization, which will be critical to the Government's achieving its growth goals. Georgia has already made significant steps toward a market economy – adopting market-friendly legislation, opening up the economy (including WTO membership), and eliminating many public subsidies to commercial enterprises. Likewise we welcome the I-PREGP's commitment to build on Georgia's progress to date in privatization, which has included strategic sectors such as energy, ports and telecommunications, other public enterprises, and land and hospitals.
- **Banking System.** The Fund and Bank support the I-PREGP's plans to promote confidence and stability in the financial sector by strengthening banking supervision and measures to deal with problem banks. In addition, the Government plans to continue developing the treasury bill market, as well as strengthening risk management in banks, and the use of collateral to broaden access to credit by the private sector and promote growth.
- **Human Development.** The I-PREGP recognizes the currently "disastrous" condition of health and education (caused in part by the poor fiscal management), and the deficiencies in social protection. The document stresses the crucial importance of better human capital development for Georgia's future. The predicament of the health sector is especially acute, with health indicators for children and youth deteriorating as the truly innovative reforms in the sector have been stymied for lack of funding. The quality of primary education has likewise been deteriorating. Children from poor families often receive an inadequate education and enter the labor force as unqualified or low qualified workers -- this also has serious longer-term implications for Georgia's growth potential as the skill demands of international markets change.
- **Environment and Natural Resource Management.** The I-PREGP rightly gives prominence to the links between the extent of poverty and ill-health and the management of the environment and natural resources. It also stresses the role in improving environmental management not just of regulation but also of price and other market mechanisms. We look forward to further elaboration in the full PREGP.

6. Further progress in these and other key areas will not come easily. Decisive attention will need to be paid to turning plans into successful outcomes, particularly in the areas of revenue enhancement, governance and anti-corruption. And the PREGP will

need to give a coherent view of where it sees active government intervention as warranted, affordable and productive.

Areas of Concern

7. Much remains to be accomplished in building a PREGP that will reduce poverty and promote growth. Further analysis of the poverty data would establish where the key needs are. The strategy could focus much more on what is achievable within financing, institutional capacity, and implementation constraints. And judiciously chosen indicators would allow the progress of the strategy to be monitored, and adjusted as necessary.

8. Prioritization is a particular concern -- indeed the I-PREGP points simultaneously in a number of different directions, reflecting the broad range of stakeholders who participated in its preparation and the very limited time available to achieve a widely shared synthesis. The document does not adequately define yet the key policies, investments, and expenditures given the constraints of the Government's institutional capacity, low revenue levels and endemic administrative corruption. This is true both between and within sectors. For example, given the very worrying social indicators and trends it would be useful to define much more specifically what the priority measures are. From our ongoing work with Government we understand them to include: capacity building within the Health, Education and Social Protection Ministries; timely and full payment of poverty benefits; fewer teachers, but more timely payment of salaries and provision of teaching materials and critical maintenance; fewer hospitals but more focus on primary health care and prevention; cleaner drinking water and better sanitation. The PREGP would need to make clear the scope for financing these key priorities, and what would need to be dropped or scaled down to make the necessary fiscal room.

9. The I-PREGP endorses some interventionist proposals that we do not believe will generate the anticipated benefits. We are concerned about: (i) additional intervention in labor markets, including in wage setting; (ii) import-substitution as a way to accelerate employment creation; (iii) state provision of "vitally important goods"; (iv) the promotion of "promising" enterprises; (v) the "rational distribution of State orders among different industries"; and (vi) the assumption that the informal sector is a negative force. However, these are a relatively small part of the overall document, which generally endorses a free market strategy.

10. The PREGP will need to go beyond the framework of the current document and develop an expenditure and governance framework within which the various sectoral plans can be assessed and prioritized. A crucial element of a truly useful PREGP will be analysis that establishes clear priorities for poverty reduction, pays close attention to the relative social impact of different types of expenditure, is realistically costed and fits within a feasible fiscal envelope.

11. A prerequisite for this kind of coherent expenditure framework to even be possible is greater revenue mobilization, based on fairer burden sharing (especially having the richest individuals and corporations paying in full). A workable expenditure framework will also require a thorough-going analysis of how the efficiency of Government spending can be raised, including how theft and mis-appropriation can be

reduced. It will also be important to improve macroeconomic data, in particular the national accounts and balance of payments data.

12. The PREGP will need to have a clear focus on practical and implementable plans for reducing the current barriers (official and unofficial) to efficient foreign and domestic investment. Unless these barriers can be reduced, sustained poverty reduction will be impossible: there will not be enough jobs for those able to work, and no means to finance an adequate safety net for those unable to work, or to finance other priority government investments and expenditures.

Preparation Plans for the PREGP

13. Chapter IV of the I-PREGP sets out a well-defined timetable for preparing the PREGP. Although the Government has kept to schedule to date, it will be difficult to meet the target of May 2001 for completing the full PREGP. We believe that it will take considerably more than five months to complete the outstanding data collection and analytical work, undertake a credible participatory process, establish an agreed set of well specified, costed and prioritized public actions to address poverty, and choose key monitoring indicators. A later completion date would also mesh well with the preparation of the Bank's Public Expenditure Review and Poverty Profile update, due to be completed in June 2001. For these reasons, we will continue to encourage the Government to work decisively towards a full PRSP, but to maintain flexibility in regard to the timing of its completion so as to benefit fully from the public expenditure prioritization exercise and the participatory exercise.

14. It would be useful for the Government to move the participation process beyond an *information* strategy and ensure that the development of the PREGP's central themes benefits from the views and insights of a wide range of stakeholders. That would likely require a detailed plan of how the consultations will be carried out, including a genuinely two-way dialogue with stakeholders' voices, and a broadly-owned process for tracking and updating indicators of progress as the PREGP is implemented.

Risks to the Strategy

15. While the development of the PREGP as a whole is on the right track, there are a number of risks:

- **Revenues.** Many of the recommendations likely to come out of the PREGP will require significant increases in Government revenues to finance them, as well as a resolute approach to prioritizing public expenditure. This will require a new sense of purpose in the Government in tackling tax evasion and theft of Government revenues, and will depend on a considerable improvement in institutional capacity.
- **Governance and institutional capacity.** Georgia has only a decade of experience with democratic government, regulation of a capitalist economy, and open dialogue between government and civil society. In addition there is a very active dialogue within government which, while healthy in itself, can make decisive decision making difficult. These constraints make implementation of the

I-PREGP and subsequent PREGP programs more difficult, and to help mitigate this risk we will support the Government's continuing efforts to improve governance, institutional capacity, public expenditure management, the quality and efficiency of the judiciary, and anti-corruption safeguards.

- **Regional Instability.** The Caucasus has throughout history been a politically volatile region, as a result both of its strategic geo-political position and of internal tensions. Any renewed political instability in the region, from whatever source, could divert attention and resources from pressing social and economic reforms. The PREGP could thus usefully examine possible strategies for conflict resolution and prevention.
- **Exogenous Shocks.** Georgia has suffered in recent years from a number of exogenous shocks -- including the Russia crisis, drought, the closure of rail links north through Abkhazia -- and there is unfortunately no certainty that similar shocks will not occur in future. This, and uncertainty over the level of external aid flows, mean that there is considerable downside risk, and the PREGP will need even tighter prioritization of public expenditures and policies than would otherwise be the case.

Overall Assessment

16. The staffs of the World Bank and IMF consider that this I-PREGP provides a sound basis for the development of a fully participatory PREGP, and for Bank and Fund concessional assistance. The staffs recommend that the respective Executive Directors of the World Bank and the IMF reach the same conclusion.

Annex: Key Bank/Fund Events Related to PRSP

Institution	Event	Expected Date
IMF/World Bank	JSA of I-PRSP	Dec 00
IMF	PRGF Board Presentation	Dec 00
World Bank	CAS	March 01
World Bank	Education Realignment and Strengthening	March 01
IMF	PRGF Review	June 01
World Bank	Public Expenditure Review	June 01
World Bank	Update of Poverty Profile	June 01
World Bank	Second Health Project	July 01
IMF/World Bank	JSA of PRSP	During FY02