An overview of the World Bank’s work in Georgia

October 2018

GEORGIA COUNTRY SNAPSHOT

At a Glance

• Economic growth accelerated in the first half of 2018 to 5.7%, supported by a strengthening of both external and domestic demand. This compares well with the 5% in 2017 and the 4.5% projection for 2018.

• Annual inflation stood at 3.1% in August 2018, within the Central Bank’s 3% target, showing a significant drop after spiking to 6.7% in 2017 in response to higher excise taxes on tobacco and fuel.

• A fiscal deficit of 3.1% of GDP is projected for full-year 2018 (below the planned deficit of 3.8%), barring any unanticipated acceleration in capital spending.

• Poverty (US$3.2 purchasing power parity measure) was slightly up to 17.1% in 2016 from 16.7% in 2015 but is expected to return to its declining trend as economic growth recovers and translates into higher incomes.

Country Context

Over the past decade, the economy has grown robustly at an average annual rate of 4.5%. This was despite numerous shocks, including the global financial crisis of 2007–08, the conflict with the Russian Federation in 2008, and the drop in commodity prices since 2014, which impacted key trading partners.

Poverty declined from 32.5% in 2006 to 17.1% in 2016. The poor have benefited considerably from the Government’s social policies, as well as from new economic opportunities.

Although inequality remains high by regional standards, it has been declining in recent years, thanks to strong improvements in the welfare of households in the bottom 40% of the income distribution.

Deep reforms in economic management and governance have earned Georgia a reputation of “star reformer.” To bolster the private sector, Georgia has introduced rules and regulations that make it easier to do business, and the country’s international ratings on governance and the investment climate have soared. The Deep and Comprehensive Free Trade Area agreement with the European Union (EU) and the Free Trade Agreement with China are expected to boost trade integration.

Moreover, energy, tourism, and agribusiness can potentially help to integrate the country further into the regional and global economies.
The World Bank and Georgia

The World Bank Group has been a key development partner for Georgia since 1992, supporting investment projects and the reform agenda in almost every sector. In 2014, Georgia graduated from the International Development Association (IDA) to become an International Bank for Reconstruction and Development (IBRD)-only borrower. Since 1992, the total lending program has amounted to roughly US$2.8 billion for 77 operations.

The current active portfolio consists of 11 investment projects with total commitments of US$699 million, of which about US$344 million is undisbursed. About 60% of commitments are concentrated in the ongoing East-West Highway and secondary roads projects and 18% is in urban development.

The remaining 20% covers energy, land management and irrigation, and the innovation ecosystem. In addition to the investment portfolio, there is an active program of five recipient-executed trust fund operations of about US$17.9 million, of which about 41% is undisbursed.

Key Engagement

The new Country Partnership Framework (CPF) for FY19–22, developed in collaboration with the Government of Georgia and endorsed by the Board on May 22, 2018, aims to support sustainable and inclusive growth and improve living standards. It is fully aligned with the Government’s vision for the country’s development and driven by the “Georgia 2020” program, which emphasizes freedom, rapid development, and prosperity through four policy goals: economic reform, education reform, spatial arrangement and infrastructure, and improved governance.

To support the Government in achieving the twin goals of eliminating extreme poverty and promoting shared prosperity, the CPF envisages support to Georgia across three areas: enhancing inclusive growth and competitiveness, investing in human capital, and building resilience. The program will pay special attention to vulnerable groups and lagging regions that have not benefited from the fruits of economic growth.

Lending commitments will evolve during the program’s implementation, and the current portfolio of investments and Advisory Services and Analytics (ASA) will serve as a solid base from which to implement any intended shifts in the CPF.

Three engagement principles will be guiding the selection of interventions: (i) maximizing finance for development, (ii) ensuring spatial equity, and (iii) promoting innovation.

The CPF reflects inputs from a range of face-to-face and online consultations with a wide range of stakeholders. The Bank also engaged the public through an online consultations campaign, encouraging citizens to provide inputs and feedback using multimedia and social media tools. As a result, the campaign has reached 888,000 people and received 2,513 responses.
Recent Economic Developments

Economic growth accelerated in the first half of 2018 to 5.7%, supported by a strengthening of both external and domestic demand. External inflows remained strong in the first half of 2018. Merchandise exports grew by 28% year-on-year (y-o-y), tourism proceeds by 24%, and money transfers by 18%.

However, robust domestic demand resulted in a 23% y-o-y increase in imports and a slight widening of the current account deficit. Despite a 4% depreciation of the lari against the U.S. dollar in August 2018, the effective exchange rate was appreciating for most of 2018 due to the weakening of the currencies of Georgia’s major trading partners, including Russia and Turkey. Annual inflation stood at 3.1% in August 2018, within the Central Bank’s 3% target.

Fiscal policy was conservative in the first half of 2018 relative to the approved budget. Outlays on infrastructure were slower than expected, while the consolidation of current expenditure remained on track. Although the fiscal accounts posted a modest surplus in the first half of 2018, a deficit of 3.1% of GDP is projected for full-year 2018 (below the planned deficit of 3.8% of GDP), barring any unanticipated acceleration in capital spending.

The banking sector is well capitalized and profitable, with a low nonperforming loans ratio (2.7% of total loans at end-July 2018). However, structural vulnerabilities persist in some areas. The economy remains highly dollarized. Although the share of both foreign currency deposits and foreign currency loans has decreased slightly compared to the past year, those figures were 60.8 and 54%, respectively, for the first six months of 2018. The declining trend in poverty in Georgia has plateaued since 2015. Limited employment growth and static social assistance transfers could be the main reasons for the stagnation.

Economic Outlook

With real GDP growth expected to reach 5.3% in 2018 and hover around 5% over the medium term, Georgia’s economic outlook is positive. A strong pipeline of investments, gradually increasing public capital spending, and improved connectivity will keep the economic activity vibrant.

The flexible exchange rate and a gradual strengthening of the monetary policy transmission mechanism will support competitiveness while preserving price stability.

After widening in 2018, the external deficit is projected to narrow gradually, though its financing may have to rely more on non-concessional debt-generating inflows. At above 108% of GDP, total external debt is already a source of vulnerability.

Government spending is expected to continue to gradually shift from current to capital spending over the medium term, reflecting the large infrastructure gap in the country and the availability of concessional financing. The fiscal deficit is forecast to hover around 3% of GDP through 2020 in line with the Government’s medium-term fiscal framework, helping to reduce Georgia’s public debt to about 40% of GDP.

Economic expansion should generate more employment and other income-generating opportunities at the bottom of the income distribution.

Discretionary increases in social assistance may also help to reduce poverty further and increase resilience in the upcoming years, although the impact on fiscal sustainability will need to be considered carefully.
Project Spotlight

Comprehensive Pension Reform – A Simple, Safe, and Cost-Effective Way for Georgians to Save for Their Retirement

A comprehensive pension reform program was launched in 2018. The purpose is to provide Georgians with a simple, safe, and cost-effective way to save for their retirement and receive a pension over and above the old-age grant.

Under the new pension savings scheme—mandatory for those under age 40—individuals will save 2% of their salaries, which will be matched by employer and government contributions of 2% of wages (all tax free), up to a ceiling limit. These savings will be managed by a central Pension Agency and overseen by a Supervisory Board of Ministers, though investment decisions will be taken independently of the government by a board of professional experts.

Through technical assistance, policy dialogue, and a Financial Sector Reform and Strengthening Initiative grant, the World Bank shared experiences from other countries in the region and globally that have implemented similar reforms. Lessons learned stressed the need for the central collection, administration, and management of pension assets in order to achieve economies of scale in a small country like Georgia and to keep the costs of the system as low as possible to avoid an erosion in investment returns.

A new law on pensions has been passed by the Parliament, along with a law establishing the new Pension Agency. The World Bank will work with the staff of the Pension Agency to help ensure that the savings of Georgia’s citizens are managed as efficiently as possible, delivering better outcomes in retirement and allowing the country to benefit from higher savings that can be used for productive investments to promote development and growth. The Bank will also work with the National Bank of Georgia, which will draft and implement the necessary regulations.

Pension reform has been a priority topic in Georgia in recent years due to the country’s rapidly aging population. In 2015, just over 700,000 Georgians received an old-age pension. This is expected to rise by over one-third in just 15 years, so that by 2030, almost 1 million people—fully one quarter of the population—will be receiving a pension.