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ANNEX I

to Commission Implementing Decision on the Annual Action Programme 2017 for the Republic of Georgia to be financed from the general budget of the European Union

Action Document for Economic and Business Development in Georgia

INFORMATION FOR POTENTIAL GRANT APPLICANTS
WORK PROGRAMME FOR GRANTS
This document constitutes the work programme for grants in the sense of Article 128(1) of the Financial Regulation (Regulation (EU, Euratom) No 966/2012) in section 5.4.1 concerning calls for proposals

1. Title/basic act/ CRIS number	**Economic and Business Development in Georgia** CRIS number: ENI/2017/040-318 financed under European Neighbourhood Instrument
2. Zone benefiting from the action/location	Georgia The action shall be carried out at the following location: country wide
3. Programming document	Single Support Framework for EU support to Georgia 2017-2020
4. Sector of concentration/ thematic area	**Economic development and market opportunities**, *including* smart, sustainable and inclusive growth **Strengthening institutions and good governance**, *including* consolidating the Rule of Law and addressing security
5. Amounts concerned	Total estimated cost: EUR 51 450 000 Total amount of EU budget contribution EUR 47 650 000 of which - EUR 21 250 000 for budget support; - EUR 19 900 000 for complementary support to budget support; - EUR 6 500 000 for support outside the scope of the sector reform contract This action is co-financed in joint co-financing by ADA for an amount of EUR 1 000 000 and might be co-financed by Sida for an estimated amount of EUR 2 800 000.

<table>
<tr><td>6. Aid modality(ies) and implementation modality(ies)</td><td>Budget Support
Direct management:
- budget support: sector reform contract
- grants – call for proposals
- direct award to the World Bank Group
- procurement of services
Indirect management with:
- Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH (GIZ)
- United Nations Development Programme (UNDP)
- Austrian Development Agency (ADA)
- The World Bank Group
- European Bank for Reconstruction and Development (EBRD)</td></tr>
<tr><td>7. DAC code(s)</td><td>15130 – Legal and judicial development
24010 – Financial policy and administrative management
24030 – Formal sector financial intermediaries
25010 – Business support services and institutions
32110 – Industrial policy and administrative management
32120 – Industrial development
32130 – Small and medium-sized enterprises (SME) development
33120 – Trade facilitation</td></tr>
<tr><td>8. Markers (from CRIS DAC form)</td><td>
<table>
<tr><th>General policy objective</th><th>Not targeted</th><th>Significant objective</th><th>Main objective</th></tr>
<tr><td>Participation development/good governance</td><td>☐</td><td>X</td><td>☐</td></tr>
<tr><td>Aid to environment</td><td>☐</td><td>X</td><td>☐</td></tr>
<tr><td>Gender equality (including Women In Development)</td><td>☐</td><td>X</td><td>☐</td></tr>
<tr><td>Trade Development</td><td>☐</td><td>☐</td><td>X</td></tr>
<tr><td>Reproductive, Maternal, New born and child health</td><td>X</td><td>☐</td><td>☐</td></tr>
<tr><th>RIO Convention markers</th><th>Not targeted</th><th>Significant objective</th><th>Main objective</th></tr>
<tr><td>Biological diversity</td><td>X</td><td>☐</td><td>☐</td></tr>
<tr><td>Combat desertification</td><td>X</td><td>☐</td><td>☐</td></tr>
<tr><td>Climate change mitigation</td><td>☐</td><td>X</td><td>☐</td></tr>
<tr><td>Climate change adaptation</td><td>☐</td><td>X</td><td>☐</td></tr>
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<tr><td>9. Global Public Goods and Challenges (GPGC) thematic flagships</td><td></td></tr>
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SUMMARY

Support for economic growth has emerged as a crucial issue in Georgia. Structural constraints and incomplete economic reforms continue to make it difficult for Georgian businesses, especially SMEs, to efficiently operate and scale up. Persistent weaknesses in the financial system continue to limit not only access to finance for business but also the build-up of savings in the economy, a precondition for building a solid safety net and a domestic investment base. The slow and flawed delivery of justice is often described as the major obstacle for investing and developing business operations in the country.

The demand for economic growth is also reinforced by the DCFTA, which notably aims at facilitating Georgia's economic integration, domestically and internationally. Supporting efficient market-oriented entrepreneurship models integrated with innovation, technology, educational skills and EU standards would certainly help to increase productivity, efficiency, competitiveness and create stronger business linkages in Georgia and its regions. The action proposes to concretely support value chains/clusters and business incubators to boost the real economy.

The **overall objective** of the programme is to foster socio-economic development in Georgia and its regions, with the **specific objectives** to make litigations faster and fairer for businesses, to modernise the financial infrastructure and to promote market-oriented and innovative business models for job creation.

The programme is structured in three inter-related thematic components:
(1) Fairer and faster litigations in commercial matters
(2) Modernised financial infrastructure
(3) Greater business sophistication

In line with the 2015 review of the European Neighbourhood Policy (ENP), the action will contribute to foster smart, sustainable and inclusive growth and resilience in Georgia and its regions and to strengthen institutions and good governance**,** which are two of the 4 pillars under the new Single Support Framework for EU Support to Georgia (SSF 2017-2020).

The EU contribution includes EUR 21 250 000 in budget support. Other support (direct award, indirect management, procurement of twinning and services) represents EUR 26 400 000, of which EUR 19 900 000 is connected to and complementary to the scope covered with budget support and EUR 6 500 000 is not connected to the budget support as highlighted in section 5.4.

This action is co-financed by the Austrian Development Agency (ADA) for an amount of EUR 1 000 000 (for Component 3). This action might be co-funded by the Swedish International Development Cooperation Agency (Sida) for an estimated amount of EUR 2 800 000.

1 CONTEXT

1.1 Sector/Country/Regional context/Thematic area

Georgia is a small country with a population of 3.7 million in 2016, 1.1 million of which live in the capital Tbilisi. Georgia has made substantial strides towards the establishment of a market economy, but still it remains a small market with low productivity, low added value production, high dependency on imports and untapped export potential. Unemployment has been on a downward trend since 2009 (16.9%) and stood at 11.8% at end-2016. However, more than half of the working population continues to be self-employed in agriculture and subsistence farming. Small and medium-sized enterprises (SMEs[1]), including co-operatives, represent 94% of the active business population, but their contribution to GDP remains low at about 15% and their performance weak due to their concentration in low value-added activities, e.g. sectors that do not require upfront investment and skilled labour. Just under 40% of small businesses operate in the trade sector, including repair of vehicles, followed by 12% in real estate. Only 10% are active in manufacturing, a significant decrease from 15% in 2010[2]. Geographically, half of Georgian SMEs are located in Tbilisi, with the rest being concentrated in two major regions, Ajara and Imereti, confirming an uneven regional development but also a potential for regional growth. According to the latest statistics 3 666 small and medium-sized units are exporting, with a contribution of 11% to the total exports.

Over the past decade Georgia has strongly focused on improving the general business enabling environment, implementing radical structural reforms that helped reducing government intervention, cutting red tape and simplifying business regulations. Notable progress was registered in anti-corruption, business registration and tax administration. Best practices in e-government services were introduced. This helped Georgia's ranking among the top 20 economies in the *Doing Business Index 2017*, yet bottlenecks and structural constraints continue to persist in the business operational and financial environment, making it difficult for businesses to scale up, expand or transform from "necessity" into "opportunity" entrepreneurship. Second-generation reforms were introduced such as preferential tax regimes also for micro enterprises or the more recent accounting and auditing regulation to facilitate financial transparency, however there is ample room for completing structural and institutional reforms in business-related and legislative areas, including the financial sector, relevant for boosting business confidence, business creation and business operation.

The court system has undergone important developments as a result of three major packages of legislative changes (aka three waves of judiciary reforms), as well as policy and capacity building over the last five years. However, businesses raise increasingly their concerns about the transparency, legality and promptness of procedures before courts, which affect their trust in the otherwise overall well depicted and rated business environment in Georgia. Similarly, once the decisions have been rendered by courts, they also need to be efficiently applied in practice by the state enforcement bureau. Finally, there are some 617 000 businesses and entrepreneurs registered in Georgia, but only 160 000 of them are active; this major discrepancy is importantly due to the ineffective insolvency and liquidation systems that have also been rated very low in the Doing Business Indexes.

Continued financial sector reforms will be essential to address structural economic imbalances and financial sector gaps. Despite a well-capitalised and sound banking sector and the availability of basic financial services, limited access to finance continues to constrain business development, technology adoption and export diversification. This is especially constraining for micro and SMEs, whose share of lending remains low at 20% of the total bank loans.

[1] In Georgia there are two conflicting SME definitions, one of which does not identify micro-enterprises. Micro businesses are defined only for tax purposes. As from 2017 the Georgian National Statistics Office (Geostat) changed the methodology, by applying the definition proposed by EUROSTAT (number of employees and turnover).

[2] SME Policy Index 2016

Limited access to credit is largely due to high cost of funds, strict collateral requirements, weak credit history and underdeveloped products for SMEs. Banks continue to rely upon real estate collateral instead of other forms of guarantees. Moreover, the existing credit market infrastructure is not used properly to reduce lending risks to SMEs, while cumbersome business closure and insolvency procedures create significant problems for business exit and re-entry appetite. The capital market and non-bank financial sector is small, undiversified and illiquid. Dollarisation is high (65.4% of loans and 71.3% of deposits were denominated in US dollars at end-2016) and translates into major foreign exchange and credit risks. Weak regulation of the non-bank financial sector and the growing financial distress of banks' borrowers translated into a boom of on-line lenders and deposit takers. Lack of financial capability of clients and weak business practices in the absence of a modern consumer protection framework increased instances of consumer abuse and consumers' losses and violations in the area of responsible lending.

The demand for economic and business growth is reinforced by the DCFTA, which notably aims at promoting prosperity and new jobs. The DCFTA, which entered into force in July 2016, is expected to catalyse institutional and regulatory reforms aligned to EU norms. It will help creating the conditions for upgrading quality standards, transferring technology and knowledge and exploiting the untapped potential of certain sectors (such as tourism, agriculture). The 3rd Association Council in Trade Configuration agreed to focus future EU assistance for 2017-2020 on economic growth, private sector support and developing efficient value chains. The Georgian government has embraced the cluster system as the right step forward at this point in time for Georgia’s economy to raise the competitiveness of suitable economic sectors, while supporting Georgia's economic integration. The clustering approach is suitable for the integration of business incubators, if they stimulate innovation or are able to absorb technology transfers. The adoption of an innovation strategy would be an opportunity to boost innovative start-ups while strengthening the link between the private sector, academia and research centres. Participation in EU programmes and exchange of experiences with EU Member States would certainly contribute to accelerate innovation, technology transfers and growth. This would well align with the 'EU4Innovation' framework, launched by the EU in November 2016 in order to consolidate all the Union's innovation activities in the Eastern Partnership under a single umbrella.

Georgia’s commitment to accelerate economic growth by further improving the business and investment environment has been confirmed in the revised 4-Point Government Plan 2016-2020. The Plan is based on a clear vision of the country's needs and priorities and has been positively assessed by the IMF. On the 1 March 2017 the IMF reached a Staff-level Agreement with Georgia on a three year USD 285 million Extended Fund Facility (EFF), which was approved by the IMF Executive Board on 12 April 2017. The programme will notably seek to address the country's macroeconomic imbalances and structural weaknesses – low production and productivity base and excessive dollarisation of the financial sector – which limit economic growth.

Following the agreement of the new IMF programme, Georgia also requested a new Macro-Financial Assistance operation from the EU, which would cover part of Georgia's financing gap that is not already covered by the IMF and the World Bank.

Going forward, and implementing the ambitious economic agenda, Georgia’s productivity, competitiveness and long-term sustainable growth will largely depend on how the future economic, business and financial legal frameworks will be able to address existing weaknesses and translate the potential for change offered by closer economic integration with the EU into tangible benefits for the entire Georgian population.

The EU action proposes a support package to promote economic development through a better legal system notably for alternative dispute resolution mechanisms for commercial disputes and contract enforcement, a modernised financial infrastructure to enhance the financing of the economy, and increased business integration and sophistication, while ensuring the delivery of better public services to business.

1.1.1 Public Policy Assessment and EU Policy Framework

The series of reforms carried out in the last decade in the business enabling environment significantly contributed to support the private sector and to expand the economy, confirming Georgia's pro-active policy towards creating favourable conditions for enterprise development. Georgia remains committed to further improve the business and investment climate in order to become a full-fledged economy integrated with regional and global markets, where the role played by SMEs as the engine of sustainable growth and added value generation is fully recognised. The government's socio-economic strategy Georgia 2020, the SME Development Strategy 2016-2020 and the most recent 4-Point Government Plan 2016-2020 are the **overarching strategic documents** of reference, complemented by sector-specific strategies.

The strategy **Georgia 2020** foresees the need to improve private sector competitiveness, increase access to finance and strengthen the investment climate. The strategy bases its vision around three elements: 1) the stimulation of a fast and efficient economic growth based on a competitive business environment, 2) the implementation of economic policies that facilitate inclusive growth, prosperity and social equality, 3) the rational use of natural resources. Regional development is also viewed as an important factor for achieving success on a national level.

The **SME Development Strategy for 2016-2020** is the main strategic document adopted in 2016 for continued reforms and support to SMEs. Its elaboration, which started in 2014 in collaboration with the EU, the European Training Foundation (ETF) and the OECD, has been an opportunity for the Georgian government to address existing short, medium and long term weaknesses of the business sector in general, as well as to create a coherent framework for regular public-private sector consultations. The Strategy was elaborated under an inclusive governance structure composed by a High Level Steering Group (at Ministers and Deputy Ministers level) and technical Working Groups. The SME Strategy sets policy targets on SMEs output, productivity and employment growth to be reached by 2020.

The **4-Point Government Plan 2016-2020** confirms the government's commitment to strengthen the business legal framework and to put forward economic and financial reforms. The Plan includes measures to improve fiscal and tax litigation systems, start-up financing, capital market development, land reform and public-private partnerships (PPPs) to promote foreign investments and ensure a more efficient cooperation between businesses and the state in the implementation of major infrastructure projects.

The government's economic policies and strategies support Georgia along the implementation of the **Association Agreement (AA)** including a **Deep and Comprehensive Free Trade Area (DCFTA)** with the EU. Chapter 5 of the AA on *'Industrial and Enterprise Policy and Mining'* stipulates cooperation on industrial and enterprise policy, thereby improving the business environment for all economic operators, but with particular emphasis on SMEs. The chapters in Georgia 2020 on "improvement of the business and investment climate", "innovation and technology", "facilitating the growth of export", "developing infrastructure to support Georgia's transit potential" and "development of financial intermediation" make clear references to DCFTA-related obligations.

One of the key priorities for action under the revised **EU-Georgia Association Agenda** is to improve Georgia's business and investment environment. The Association Agenda confirms the need to develop alternative means of dispute settlement (mediation, arbitration), to ensure simple rules and procedures on registration of companies and entrepreneurs, as well as liquidation of businesses. Particular attention is given to the implementation of the SME Strategy and Action Plans; the regulatory framework and business operational environment; and the the role played by public private dialogue in the identification of needs and priorities of the private sector. The Association Agenda highlights the medium term priority to link SME development to the opportunities created by the DCFTA, including through business networks and clusters. Furthermore, the Association Agenda stresses the importance to reform the financial sector infrastructure.

There is no specific governmental strategy in the area of commercial legislation. However, the government formed a specifically dedicated Inter-Agency Council with four thematic working groups and assigned them with specific priorities in 2016, such as establishing commercial chambers, enhancing mediation and arbitration, decreasing courts' backlogs and regulating mortgage issues. The first ever comprehensive **Judiciary Strategy** and Action Plans were adopted in May 2017 with specific actions foreseen under specific chapters, such as independence, accountability, quality and efficiency, and access to justice.

1. Fairer and faster litigations in commercial matters

After years of focusing primarily on criminal law areas, the Ministry of Justice declared civil, commercial and administrative legislative reforms as a priority in 2016. This was reflected in August 2016 in the transformation and promotion of a Consultative Council on Private Law Reform attached to the Ministry of Justice into an **Inter-Agency Coordination Council on Implementation of Private Law Reforms** established directly under the Government of Georgia. While no specific strategies were drafted yet, the four newly formed working groups reflect clearly the priorities set by the Ministry of Justice: 1) Establishment of commercial collegiums/chambers within the common court system; 2) Development of means of alternative dispute resolution (arbitration and mediation); 3) Reduction of the court workload related to minor disputes (litigations with microfinance organisations and other litigations), and 4) Mortgage issues and models for preventing disturbance of the right of ownership on immovable property. In addition, informal working groups continue to work on other aspects of civil, commercial and administrative laws.

The Ministry of Justice presented their first project of establishing specialised **commercial chambers** in mid-2016. Although most questions remain unsolved and important concerns exist about the nature and impact of the chambers, the general idea is to hire high-qualified legal experts to preside over medium and high value disputes in business-to-business cases, with possible involvement of international judges. While the concepts shall be further scrutinised with reference to EU and international best practices and experience, the initiative underlines the urgency to solve the issue of protracted judicial proceedings in commercial disputes.

In-court **mediation** was first introduced in December 2013, but it is still rarely used in reality. In order to further exploit its potential, a new law has been drafted with a wide involvement of various stakeholders, and is now being finalised by the Ministry of Justice. It will further regulate the in-court as well as introduce general rules for an out-of-court mediation. The in-court mediation is mandatory for several specific types of disputes, while the out-of-court one should be used on a fully voluntary basis. Concerning the EU policy framework, in 2011 a Mediation Directive entered into force to regulate cross-border disputes in civil and commercial matters. Yet, national regulations and extent of the mediation continue to largely vary in the EU Member States.

Arbitration was introduced in Georgia back in 1997. Several arbitration tribunals have been formed but they almost exclusively deal with banking and micro-credit disputes. The Ministry of Justice (MoJ) supports the extended use of arbitration, including the idea of creating a regional hub for arbitration in Georgia. Although this idea is now premature given the so far very limited number of business-to-business cases dealt with by the arbitration tribunals. As regards the EU, there is no uniform regime on arbitration (and it is excluded from Brussels 1 Regulation on enforcement of judicial decisions). In fact, arbitration continues to be regulated through the 1958 New York Convention and varying regimes established within EU Member States. The practice of arbitration in the EU also remains strongly national or regional, including references to arbitration tribunals; only the ones seated in London, Paris and Stockholm (and Geneva) achieve Europe-wide recognition.

The other immediate priority of the governmental Inter-Agency Council is to consider fast-track procedures in resolving minor disputes ("micro-credits") that constitute a large bulk of cases overloading the courts' civil chambers. Indeed, it is no longer sustainable to accumulate large numbers of cases, and a solution is urgently needed. As a starting point idea, the Ministry of Justice considers awarding judicial competence to judicial clerks with higher qualifications, but this needs to be further scrutinised with regard to the Constitution. In this context, **the civil code, civil procedure code** and the related legislation need to be further reviewed. Informal working groups were formed earlier and continue to draft amendments in that respect.

Similarly, a first draft of a new **company law** ("law on entrepreneurs") was submitted for finalisation to the Ministry of Justice in 2016. The law is a robust package of provisions (258 articles) regulating the legal forms and activities of individual entrepreneurs and entrepreneurial entities: open partnerships, limited partnerships, limited liability companies, joint stock companies and cooperatives. It provides for detailed default regulations in case companies would not set different rules in their statutory documents. Furthermore, the new law shall incorporate a number of relevant EU directives, including the ones referred to in the Association Agreement, and approximate the regulation to practices in the EU. A regulatory impact assessment of the law is to be finalised in mid-2017 and further point to its possible gaps and final effects.

Resolving insolvency remains the weakest area in the World Bank's *Doing Business 2017* due to deficiencies in the overall framework, costs, durations and recovery rates. To improve them is also one of the priorities set in the SME Strategy. Also, the Ministry of Justice and its subordinated Enforcement Bureau recognise the need to substantially revise the legislation and enhance the numbers and skills of administrators. In February 2016 a special working group was formed in cooperation with the Ministry of Justice and elaborated papers on commencement of insolvency proceedings, legal consequences of commencement, strengthening of creditors' rights and rehabilitation possibilities for enterprises. A new law is foreseen to be submitted to the Parliament in 2017-2018 after a regulatory impact assessment.

Still, different opinions exist about the need to introduce an institute of private administrators next to the public ones entrusted by the Enforcement Bureau. In the EU, different models of insolvency frameworks co-exist. The European Commission recommended in 2014 to put in place a framework that enables the efficient restructuring of viable enterprises in financial difficulty and gives honest entrepreneurs a second chance, thereby promoting entrepreneurship, investment and employment and contributing to reducing the obstacles to the smooth functioning of the internal market. A Council Regulation on (cross-border) insolvency proceedings was adopted in May 2000.

Currently, the **enforcement of judicial decisions** is ensured by agents of the Enforcement Bureau as well as private bailiffs. The latest revision of the law on enforcement is now with the Ministry of Justice, but a fundamental question remains to be decided: how the proceedings should be administered by both private and public bailiffs. A comparative study with EU Member States systems was already produced for that purpose, and it showed different approaches applied across EU Member States.

2. Modernised financial infrastructure

Improving access to finance is one of the strategic directions of the SME Development Strategy 2016-2020, with actions on financial literacy, accounting and reporting standards, innovative funding sources and grants. Structural reforms of the financial sector are envisaged in the Georgia 2020 Strategy and in the 4-Point Reform Plan. Following the time-table agreed in the AA, the approximation to the EU *acquis* in the financial sector is foreseen during 2 - 8 years from the entry into force of the AA. In order to enhance the financing of the economy, boost financial stability and stabilize the local currency, the Georgian government recently embarked on major reforms of the financial sector.

In April 2016 the government approved a **Capital Market Development Strategy**, deemed essential to support the diversification of the financial system and increase the availability of investment resources. The Strategy envisions reforms of the legal and regulatory framework to approximate it with relevant EU Directives[3] and IOSCO (International Organization of Securities Commissions) principles. An Action Plan accompanies the strategy with specific measures on money, derivatives, government, corporate bonds, insurance and stock markets. The NBG is actively engaged in this process and, recognising the importance of the reform, has created a Capital Market Department in February 2017.

An insurance strategy *per se* does not exist, however the insurance market is mentioned under the Capital Market Development Strategy. The introduction of a Motor Third Party Liability Insurance (MTPL) is at the top of the reform agenda. The plan is to initially proceed with the introduction of the compulsory Border MTPL Insurance Law[4] (to submit to Parliament in October 2017) to be then followed by the overall MTPL Insurance Law (to submit to Parliament in February 2018), which will integrate the provisions of both Border and Domestic MTLP

[3] Financial services are referred to in sub-section 6, Title 4 of the AA (Trade and Trade Related Matters). Article 122 states that "With a view to considering further liberalisation in trade in services, the Parties recognise the importance of the gradual approximation of Georgia's existing and future legislation to the international best practice standards listed under Article 116(3) of this Agreement as well as to the list of the Union *acquis* included in Annex XV-A to AA".

4 The Border Motor Liability Insurance is a type of insurance required by law for all motor vehicles registered abroad (foreign plates) that circulate in the territory of Georgia. The adoption of this law will facilitate Georgia's membership in the Green Card system.

Insurance. The introduction of a Civil Liability Insurance for motor vehicles is also envisioned under the EU-Georgia AA (Directive 2009/103/EC). In 2013 the **Insurance State Supervision Service of Georgia (ISSSG)** was created**,** as an independent entity from the NBG. It proved to be an important step towards fostering the insurance market and improving its supervision, in line with the EU Solvency I principles of minimum capital and solvency margin requirements for insurance companies. ISSSG is currently tasked with the development of a roadmap for new compulsory insurance classes.

Non-loan products such as factoring and leasing are referenced in the Law of Georgia on Microfinance Organisations. The law approves activities for Micro Finance Institutions, which include micro leasing and factoring. The demand for such services however remain scarce for reasons such as small market size, the unavailability of these instruments to attract capital and a more general lack of understanding or awareness of the products.

In June 2016 a new law on **accounting and audit** has been approved by the Parliament. The law will align the legislation on financial reporting and auditing more closely with EU laws. The legislation will also introduce a **public audit oversight body** for the regulation of the audit sector, which will enhance transparency in audit and financial reporting.

Financial Education and **Consumer Protection** is one of the top priority reforms of the NBG, as evidenced by the recent establishment of a new department on Consumer Protection that will directly report to the NBG Governor. In July 2016 the NBG has also approved a Financial Literacy Strategy that aims to increase consumer's financial awareness about financial products.

3. Greater business sophistication

The Ministry of Economy and Sustainable Development (MoESD) is responsible for business-related and SME policy making in Georgia and also coordinates the DCFTA part of the AA. In 2014 the MoESD strengthened the institutional environment for private sector and SME development with the establishment of two agencies: Enterprise Georgia (EDA) - since April 2017 renamed "Produce in Georgia" – and the Georgian Innovation and Technology Agency (GITA).

EDA in Georgia is responsible for the implementation and coordination of SME support measures, and for the implementation of the programme *"Produce in Georgia"* which supports local agri-processing, industrial production and tourism through concessional loans, infrastructure support and the provision of consulting services. With the expansion of the programme, the staff of the agency increased, thus creating favourable preconditions for a bottom-up approach. In 2015, EDA launched the programme "*Micro and Small Enterprise Development*" with the priority to support female entrepreneurs (current rate of female beneficiaries is 40 %). One of EDA's most important activities is SMEs needs assessment. Thematic meetings have been held with representatives of different economic sectors to help identifying challenges and opportunities for Georgian SMEs. EDA is involved in export promotion activities, assisting Georgian companies through export education programmes, an export catalogue, a web portal www.tradewithgeorgia.com and a multifunctional business service centre which allows SMEs to receive DFCTA-related advisory services. According to the EDA Annual Report 2016 (published in February 2017) more than 220 Georgian SMEs were provided with training, advisory/consultation services and long-term guidance during 2016.

Recognising the importance to develop an innovation-driven and knowledge-based economy, in 2015 the government created a platform for public-private dialogue on innovation (Research and Innovation Council) and subsequently started to develop a National Innovation Strategy 2020. In 2014 GITA was established to support and coordinate the innovative ecosystem. GITA elaborated the draft law on innovation, adopted in June 2016. The agency launched a small grant programme for technology innovation open to individuals, NGOs, research organisations and universities. The competition was well received but it also revealed some weaknesses in the capacity of many applicants to prepare and present grant proposals. On the infrastructure front, GITA launched several projects which include the establishment of tech parks, incubators, accelerators, innovation laboratories and pilot university-based fabrication laboratories (FabLab). The two tech parks operating in Tbilisi and Zugdidi anchor a proposed national network of innovation centres aimed at stimulating innovative activities and promoting awareness of the benefits of innovation. In collaboration with the Georgian National Communication Commission GITA launched the "OpenNet" initiative, to provide broadband internet connectivity to about 2 000 villages. The Ministry of Education and Science (MoES) and MoESD have committed to cooperate on better alignment of education policy to market needs. GITA is in the process of partnering with the Georgian National Academy of Sciences to establish a bio-technology centre that will help Georgia realise its market potential in innovative applications of indigenous bacteria, enzymes and phages.

In 2015, EDA and GITA officially became members of the Enterprise Europe Network (EEN). The performance of EEN in Georgia should be however improved given that only few companies benefitted from the network.

The MoESD is drafting the ***Export Development Initiative 2030,*** a long-term roadmap for the development of the export potential, the ***E-Commerce Strategy*** and a ***Communication Strategy*** with a deep analysis of the products attractive for investment. In cooperation with the EU-funded project "SME Development and DCFTA in Georgia" the MoESD is assessing the value chain and clustering potential in Georgia. Despite that a cluster and industrial policy *per se* does not exist, the MoESD and the Georgian Industrial Development Group (previously under EDA) considered that four priority industrial sectors provided economic opportunities for the establishment of value chains: agro industry, agro forestry, mining/mineral resources and light manufacturing. The study assessed the competitiveness of local inputs, the import substitution effect, the spill-over opportunities and the role played by the state and the private sector.

Positive steps from the MoESD have been the set-up in 2016 of the **Private Sector Development Advisory Council** and the **DCFTA Advisory Group** as part of the Advisory Council on Georgia’s Trade Related Issues. Both contributed to institutionalise the public-private dialogue, thanks also to the involvement of the civil society and the business community in the process. However, more efforts are needed, especially to more systematically organise the discussions around challenges and solutions faced by the private sector, to more properly represent small businesses and sectoral organisations and to take concrete follow-up actions.

The MoESD has a working group on SME Strategy implementation and publishes Annual Progress Reports. The first such report is the Annual Progress Report of 2016, but it remains an activity-based more than a results-oriented document.

The ***Business House (BH)*** was launched by the government in 2016 as part of its agenda to improve relations between the state and the business community. At the cross point between E-governance and Public Administration Reform, the one-stop-shop concept supports the GTB ("Government To Business") approach from the e-governance angle. Once operational, more than 600 state services will be available under a unified portal, with services available on-line via a new electronic platform. This idea is expected to stimulate Georgia's investment and business climate. The concept fits with the "E-Georgia Strategy", under revision by an on-going twinning, and with the principle of modernisation of services of Georgian agencies (led by the Ministry of Justice). By the end of 2017 the full package of the *Service Delivery Policy* will be ready and the BH project will be included under the *Service Delivery Strategy*. The portal will be owned by the Data Exchange Agency (DEA), whereas the MoESD will lead the process.

Within the **EU Policy Framework**, the proposed action is in line with the recommendations of the European Neighbourhood Policy's review, where economic governance and structural reforms for improving competitiveness, inclusive growth and social development are key for economic resilience. The EU intervention matches with Priority 1 on economic development and market opportunities and Priority 2 on strengthening institutions and good governance of the Deliverables for 2020 as well as with the EU's Global Strategy of June 2016, recalling the importance of the resilience aspect. In the context of the EU Single Support Framework (SSF) 2017-2020, the action falls under the specific objectives to support economic development and good governance.

1.1.2 Stakeholder analysis

The main stakeholders are the Georgian authorities, including implementing and regulatory agencies, and the private sector. Given the inter-related policy areas covered by this action, the main institutional stakeholders will be the Ministry of Economy and Sustainable Development (all components), the Ministry of Justice (component 1), the Ministry of Finance (all components), the Ministry of Agriculture (component 3) and the National Bank of Georgia (component 2). These are well established institutions with clearly outlined and stable responsibilities. These institutions do not necessarily work together, and in this respect the action will contribute to a better institutional cooperation and coordination.

The governance structure set up by the MoESD in order to elaborate and oversee the SME implementation process - composed by a High Level Steering Group at Ministers and Deputy Ministers level and technical Working Groups – might constitute the institutional framework for economic policy coordination and monitoring, including financial and technical monitoring.

The government's Inter-Agency Council on Private Law Reform and its four working groups started operating in mid-2016; their capacity and outreach needs to be further established. The Ministry of Justice coordinates the reforms in the private law areas through its Legal Drafting Department; the department relies much on advice and practical output of different working groups, external consulting companies and donors' projects. The capacities of the Enforcement Bureau, an agency established under the Ministry of Justice, has been strengthened over the past years with a large involvement of EU and other donors, but it will have to cope with new challenges once the laws on insolvency and enforcement of judicial decisions have been adopted. Concurrently, these laws may establish (new) professional associations of private administrators and private bailiffs that would need support with operationalisation. The arbitration and mediation associations failed to attract other than microcredit disputes, and so they need to be further transformed and activated in order to increase significantly their caseloads. The Bar Association focused on successfully defending the lawyers from intrusions by law enforcement agencies in the past, but now it needs to pay furthermore attention to increasing the lawyers' skills in commercial matters.

In 2016 the MoESD created the departments of Economic Growth Analysis, Economic Growth Policy and Planning, Service of Macroeconomic Analysis and Division of Regulatory Impact and Competitiveness Survey. An internal assessment of their gaps and needs revealed the need to strengthen their capacities to more effectively design economic policies and initiatives in consultation with relevant stakeholders and to monitor the progress in the implementation of the policies.

Well established work relations exist, notably with EDA, which is already receiving support from the EU and other donors. EDA's internal assessment highlighted the need to refine the agency's products, align its strategic framework and improve the efficiency of the internal processes. Work relationships exist also with GITA, which is receiving a considerable support from the World Bank. GITA's biggest challenge is to improve its strategic management capacities and link its products to the real needs of the industry.

The NBG and the Insurance State Supervision Service of Georgia (ISSSG) are receiving some support from the World Bank, but continuous capacity building activities are further requested to improve their institutional and regulatory mandate.

To ensure demand-driven measures, it is also essential that relevant private sector representatives, including universities and research centres, will be engaged in the action.

The final beneficiaries of the action will be the private sector at large and the Georgian citizens. Other final beneficiaries are academia, technical universities, business supporting organisations and financial service providers that will benefit from an enhanced policy focus on access to finance.

*1.1.3 **Priority areas for support/problem analysis***

Fairer and faster litigations in commercial matters, a modernised financial system and higher business sophistication have been identified as key ingredients for boosting economic development. The Georgian government has initiated reforms in several economic policies, and a number of donors is covering them. The EU has already focused on supporting the private sector, the financial system for SMEs and the broad justice sector for business via bilateral and multi-country programmes. This new EU programme will push for the completion of business and finance-related reforms and for strengthening the policy implementation process. Particular focus will be given to improving the dispute resolution process, stimulate business linkages within the economy and to improve the productivity and competitiveness of selected value/supply chains, clusters and business incubators/accelerators. The EU action will address regional imbalances, proposing to support such models in pilot regions, while ensuring synergies and coordination at central and local level. Building on the results achieved so far, the EU programme proposes three thematic components. The EU intervention is aligned with the overarching government's strategies mentioned in paragraph 1.1.1 and with the SME Development Strategy 2016-2020, which remains the major strategic document for continued reforms and support to Georgian SMEs.

(1) Fairer and faster litigations in commercial matters

The entrepreneurs point to protracted and unfair resolutions of commercial legal disputes as one of the major problems for developing business activities in Georgia. Together with monitoring organisations, they refer to illegal practices and schemes that persist before courts, and the prolonged duration of disputes due in particular to the huge backlog and increasing caseload of the major courts.

Currently, the judges of the civil chamber of the Tbilisi City Court (that deals with most cases in 1st instance) face more than 900 pending cases each, consisting importantly of petty payment recoveries by micro-credit institutions and banks from their clients. While the Enforcement Bureau may issue fast-track decisions in such cases, most of them are eventually appealed and then undergo standard proceedings before courts.

The EU supports judiciary reforms in various areas of both criminal and civil proceedings through a technical assistance project (October 2016 – May 2019), but further attention shall be paid to streamlining the procedures specifically in commercial disputes. Once the concept of the **commercial chambers** has been defined in more details, their establishment may require further technical expertise with the aim to ensure its alignment with EU standards.

Besides that the **civil procedural code** and related legislation, such as the civil or administrative codes, need to be further revised in order to allow for more streamlined and prompt proceedings before courts in both low and high value commercial disputes respectively.

Simultaneously, the proceedings have sometimes been marked with insufficient **skills** of judges or lawyers in complex business and economic cases, including recent high value competition (monopoly/cartel) disputes. The qualification of the legal professionals will be further enhanced in order to reduce procedural flaws and unfair decisions.

A certain number of potential court cases could be redirected to alternative dispute mechanisms, such as mediation and arbitration.

Since its introduction in December 2013, the use of **mediation** is very limited and increased very slowly, despite a number of trainings provided to judges, lawyers and mediators, introduction of curricula at universities, establishment of the National Centre for Alternative Dispute Resolution, and holding a series of workshops and campaigns. Also, two mediation associations have been operating in Georgia with only limited engagement and results. Altogether only 98 cases were referred to two existing mediation centres at Tbilisi and Gori courts since 2014, and only 23 mediators have been active with different levels of certifications. The use of both in-court and out-of-court mediation will be further supported, but attention will be paid to ensuring a balance between investments and numbers of mediation cases commenced, efficiently handled, effectively recognised and enforced in reality, comparatively to the number of cases before courts.

Compared to mediation, **arbitration** was introduced in Georgia much earlier, back in 1997. However, very soon it lost the trust of the public as well as judges after being oftentimes misused by banking or micro-credit institutions and seen to follow illegal schemes. Confidence is yet to be restored: almost all arbitration decisions (2 684 applications in 2015 and 3 295 applications in 2016 were submitted to courts for endorsement) are still related to microcredit disputes and judges continue to be reluctant to recognise the arbitral awards without further scrutiny, which eventually strips the arbitration of one of its principal goals – reducing the courts' caseload. Two major business-to-business arbitration courts operate in Georgia: The Georgian International Arbitration Centre founded by the Georgian Chamber of Commerce and Industry and the Dispute Resolution Centre partnering with the Business Association of Georgia. Arbitrators are members of the profession's Georgian Arbitrators Association. The commercial arbitration will be further supported proportionally to the number of business-to-business cases, number of contractual clauses referring to Georgian arbitration tribunals, and the effective recognition by courts and enforcement of arbitral awards. The idea to create a regional hub for arbitration will be supported accordingly.

While Georgia is overall rated high in the World Bank's *Doing Business*, it has been considerably lagging behind in the resolving **insolvency** index (combining the recovery rate, time, costs, outcome and insolvency framework): place 101 in 2016 and 106 in 2017 out of 190 economies monitored. Currently, the number of insolvency proceedings is insignificant as compared to the size of the country and the number of enterprises and there are almost no insolvency proceedings which would lead to rescuing an enterprise. Effectively, most cases end with liquidation after around 2 years' time due to procedural delays and only after a piecemeal sale of assets for lower than first envisaged values.

One of the reasons for the lack of transparency and prolonged duration of the judicial cases is the conciseness of the current **company law**. When gradually reformed several years ago, the idea was to let enterprises define most details in their statutory documents. However, many of them having failed to regulate all subtleties, the courts had to establish sometimes contradictory ways of interpretation of the law including in high profile business cases in Georgia. The draft of the new company law extends significantly the scope and level of detail of the legal provisions, and its finalization after the regulatory impact assessment and application in practice will be supported.

Finally, the judicial decisions, including on arbitral awards, must be enforced in reality for the disputes to be effectively solved. Also thanks to a strong support from EU and its Member States, the **enforcement of judicial decisions** in commercial matters has improved over the last years. However, further adjustments and clarifications are needed to make it more efficient, predictable and reliable. A fair balance shall be further established between the needs of the creditor and the rights of the debtor; this problem is most apparent in the wide availability and use of micro-loans with extremely high rates and hard conditions for debtors that have caused large social problems in Georgia. The legislation, as well as practices and competence of private and public bailiffs shall be further revised for this purpose.

(2) Modernised financial infrastructure

The EU action will primarily complement the on-going efforts of the government to enhance the financing of the economy, by supporting reforms of the financial sector and by promoting the use of best market practices. While the Georgian financial system is widely dominated by commercial banks (accounting for about 93% of the total financial sector assets)[5] access to finance for SMEs remains severely constrained. This is mostly due to high costs of credit, lack of credit history and stringent collateral requirements. As a result, a vast majority of Georgian businesses rely on internal sources of funding (mainly retained earnings) or apply to non-bank lenders with higher rates, risks and no regulated procedures. The absence of a proper legal infrastructure, including a sound consumer protection framework, contributes to spread informal and irresponsible lending practices.

In view of providing a comprehensive package encompassing all the different dimensions of access to affordable finance for Georgian businesses of all sizes, the EU action will work on different axes.

In the area of **capital market development:** Following the Strategy on Capital Market Development and its Action Plan[6], the EU action will be intended to broaden the sources of funding for businesses with high perspective of growth and employment generation. Capital markets help mobilise price capital, but also provide opportunities to hedge risks. The development of the Strategy highlighted the problems that remain to be solved to boost

[5] Neighbourhood SME financing - Georgia, the EIB, February 2016

[6] Final Report April 2016; prepared by the working group composed by the Ministry of Economy and sustainable Development of Georgia, the Ministry of Finance of Georgia and the National Bank of Georgia

economic development. These are the obsolete capital market infrastructure which complicates trade and settlement processes, insufficient knowledge and experience of the market participants, insufficient liquidity which limits investors' interest, weak corporate governance and ineffective system of assessing creditworthiness, lack of institutional investors, and a taxation system not conducive to market development. Finally, Georgia is lagging behind in terms of capital market vehicles and instruments. The Strategy and Action Plan aim to remove these impediments through systemic and market methods. Strengthening the institutional capacity of the regulator (NBG) and the respective legal and regulatory framework are considered priorities for enhancing investor protection and increasing market transparency and attractiveness. Supporting the development of the capital market shall also enhance the expansion of insurance resources. The EU action therefore proposes to assist the NBG to develop a roadmap for implementing the relevant EU legislation, develop and implement a new legal framework for investment funds and mutual collective schemes, strengthen the capital market infrastructure and support the development of selective capital market instruments.

Responsible financial inclusion and alternative sources of financing: Under this area the proposed action will primarily work to promote responsible lending practices, enhance financial literacy to increase consumers' awareness about financial products, including financial literacy of microfinance clients in Georgia, and improve the framework for movable collaterals. The EU action will assist the government to streamline the "secured transaction framework" and implement a modern "transactions registry" in order to increase lenders' appetite for using movable collaterals as a form of guarantee. The lending market, especially for lower value loans, can also be enhanced through **further reforms of the credit market infrastructure, including credit reporting and oversight**. The first (and only one) private credit bureau established in 2004 in Georgia is operating without any regulatory framework and the NBG does not have any oversight responsibilities to ensure a sound market conduct and consumer protection in line with international best practices. The EU action will contribute to fill this gap, supporting the finalisation and implementation of a Credit Bureau law and regulatory practices. Additionally the EU action will support the development of financial instruments which can complement and increase the variety of financial products currently offered by commercial banks. This may include **factoring** and **leasing practices** as well as **other banking services** that could fit the needs of local SMEs. Areas of improvement in factoring are for instance a revised legislation defining different types of products (international factoring, reverse factoring, factoring on future receivables) to increase legal certainty. Areas of improvement in leasing are the introduction of provisions that would clarify the interpretation of rights and obligations of the parties to the leasing agreement.

Insurance market development: Insurances play an important role for financial stability. However currently sector performance is weak; major deficiencies exist in the regulatory framework and insurance products options are missing. Georgia does not comply with EU requirements regarding insurance classes and products classification. Life insurance is not developed. Property insurance exists but its level of penetration is very low due to lack of compulsory requirements and social background. Mandatory insurance classes such as Motor Third Party Liability (MTPL) are nearly absent. However, the introduction of a MTPL insurance is at the top of the reform agenda. The government also engaged on reforming the regulatory framework for the insurance market stability and solvency, under the responsibility of the ISSSG. In order for ISSSG to be able to effectively fulfil its supervision mandate (as foreseen under EU Directive 2009/138/EC, Solvency II) and to advance in the preparation of major insurance laws, the EU action proposes to assist this regulatory body with the overhaul of the legal framework, through capacity building activities and trainings of its young but dynamic staff. Also, ISSSG needs to improve the fit and proper criteria of a unified system for the management of insurance companies (e.g. testing, interviewing, including the electronic delivery of this process and identifying all necessary procedures which are used in the EU in this regard).

Better Financial Information: To manage their finances successfully and make sound business decisions, enterprises need solid financial information, analysis and a seasoned perspective. As professional accountants are a major source of external business advice for enterprises, there is an opportunity for the accounting profession to play an increased role in the development of the private sector, by providing financial information, analysis and advice required for a better financial management and decision-making to businesses. The latest report of the EU supported STAREP initiative (2017) highlighted the need to further strengthen the capacities of banking and insurance regulators and supervisors on International Financial and Reporting Standards, and to enhance the ability to monitor the **quality of financial statements**. This translates into the need not only to increase cooperation between auditors, supervisors and other actors, but also to raise awareness for business on the importance of providing reliable and accurate financial reporting. The EU action proposes activities to support the implementation of the recently adopted Accounting and Audit Law, building capacity of business service providers that would in turn provide business support and advice to all businesses and in particular to SMEs. The action also aims to strengthen the regulatory and operational capacities of the newly established **Service for Accounting, Reporting and Audit Supervision (SARAS)** under the Ministry of Finance (MoF), responsible for the enforcement of company reporting requirements, application of accounting standards and for quality control of audit. Establishing such enforcement will allow the government to close the existing gaps in supervision, enforcement and monitoring of entities important to the Georgian economy. These changes will help to simplify access to credit for business and improve the transparency of business and investment climate in Georgia.

(3) ***Greater business sophistication***

Besides access to finance, major bottlenecks for business are the low levels of entrepreneurship spirit, insufficient manufacturing and transformation capacities, business skills, underdeveloped clustering, poor export diversification and trade opportunities. In addition, the poor innovation and technology base (including green technologies) is hindering the potential for wider opportunities. In the *Global Competitiveness Report 2016-2017,* business sophistication and innovation continue to rank very low*,* witnessing the need to improve the current state of play.

***Clusters, business integration and business sophistication*: ** The state of cluster development, the local supply quantity and quality, the value chain breadth and the sophistication of the production process are among the indicators used to measure the degree of business sophistication. They all rank low in the *Global Competitiveness Report 2016-2017*.

An on-going EU-funded project is bringing the clustering approach to Georgia on a wider scale. The project highlighted that crucial factors for ensuring a well-functioning cluster model are the presence of adequate conditions in the business environment to encourage its development (institutional framework) and the existence of a structure where coordination and management activities are carried out in a transparent and systematic manner (a so-called "cluster governance and management organisation"). Helping Georgian entrepreneurs organize themselves in clusters initiates teamwork among them and enables them to form the critical mass needed to face new challenges, strengthen competitiveness and become attractive business partners for European clients. Work is underway in apparel, furniture, honey and film/post-production, while similar activities commenced in Information and Communication Technology. Other potential sectors are under discussion.

In view of enhancing business integration and creating the incentive for companies to link, the EU action aims to develop at least five pilot clusters in Georgian regions in manufacturing, agriculture and services. Clustering is a suitable approach to organise value chains, particularly when participating companies are SMEs eager to create synergies. In manufacturing, developing a cluster around construction materials will benefit from on-going reforms in energy efficiency and will contribute to reduce Georgia's import dependency. Packaging bears a high growth potential and enables the development of related sectors (such as food and beverage, transport). A cluster on packaging will contribute to improve the quantity and quality of materials used and promotes better regulation on raw materials, recycling and waste management. Apparel has an export potential and in combination with fashion/design (creative industry) a comprehensive integrated approach could be developed. Given the contribution of tourism to GDP and job creation, the EU action will also support a cluster built around mountain and non-mountain sustainable tourism, in combination with agri-tourism. In agriculture, a cluster on seeds/seedlings will benefit of Georgia's numerous climatic zones and will contribute to higher productivity and diversification of farming, notably to develop demonstration plots for testing new varieties. Such a cluster also requires good cooperation between scientific institutions and the private sector on R&D. Cluster development on organic/bio agriculture will benefit rural, smaller enterprises and might strengthen Georgian cooperatives. Existing cooperatives could integrate into a cluster and/or become a cluster themselves.

The EU action aims also to create the incentives for Georgian companies to cluster not only among each other but also with similar clusters in Europe. In line with AA/DCFTA provisions, regulatory (food safety, quality standards) and business standards (social compliance, workplace conditions), including best practices on gender equality standards, will be supported through the action, also thanks to synergies with other EU-funded programmes. The expected economic benefits of the cluster are, among others, increase in efficiency through information exchange and cooperation, improved manufacturing/transformation capacities, accelerated innovation, easier and cheaper access to market (providers and buyers), enhanced relationships between producers, suppliers, contractors and consumers, better advocacy and as a result business growth. Besides, major benefits are felt by workers (occupational safety and health), farmers (more income), the labour market (more skilled jobs), the environment and the Georgian economy as a whole.

Business incubators, innovative start-ups and innovation ecosystem: Despite the initial efforts of the Georgian Government to further develop the nascent innovation ecosystem, many challenges remain. The innovation pillar of the *Global Competitiveness Index Report 2016–2017* continues to lag behind, showing weaknesses on capacity for innovation, quality of scientific research institutions, company spending on R&D, university-industry collaboration and government's procurement of advanced technology products. Low innovation-readiness, undeveloped innovation infrastructure and limited access to finance for innovation hinder the capacity of Georgian enterprises to innovate and scale up. Coaching, mentoring and specialised training opportunities for innovative entrepreneurs are insufficient. The existing incubators, accelerators and technology transfers lack practical application and links with the industry. Innovation infrastructure is not developed outside Tbilisi. If GITA's grant programme was a strong initial start, the grant regulatory framework and their modest amount limit their effectiveness. The overall use of ICT in the industry is not optimised and its competitive benefits not properly understood, especially by SMEs. Given the complex and interactive innovation ecosystem, a closer co-ordination with all the stakeholders including technical Vocational Educational Colleges and other entities under the Ministry of Education and Science, is much needed. Furthermore, despite the progress registered since its establishment, GITA remains a small and young institution, with the biggest challenge to improve its strategic management capacities and attract participation from the industry. Its ability to meet growing demand for its services could benefit greatly from additional support.

The priority for EU intervention rests on the need to complement the government's efforts to boost the national innovation ecosystem, support the functioning of existing and/or planned business incubators/accelerators for sustaining new firm's creation and promoting innovation across Georgia.

The EU action will support GITA's capacities to develop and implement (in-house) innovation and entrepreneurship policies and programmes with medium-and long-term results and to act as a one-stop shop for innovation activities. Sharing of expertise with agencies in newer Member States such as PARP and/or NCBIR in Poland and Hamag Bicro in Croatia would support the transition of GITA from a "start-up" mode to a "fully-fledged" innovation agency. Demonstration effects of innovation through collaborative grant schemes led either by public universities or research centres or private entities will be promoted through the EU action, with the ultimate goal to translate research results into innovative economic activities and expand the opportunity for innovative start-ups and incubators to bring services to the market. Co-investment schemes will be stimulated thanks to grant financing for innovative firms (where grants are disbursed along with investment readiness programming for companies and potential investors). Tourism is an area receptive to innovation activities. The EU action will likely target Zugdidi as an excellent location for traveling and tourism and where new potential services from innovative start-ups can be further stimulated (such as financial technology for travel, free wi-fi in non-served areas, etc.).

One-stop-shop model for better quality and more efficient public services to businesses: At this stage the concept is still under development and an on-going twinning with the Data Exchange Agency is helping with the concept and the platform structure. Legislative changes are needed in order to develop the approach, the 'ecosystem' and the governance mechanism, which should also integrate the Georgian local communities and other business service providers. A subsequent twinning with the Data Exchange Agency or Enterprise Georgia/Produce in Georgia or a relevant agency, mandated with policy implementation, might be envisaged.

1.2 Other areas of assessment

1.2.1 Fundamental values

Fundamental values of democracy and human rights are protected by the Georgian Constitution, in line with international standards. Georgia is considered to be a country adhering to the rule of law, although improvement is still expected namely in the areas of enforcement of judicial decisions and the independence of the judiciary.

1.2.2 Macroeconomic policy

The economic slowdown in the region and sharp currency depreciations in major trade partners of Georgia since end-2014 have led to reduced exports and inflows of remittances. This has contributed to a slowdown of economic growth to 2.7% in 2016, from 2.9% in 2015 and 4.6% in 2014. GDP growth is projected to increase gradually to 3.5% in 2017, supported by consumption and investment. Regional and global growth is also expected to pick up in 2017, but will remain subject to downside risks.

External vulnerability contributed to the depreciation of the national currency (GEL) that lost 22% of its value against the US dollar between 2014 and 2016. The effects of this volatility are amplified by the still high dollarisation of the Georgian economy, where 70% of deposits and 65% of loans were denominated in US dollars in 2016.

The current account deficit has widened to 12.4% of GDP in 2016 (from 12.0% of GDP in 2015 and 10.6% in 2014) and remains a major source of vulnerability. The current account deficit, which is expected to worsen further to 12.9% in 2017, is mainly driven by the trade in goods deficit which is only partly offset by the trade in services surplus and income and transfers from abroad, including remittances. Although the current account deficit has mainly been financed by inflows of foreign direct investment (FDI), FDI is expected to decrease slightly from 11% of GDP in 2016 to 10.3% of GDP in 2017. Moreover, debt-creating financial inflows have also contributed to the financing of the current account deficit. Hence, Georgia's external debt, which hovered around 80% of GDP in 2008-2014, has increased significantly in the following years, to 111.8% of GDP at end-2016. As most foreign debt is denominated in US dollar, the lari depreciation has played an important role in this increase.

The period-average inflation (consumer price index, CPI) decelerated to 2.1% in 2016, compared to 4.0% in 2015. CPI is projected to increase to 5.7% in 2017, in line with the increase of excise duties which entered into force in January 2017. In 2016, in line with the economic slowdown and abating inflationary pressures (and even a brief period of falling prices), the central bank gradually reduced the key policy rate from 8% to 6.5%. However, in 2017, with an increase in inflationary pressures (mainly due to increases in excise duties and a pick-up in global commodity prices), the NBG raised the refinancing rate two times: from 6.5% to 6.75% (in January 2017) and to 7% (in May 2017).

Following a long period of fiscal consolidation since 2009, the fiscal situation started to deteriorate in 2015, partly resulting from an increase in social spending (35% of the State budget) aimed at addressing the country's persistently high levels of poverty and inequality. Thus, the budget deficit has widened from 3.1% of GDP in 2014 to 3.8% in 2015. The budgetary position further deteriorated in 2016, with the government's deficit estimated by the IMF at 4.1% of GDP, as a result of both weaker-than-expected revenues and spending increases ahead of the October parliamentary elections (mainly in defence, public transport, infrastructure and healthcare). The fiscal deficit (which was projected to increase further, to around 6% of GDP this year) is now forecast to remain at the same level (4.1%) in 2017 and to decrease gradually afterwards. Meanwhile, the public debt ratio also increased from 41.4% of GDP at end-2015 to 44.6 of GDP at end-2016.

On 1 March 2017, the IMF reached a Staff-level Agreement with Georgia on a three year USD 285 million Extended Fund Facility (EFF), which was approved by the IMF Executive Board on 12 April 2017.[7]

According to the IMF, the Georgian economy has remained resilient despite the external shock starting end-2014. The continued implementation of structural reforms is expected to create favourable conditions for private investment, productivity growth and improved export

[7] IMF Press Release No. 17/130, April 12, 2017

competitiveness. The IMF notes that the authorities' agreed economic program aims at preserving macroeconomic and financial stability and addressing structural weaknesses in the economy to support higher and inclusive growth. The 2017 Budget includes strong fiscal measures to ensure that budget discipline is maintained, debt sustainability is preserved and fiscal space is created for public investment and social spending. Fiscal reforms will contribute to budget discipline while national authorities agreed with the IMF on the importance of strengthening public financial management, control and disclosure of fiscal risks and continuing to strengthen tax administration[8].

Following the IMF Board decision, the World Bank's Board of Executive Directors was able to approve in April 2017 a EUR 47.2 million development policy operation (DPO) for Georgia. In May, the European Commission was able to approve the disbursement of the second tranche of EUR 23 million under the EU's Macro-Financial Assistance (MFA) to Georgia.

1.2.3 ***Public Financial Management (PFM)***

There is no overarching Public Finance Management strategy in Georgia. However, key government institutions – Ministry of Finance, State Audit Office and the Budget and Finance Committee of the Parliament have medium term policy documents and action plans for 2014-2017 years. Strategic documents take the 2012 PEFA findings as a baseline while reform milestones were being developed through inclusive policy dialogue processes via the EU Public Finance Policy Reform (PFPR) programme.

The MoF PFM Strategy highlights its reform activities in the following areas: (i) budgeting; (ii) tax and custom policies; (iii) State debt management; (iv) macro-economic forecasting; (v) accounting and reporting; (vi) Public Internal Financial Control; (vii) PFM-related IT development; (viii) resource management. In 2015 – 2016 new components were added to the Action Plan reflecting the commitments taken under the EU Georgia Association Agenda as well as incorporating the World Bank's Public Expenditure Review (PER) recommendations. Actions are envisaged for harmonising VAT and excise legislation with the EU acquis, as well as for creating mechanism for investment projects selection and implementation. In 2016 the Cabinet of Ministers approved the guidelines for identification, evaluation, prioritisation, and funding of Public Investment projects to make sure that investment planning is aligned with medium to long term national economic and social priorities. Proposed projects with the value above GEL 5 million should undergo a feasibility study and cost-benefit analysis.

The Georgian State Audit Office fulfils the role of SAI in Georgia. The SAO has a Strategic Plan, covering the period from 2014 to 2017, and with reference to the EU PFPR aims to continue the work of establishing the SAO as a credible and independent SAI. The SAI plan sets out four strategic goals: (i) support Parliamentary oversight of the government through audit work, (ii) support government reforms aimed at improving government accountability, (iii) promote transparency and accountability in political party financing, (iv) enhance the institutional capacity of the SAO to foster quality of work. The State Audit Office submits its opinion to the Parliament on the draft budget (November) and the annual execution report (June). SAO also conducts financial and compliance audits of budgetary organisations. Audit opinions and reports are available online and accessible to the public. During recent years use of SAO reports by members of Parliament and media has increased (one of the benchmarks of the PFPR programme).

[8] IMF Press Release No. 17/68, March 1, 2017

Overall monitoring of the PFM Reform Strategy is undertaken by the Coordination Council for the Implementation of the PFM Reform Strategies for 2014-17, chaired by the MoF. The implementation of the PFM strategies is done through annual action plans that are developed by the State Audit Office, MoF and Budget and Finance Committee of the Parliament. Regular meetings are held to receive reports on progress, and recorded minutes of outcomes and decisions are produced.

A new PEFA is under the preparation which is based on the updated methodology and will take stock of already implemented reforms. The MoF anticipates publishing the assessment in late 2017 after it is quality checked and validated by the PEFA Secretariat.

*1.2.4 **Transparency and oversight of the budget***

Georgia's ranking in the 2015 Open Budget Survey was 16 among the 102 countries included in the survey – a significant improvement from its position of 33 in the 2012 survey. Its score places it among a grouping of high-scoring countries classified as substantially transparent. In December 2016 the International Budget Partnership (IBP) published an update stating that Georgia makes "eight of eight key budget documents publicly available online in a timeframe consistent with international standards".

As part of the Public Finance Policy Reform programme, MoF prepares and makes a "Citizen's Guide to the annual Budget" in Georgian and English publicly available which also invites citizens to take part in budget planning and defining budget priorities. The Parliament also holds hearings on the SAO's annual report as well as the report on the execution of the State budget at its spring plenary sessions.

In order to strengthen the accountability mechanism the PFPR programme has helped the Government to establish a mechanism for follow-up of State Audit Office (SAO) recommendations. A report on progress of implementing recommendations is annexed to the annual budget execution report submitted to the Parliament in May.

Important milestones for the EU-Georgia policy dialogue are enhancing the legal independence of the SAO by upgrading the status of the SAI law and granting the right to appeal to the Constitutional Court, thus removing the responsibility for the monitoring of political party expenditures, which is incompatible with INTOSAI rules.

With the support of the EU, the Budget Office of the Parliament was re-established as an Independent Institution providing expert advice to the members of Parliament on the fiscal and macroeconomic environment and contributing to oversight of the budget process.

2 RISKS AND ASSUMPTIONS

Risks	**Risk level (H/M/L)**	**Mitigating measures**
Reform fatigue/lack of commitment from the Government in carrying out the targeted reforms	**M**	A strong policy dialogue will be established with the different beneficiaries in supporting national strategies, law drafting and legislative

/weaknesses in the legislative process		processes and implementation mechanisms.
Lack of commitment or delay in the implementation of policy reforms most complementary to this action (VET policy; for specific clusters: waste management reform for packaging, energy policy for energy efficient construction materials, agriculture policy for food standards, bio products and seeds, IPR for innovation).	**M**	Continuous and regular policy dialogue with the authorities and key stakeholders on relevant policies for the action, making use of existing coordination mechanism and EU project platforms (for instance the VET Council).
Deterioration on the domestic market and/or in regional trading partner that might reduce economic opportunities	**M**	Continuous support to economic governance reforms and stability-oriented macroeconomic policies, through a regular dialogue, including IMF.
Insufficient capacities/lack of skills of the beneficiary institutions in charge of financial infrastructure	**H**	The action will provide targeted assistance.
Weak inter-ministerial co-ordination in the adoption and/or implementation of laws and regulations	**M**	The action will strengthen co-ordination in legislative and policy reforms.
Rotation of civil servants and absorption capacities of key beneficiaries	**M**	The action will provide targeted assistance to maintain trained personnel.
Insufficient ownership, including the involvement of the private sector (academia, small business) to ensure that the expected results will be achieved	**L/M**	Continuous policy dialogue with the stakeholders and measures to promote greater participation of the private sector, (for instance participation of the private sector to steering committees and other platforms for coordination).
Policy measures and supporting actions do not achieve a tangible impact on the economy	**M**	Inclusive policy dialogue and assistance to set up targets, take corrective actions and monitor the effects of policies
Duplication with other EU and donors' initiatives	**L**	The action will enhance coordination mechanisms between the development partners for the implementation of complementary initiatives.
Assumptions		

The Government of Georgia (a) continues actions for political and economic integration with the EU; (b) pursues economic/financial reforms in line with best international and EU practices; (c) maintains the dialogue with the private sector through official institutional mechanisms; (d) has sufficient institutional capacity/maintenance of key leadership and technical staff as well as strong planning, implementation and coordination capacity in beneficiary institutions.

3 LESSONS LEARNT, COMPLEMENTARITY AND CROSS-CUTTING ISSUES

3.1 Lessons learnt

Lessons learnt come from the implementation of EU technical assistance and twinning projects in trade, SME and agriculture-related fields, from the implementation of EU regional programmes in support of SME policies and access to finance as well as from the use of budget support in trade, SME and other policy areas (justice, agriculture, public administration reform, regional development, public financial management).

The EU previously worked or is working with most of the beneficiary entities and strong operational relations exist with some of them. Experience shows that the MoESD and agencies under its responsibility are in considerable need of external technical and financial support. Support to provide financial tools to help SME adapting to EU norms has been continuously requested. The development of the 'DCFTA Facility' was indeed thought to fill this financing gap. Furthermore, experience shows that some beneficiaries would like to be fully responsible over the choice of aid modality, without accounting for the degree of institutional maturity or management capacities.

The EU engaged more significantly in the civil, administrative and commercial law areas since 2015 through policy dialogue led with and technical support provided to the Ministry of Justice and its agencies, as well as to associations of lawyers, arbitrators and mediators. The justice budget support programme appeared to be a useful tool for keeping an in-depth and constant dialogue on timely reforms. Furthermore, the Ministry of Justice and its agencies, the judiciary and professional associations benefitted from robust technical support, translated into new strategies, draft laws, internal reorganisations, but there is still a need to improve the speediness and fairness of judicial litigations, enforcements and insolvency proceedings, and the quality and proper caseload of arbitration and mediation. Experience also shows that the wording and timelines of the targets or indicators must be very carefully designed in order to achieve a balance between ambition and feasibility; for that purpose it is advisable to engage beforehand in an in-depth baseline study and transpose the findings into an explanatory note to the policy matrix, or relevant project descriptions.

Main lessons learnt/challenges:

1) Sector policy dialogue and coordination between line ministries over inter-related economic areas (education, agriculture, justice, etc.) must be strengthened; monitoring the implementation and the impact of activities carried out.

2) Coordination between EU interventions and timeframe of EU interventions is necessary. Decisions taken prior to impact assessment or evaluations of on-going EU projects can lead to mistakes in the formulation of the action. Timelines and targets/indicators must be carefully designed and based on in-depth situational analyses.

3) It is important to set up an official Private Sector Development or Business Development donor coordination platform with identification of a donor's leadership and a clear calendar of meetings.

4) Political will to continue support after EU interventions must be ensured.

5) Budget support challenges demonstrate the need to improve inter-governmental coordination, increase the efficiency of public spending and improve the strategic analytical capacities of the targeted institutions.

6) More flexibility of EU actions and possibility to rapidly adapt EU interventions to policy changes and/or needs is needed, including budget support matrixes or projects' logical frameworks, though without compromising much on the initially defined ambitions.

7) In order to prevent duplications, close coordination between bilateral and regional activities in support of business reforms, access to finance, agriculture value chains, justice and public administration reforms is required.

The action also draws on EU experience on providing support to business organisations through grant schemes. Experience shows that most of the beneficiary entities still lack appropriate capacities to propose valuable initiatives and manage EU grants. However, given the relevance of business and sectoral organisations along the value chain, capacity building activities to strengthen their capacities to more efficiently interact with the business community, especially at regional level, will be part of the action.

The support to a business incubator in Abkhazia through the ENPARD just started therefore it is premature to assess its impact and to draw lessons learnt.

3.2 Complementarity, synergy and donor coordination

On Component 1, the ongoing *EU4 Justice* budget support programme is primarily focused on criminal justice, but also contains significant technical support in the civil, administrative and commercial law areas, as well as one set of indicators related to introducing systemic land registration in the country.

An EU project with UNDP supports the development of state-funded free legal aid, legal services, arbitration, and mediation. An EU project with GIZ assists with revisions of the civil code, civil procedural code, administrative code, insolvency law, law on enforcement of judicial decisions, land registration, and international judicial cooperation. The project is a part of the GIZ programme on Legal approximation towards European standards in the South Caucasus. EBRD and the United Kingdom Government envisage supporting the establishment and operationalisation of the commercial chambers. USAID's and Council of Europe's initiatives support significantly judiciary reforms, but without focus in the commercial law areas specifically. Since there are only few donors in the commercial law area, and financed mostly through EU projects, donor coordination is ensured through bilateral or small multilateral meetings. Besides that, the Government's Private Law Reform Inter-Agency Council and its working groups form a discussion and coordination platform for the relevant institutions, donors, civil society organisations and other actors.

On part of Component 2 and on Component 3 the action complements on-going and upcoming EU interventions at bilateral and regional level in the area of support to SME development, trade and enterprise policy, business support organisations and access to finance, including women in business, all framed under "*EU4Business*". The ongoing sector budget support "Support to SME development and DCFTA in Georgia" focuses on trade and SME reforms and contains two major actions currently implemented by GIZ and EBRD in support of core SME-related institutions, SMEs, business organisations and value chains. The new programme on "Supporting firm competitiveness and business environment reforms in the Eastern Partnership: an EU4Business initiative" implemented by the OECD will be highly complementary to this action. It will assist the government in preparing and operationalising the SME Strategy Action Plan 2018-2020, strengthen the policy making process by introducing a public-private SME strategy stakeholder process and strengthen the institutional capacity of the government (MoESD, EDA) to monitor the implementation of the SME Development Strategy 2016-2020. Furthermore, the ongoing ITC project on "Eastern Partnership Ready to Trade – an EU4Business initiative" will help SMEs from EaP countries integrate into international value chains and access new markets with a focus on the European Union.

The action complements a set of future projects under the Technical Cooperation Facility, targeting trade policies and the financial sector. The action will be in synergy with the upcoming EU programme "Skills Development and Matching for Labour Market Needs".

The EU action is in line with the joint programming Fiche on Economic Growth elaborated with representatives of the EU Member States Embassies in Georgia and coordinated with other non-EU donors such as UNDP, other UN agencies, USAID and International Financial Institutions (EBRD, Word Bank).

The donor community supporting business reforms and private sector development is mostly represented by GIZ, UNDP, USAID, the Czech Development Agency (CzDA), the Austrian Development Agency, OECD, the World Bank, EBRD, EIB and other development banks. Donors' programmes target the more general business enabling environment as well as specific projects, mostly in agriculture and tourism. The Qvevri wine cluster implemented by GIZ is an example of a pioneer agricultural cluster. Other donors' initiatives are implementing the value chain approach to several agricultural commodities. Complementarities exist with the World Bank Financial Sector reform and Strengthening Initiative (FIRST), the World Bank's Georgian National Innovation Ecosystem Project (GENIE), the CzDA project on Sustainable Development of Mountain Regions 2018-2023 and GIZ' South-Caucasus Private Sector Development Programme 2017-2020.

Some practice of coordination on thematic areas (SMEs, economic development, financial system) exists, such as the Investors Council, the Private Sector Development Advisory Council, the DCFTA Advisory Body, inter-ministerial working groups. However development partners are not always and systematically consulted. Thematic Coordination Groups have been set up by the Donor Coordination Unit under the Administration of Georgia (working group on Economic Growth) and a similar structure exists under the State Ministry for European and Euro-Atlantic Integration.

A list of EU-funded bilateral, EU multi-country programmes and other donors' most relevant actions supporting the private sector development can be found annexed to this Action Fiche.

3.3 Cross-cutting issues

All activities under this programme will be designed and implemented in accordance with principles of good governance, gender equality and environmental sustainability and the inclusion of socially or economically deprived groups wherever these issues are of particular relevance to the institutions to be assisted. This is particularly prominent in the area of access to finance, where the action has the ambition to broaden and ease access to finance for women, youth and disadvantaged groups. The project will mainstream gender considerations and youth inclusion in the implementation of activities with impact on the real economy, notably gender imbalances related to business ownership, employability and remuneration. As significant economic opportunities are provided through the deeper involvement of women and youth in economic activities, the EU action will pay specific attention to facilitate their integration in the development of business sophistication models, where digital economy, innovation, and research/industry partnerships will be promoted. The application of EU standards, including environmental and labour standards, will be promoted. The action will also support the Government's efforts to develop a green and sustainable economy, encouraging the use of renewable energy resources, reduce solid and liquid waste, and reduce carbon emissions, therefore helping developing capacities in the field of eco-innovation and circular economy.

In particular, economy-environment linkages will be considered in the development of clusters on packaging and bio/organic farming, while promoting raw materials and waste management best practices. Opportunities for improving building material efficiency will be promoted in the construction materials' cluster and with further stakeholders of this sector. Climate change considerations impacting bio-diversity and eco-systems will be streamlined in the support of a sustainable tourism.

The use of energy-efficient technologies, the optimisation in the use of resource inputs to minimise the generation of waste, and environment protection are promoted along the development of the value chains.

4 DESCRIPTION OF THE ACTION

4.1 Objectives/results

The **overall objective** of the action is to foster socio-economic development in Georgia and its regions. The **specific objectives** are to:

1. Make faster and fairer the litigations in commercial matters
2. Modernise the financial infrastructure
3. Promote market-oriented and innovative business models for job creation

The specific objectives will be addressed through three thematic components. The expected results, by component, are:

Component 1: Fairer and faster litigations in commercial matters
Result 1.1: Fairer and faster litigations in commercial disputes

Component 2: Modernised financial infrastructure
Result 2.1: Capital market development
Result 2.2: Responsible financial inclusion and alternative financing
Result 2.3: Better financial information
Result 2.4: Enhanced insurance system

Component 3: Greater business sophistication
Result 3.1: Strengthened policy framework to facilitate the development of SME, clusters and incubators

Result 3.2: Development and functioning of the clustering approach in at least 5 pilot sectors in Georgian regions (such as construction materials, packaging, apparel, creative industry, tourism, organic farming, seeds/seedlings)
Result 3.3: Development and functioning of business accelerators/incubator, serving target regions and sectors
Result 3.4: Improved delivery and quality of public services to businesses

4.2 Main activities

The main activities of the proposed Sector Reform Contract are policy dialogue, capacity building, performance assessment and financial transfers.

The activities shall be channelled through both a budget support policy matrix as well as complementary support to budget support and other support contributing to the specific objectives of the action consisting primarily of projects with international organisations and development agencies as well as twinnings.

4.2.1 ***Budget support***

Budget support is proposed for areas where a sound level of policy framework, coordination and ownership of the reforms has been shown. The main activities are geared towards policy targets that the Government will commit to achieve in relation to the following policy areas: legal reforms in the commercial sphere (insolvency and enforcement proceedings); modernised financial infrastructure in insurance; and enterprise development focused on business integration through clusters and innovation. Further details on these inputs are provided under section 5.3.2.

The budget support in commercial litigation responds to the commitments of the government set out in Direction 1 of the SME Strategy (Improvement of legislative, institutional framework and operational environment for SMEs) and in particular Priority Action 1.1: "Improvement of business closure and insolvency procedures". As regards modernised financial infrastructure in insurance, insurance is part of a broader commitment of the government to reform the financial sector. Targets on business integration and innovation fall under Direction 4 (Export promotion and SME Internationalization) and Direction 5 (Facilitation of innovation and R&D in SMEs) of the SME Strategy.

As regards **Component 1**, the following activities will be supported through budget support to achieve <u>Result 1.1: Fairer and faster litigations in commercial disputes:</u>

- R.1.1.4 Strengthened and rehabilitation-oriented insolvency proceedings
- R.1.1.5 More efficient enforcement of judicial decisions

As regards **Component 2**, the following activities will be supported through budget support to achieve <u>Result 2.4: Enhanced insurance system:</u>

- R.2.4.1 A functional insurance supervision system is in place
- R.2.4.2 Insurance market is expanded through compulsory insurance products

As regards **Component 3**, the following activities will be supported through budget support:

To achieve Result 3.1: Strengthened policy framework to facilitate the development of SME, clusters and incubators

- R.3.1.1 The institutional framework for business integration is developed and tailored for target regions and sectors
- R.3.1.2 Economic opportunities are identified in pilot regions and are elaborated in consultation with local authorities and the private sector

To achieve Result 3.2: Development and functioning of the clustering approach in at least 5 pilot sectors in Georgian regions (such as construction materials, packaging, apparel, creative industry, tourism, organic farming, seeds/seedlings)

- R.3.2.1/R.3.3.1 Diversified and increased number of services delivered by incubators to businesses, start-ups and social enterprises
- R.3.2.2 Cluster governance and management structure(s) are leading to better private-public coordination
- R.3.2.3 Synergies among economic actors, including BSOs, in the cluster are intensified
- R.3.2.4 EU standards are promoted in the cluster

To achieve Result 3.3: Development and functioning of business accelerators/incubator, serving target regions and sectors

- R.3.3.1/R.3.2.1 Diversified and increased number of services delivered by incubators to businesses, start-ups and social enterprises
- R.3.3.2 Increased synergies among business incubator(s), private sector and academia/research centres are created

At this stage, it is foreseen that EUR 21.25 million will be disbursed through this Sector Reform Contract, in 4 annual tranches (disbursed indicatively in 2019 to 2022). The amount defined for budget support is expected to have an effective impact on the fulfilment of the conditionality and providing substantial leverage for the policy dialogue.

4.2.2 Complementary support to budget support

Complementary measures to budget support, as well as other measures outside the scope of the budget support, amount to EUR 26 400 000, of which EUR 19 900 000 are connected to the scope covered with budget support and EUR 6 500 000 not connected to the budget support as highlighted in section 5.4. This support will focus on strengthening the capacities of the national stakeholders to address the above result areas and to target the real economy through pilot initiatives on value chains, clusters and innovative start-ups with a specific attention to pilot regions. Support to core institutions and government agencies will be primarily delivered via twinning projects and technical assistance through the services of EU Member States agencies and specialised international organisations. The main activities by component and results are the following:

As regards **Component 1**, complementary support will be provided to the activities mentioned above through indirect management to achieve Result 1.1: Fairer and faster litigations in commercial disputes.

- R.1.1.4. Strengthened and rehabilitation-oriented insolvency proceedings: Assist with the finalisation (approximation), adoption and implementation of the new insolvency law (or amendments to it) based on a regulatory impact assessment, including possibly the establishment and operationalisation of a chamber of private administrators; enhance skills of lawyers, judges and administrators, raise awareness of business operators about the law and its potentials.

- R.1.1.5. More efficient enforcement of judicial decisions: Assist with improving the legislation and implementation in practice, enhance capacities of public and private bailiffs and lawyers.

As regards **Component 2**, complementary support will be provided to the activities mentioned above through direct management (twinning, direct award) to achieve Result 2.4: Enhanced insurance system.

- R.2.4.1 A functional insurance supervision system is in place: Capacity building and regulatory reforms, regulatory strengthening, development of procedures, skills and knowledge, market trainings on introduction of new ISSSG regulations; trainings and capacity buildings related to the EU approximation process, which have to be defined on the basis of mutual agreement between the parties.

- R.2.4.2. Insurance market is expanded through compulsory insurance products: Assist to identify compulsory insurance types and put MTPL law into practice; training of insurance companies and communication campaigns for clients; assist with the introduction of other relevant insurance products.

As regards **Component 3**, complementary support will be provided to the activities mentioned above through indirect management, to reach the following results.

To achieve Result 3.1: Strengthened framework of policy makers to facilitate the development of SME, clusters and incubators

- R.3.1.1 The institutional framework for business integration is developed and tailored for target regions and sectors: Assistance on role and responsibilities of public and private sector in business models; assistance with setting up the legal and institutional framework for business integration and business partnerships.
- R.3.1.2 Economic opportunities are identified in pilot regions and are elaborated in consultation with local authorities and the private sector: Assist with the development of economic initiative's master plans (cost-benefits analysis, fiscal stance, planning, etc.); policy dialogue with local communities, including BSOs and the private sector; communication and awareness raising activities.

To achieve Result 3.2: Development and functioning of the clustering approach in at least 5 pilot sectors in Georgian regions (such as construction materials, packaging, apparel, creative industry, tourism, organic farming, seeds/seedlings)

- R.3.2.1/R.3.3.1 Diversified and increased number of services delivered by incubators to businesses, start-ups and social enterprises: Provision of support for assessing market needs; advice on the type of services meeting the industry demand (VET colleges could be seen as incubators for service providers);
- R.3.2.2 Cluster governance and management structure(s) are leading to better private-public coordination: Support the selection of sectors for clusters; support in the identification of leader companies and potential partners linked to international markets;

tailored mentoring and coaching for clusters and incubators' participants; advice on enforcing public-private dialogue and on communication strategies to brand Georgia.

- R.3.2.3 Synergies among economic actors, including BSOs, in the cluster are intensified: Promotion of relationships between producers, suppliers, contractors and consumers; guidance on making sector associations more operational (for instance through match-making support, services delivery, etc.); public awareness of the benefits of the clusters.
- R.3.2.4 EU standards are promoted in the cluster: Support in the introduction of best practices on quality, food safety standards, environmental, energy efficiency and Responsible Business Conduct; advice on amendment of domestic legislation, where relevant.

To achieve <u>Result 3.3: Development and functioning of business accelerators/incubator, serving target regions and sectors</u>

- R.3.3.1/R.3.2.1 Diversified and increased number of services delivered by incubators to businesses, start-ups and social enterprises: Provision of support for assessing market needs; advice on the type of services meeting the industry demand (VET colleges could be seen as incubators for service providers);
- R.3.3.2 Increased synergies among business incubator(s), private sector and academia/research centres are created: Assist in reviewing the framework for research/industry collaboration; advise on best use of grant schemes; capacity building to improve GITA's capacity to create productive alliances; partnerships are created between GITA and relevant industries.

4.2.3 Other support

As regards **Component 1**, other support will be provided through indirect management to achieve <u>Result 1.1: Fairer and faster litigations in commercial disputes.</u>

<u>R.1.1.1. Streamlined judicial proceedings</u>: Revise procedural legislation, regulations and practice, provide expert advice on specialisation of judges or chambers, and enhance capacities of lawyers and judges; connect local and international business law firms.

<u>R.1.1.2. Increased use of mediation and arbitration</u>: Increase awareness and confidence in alternative dispute resolution mechanisms; review implementation of the new mediation law, including establishment and operationalisation of the new mediation association(s) and development of out-of-court mediation.

<u>R.1.1.3. New company law put well into practice</u>: Provide expert advice to the finalisation (approximation), adoption and application of the new company law and all related legislation and secondary regulations; raise awareness and knowledge of business operators, lawyers and judges of the new law and its effects.

As regards **Component 2**, other support will be provided through direct management (twinning, direct award).

To achieve <u>Result 2.1: Capital market development</u>

- R.2.1.1 Strengthened NBG in approximating EU legislation on capital markets: Review of the capital market action plan; advice and capacity building for approximation with EU legislation; promotion of best practices between Georgia and other EU countries which faced similar challenges, and preparing of private sector, including SMEs for the participation in capital markets;
- R.2.1.2 Improved capital market infrastructure: Review of trading/post trading, clearance and settlement system and development of recommendations for reform.
- R.2.1.3 Improved legal framework for selective capital market instruments: Assist on the development of asset backed securities/covered or mortgage bonds, derivatives, convertible bonds.
- R.2.1.4 Improved legal framework for investment funds and mutual collective schemes: Expert advice to recommend and develop the new legal framework, including respective legislation and regulations reporting and governance requirements.

To achieve <u>Result 2.2: Responsible financial inclusion and alternative financing</u>

- R.2.2.1. Improved collateralisation framework: Revise the secured transactions framework and develop a modern on-line based security registry (movable collateral registry); advise on legal and regulatory revisions; building market awareness on assets based financial products to improve collateralisation requirements;
- R.2.2.2 Improved legal framework and regulation of private credit bureau and microfinance institutions: Assist on revision of legislative framework on credit reporting by enacting the Credit Bureau law; establish NBG capacities to oversee the credit reporting system and to better supervise Micro Financial Institutions (MFIs); increase awareness of the public and consumers on private credit bureau;
- R.2.2.3 Enhanced consumer protection and financial literacy: Assist on consumer protection reform including amendment to legislation; develop new regulations; establish NBG capacities to ensure a sound consumer and information protection in line with EU best practices; design and implement selected financial literacy activities for different groups including financial literacy of microfinance clients in Georgia and financial literacy in insurance;

To achieve <u>Result 2.3: Better financial information</u>

- R.2.3.1 Improved Accounting and Auditing Quality Control: Capacity building for the Service for Accounting, Reporting and Audit Supervision (SARAS) to effectively and efficiently develop the right processes, procedures and methodologies for enforcement of financial reporting and auditing requirements.
- R.2.3.2 Enhanced accounting framework for SMEs: Expert advice on the implementation of the new Law on Accounting and Audit and on reporting requirements for small entities in accordance with EU Accounting Directive; dissemination of the benefits of the law to SMEs.
- R.2.3.3 Strengthened capacity of business service providers: Support the development of professional accountants and other business support organisations to provide advice to businesses/SMEs on sound financial management's best practices (business life-cycle, strategies and business plans, cash flows management, seeking funds for business, risk management, etc.).

As regards **Component 3**, the below activities cannot be achieved through budget support; they will be implemented through indirect management and direct management via a twinning project.

To achieve Result 3.1: Strengthened policy framework to facilitate the development of SME, clusters and incubators

- R.3.1.3 Business network with Europe is accelerated (performance of Enterprise Europe Network Georgia, led by EDA and GITA consortium): Capacity building for improving EDA and GITA's capacities to extend business linkages with EU counterparts; facilitation of business 'alliances'.

To achieve Result 3.3: Development and functioning of business accelerators/incubator, serving target regions and sectors

- R.3.3.3 Higher number of businesses participating in the EU programme Horizon 2020: Create conditions and incentives for businesses to use EU grants; communication and information campaigns for wider outreach of opportunities from EU innovation programmes.

To achieve Result 3.4: Improved delivery and quality of public services to businesses

- R.3.4.1 The digitalisation of public services to business in Tbilisi and Georgian regions is prepared: Advice and capacity building activities on digitalisation for simplifying business procedures.

4.3 Intervention logic

The action has been formulated having in mind that a favourable business climate at all levels and an improved policy framework for financial inclusion and business dispute resolutions are necessary to unleash the potential of the private sector and stimulate investment. The EU programme aims to achieve its objectives through the provision of budget support to reach the national policy targets. Complementary measures will strengthen key institutions in policy design and implementation and will stimulate economic opportunities thanks to the development of selected value chains, clusters and business incubators. The proposed action will include policy and regulatory reforms and improve business integration and sophistication.

As for Component 1, in the first stage, the action will streamline legislative and regulatory frameworks for business disputes before courts, arbitration tribunals and mediators, as well as improve recovery rates in insolvency and enforcement procedures; it will also further enhance skills and awareness of relevant professionals and businesses. In a medium term, this will lead to fairer and faster proceedings and eventually to higher trust of businesses towards courts and competent authorities. In a long term perspective, this will contribute to increasing the volume of commercial transactions, foreign investments, and eventually to enhancing economic growth, employment and household incomes.

As for Component 2, the action will support both the institutional and legislative framework for developing an efficient capital market system and infrastructure, currently lagging behind, and in view of approximation with relevant EU legislation. The action will further enhance financial literacy, promote alternative sources of financing, trying to reduce the risk of lending and the risk associated to high collaterals. In addition, the legal system for insurance, including supervision, will be streamlined. In the long run the financial system and the financial stability will be enhanced thanks to increased credit to the private sector and to SME, improved financial literacy and supervision, better regulated practices in lending and the introduction of compulsory insurance products to mitigate the risks for the users and reduce social costs for the government.

As for Component 3, the action will support the institutional set-up for cluster and innovation development. The action will support the establishment of integrated models of entrepreneurship that will better promote business linkages as well as better access to services, skills/technologies/investment (also through the use of business incubators and accelerators) for the actors of the value chains and for the services/technology/skills/capital providers. The role and importance of services such as business services, transport, capital access and trade will be supported to enable production, process and marketing of higher quality products and services. This will result in the long run in better clusters governance systems, more economic opportunities, higher productivity goods, increased access to the national and international investors' community, and more skilled jobs created.

Support to government agencies will be delivered primarily in the form of twinning projects and technical assistance through the services of EU Member States agencies and specialised international implementing agencies.

One twinning project is foreseen under component 2 in support to the Insurance State Supervision Service of Georgia to enhance insurance supervision and new legislation on insurance.

The programme will focus on initiatives that will have a high impact at local level and great visibility of the EU, demonstrating the added-value of the EU action.

The intervention logic is based on Georgia's commitment to improve the business and investment environment (Georgia 2020 Strategy, 4-Point Programme 2017-2020, specific sector strategies and action plans) as well as Georgia's commitment through international agreements such as the Association Agreement with the EU and the UN Sustainable Development Goals adopted by the Georgian Government.

The monitoring framework of the programme will aim to capture lessons learnt and facilitate good practice examples to inform future policy making processes. The approach aims for the actions to be complementary and enhance impact both at the national and local level, by feeding successful practices, approaches, projects and stories into the policy-making processes.

The effectiveness of the EU intervention will be assessed through indicators that measure policy implementation and outcomes for the final beneficiaries in pilot regions.

5 IMPLEMENTATION

5.1 Financing agreement

In order to implement this action, it is foreseen to conclude a Financing Agreement with the partner country, referred to in Article 184(2)(b) of Regulation (EU, Euratom) No 966/2012.

5.2 Indicative implementation period

The indicative operational implementation period of this action, during which the activities described in section 4.1 will be carried out and the corresponding contracts and agreements implemented, is 60 months from the date of entry into force of the financing agreement.

Extensions of the implementation period may be agreed by the Commission's authorising officer responsible by amending this decision and the relevant contracts and agreements; such amendments to this decision constitute technical amendments in the sense of point (i) of Article 2(3)(c) of Regulation (EU) No 236/2014.

5.3 Implementation of the budget support component

5.3.1 Rationale for the amounts allocated to budget support

The amount allocated for budget support component is EUR 21 250 000 and for complementary support EUR 19 900 000. This amount is based on the commitment of the partner country to allocate national budget resources (including EU budget support) for supporting enterprise and business development, including start-up financing. The amount proposed for the budget support will provide substantial leverage for the policy dialogue. The line ministries concerned with the performance targets have demonstrated sufficient absorption capacity and a sufficiently good track record in fulfilling the conditions under existing EU funded budget support programmes. Overall four instalments are planned. The first instalment of EUR 4.25 million will be released upon signature of the Financing Agreement and subject to compliance with the General Conditions for tranche release.

5.3.2 Criteria for disbursement of budget support

a) The general conditions for disbursement of all tranches are as follows:

- Satisfactory progress in the implementation of the policies covered by the present action and continued credibility and relevance thereof;
- Implementation of a credible stability-oriented macroeconomic policy;
- Satisfactory progress in the implementation the Government's PFM reform programme;
- Satisfactory progress with regard to the public availability of timely, comprehensive and sound budgetary information.

b) The specific conditions for disbursement that may be used for variable tranches will be set on the basis of government's policy targets. The list of performance indicators used and the targets for disbursement of the variable tranches have been selected from relevant commitments and are results or impact oriented.

Component 1 - <u>More efficient insolvency and enforcement proceedings.</u>

The indicators will measure the increase of efficiency of the insolvency and enforcement proceedings. This will be measured through different impact-oriented indicators, such as the World Bank ranking of resolving insolvency, number of rehabilitation cases per year, recovery rates in insolvency and enforcement, average duration of enforcement and/or success rate in mediation cases before the Enforcement Bureau and court user satisfaction. The exact wording and benchmarks of the indicators are subject to results of specific baseline studies carried out in May – August 2017 and negotiations with the competent authorities. As a result, the insolvency proceedings will be more efficient in terms of recovery rates, costs and duration with more focus on rehabilitation on insolvent businesses. Similarly, the faster and fairer enforcement of judicial decisions will increase the chances for businesses to recover (at least partially) their assets and thus continue their activities without too much impact on their cash-flows and liquidity.

Component 2 - Efficiency in implementing the compulsory MTPL insurance law.

The indicators will measure the government's efficiency in progressively introducing the compulsory domestic MTPL insurance law and its positive effects over the period 2019-2021 such as increased number of vehicles insured and increased volume of turnover for insurance companies, which in the long term will help the financing of the economy, reducing the road accident rate and the costs for the government for the treatment of victims of road accidents caused by uninsured vehicles. The exact wording and benchmarks of the indicators are subject to results of specific baseline studies and negotiations with the competent authorities.

Component 3 - More efficient production systems in selected clusters.

The indicators will measure more economic opportunities and benefits received by the clusters as a result of government actions, improved access for businesses in the cluster to a wide range of factors related to the business enabling environment and production inputs, and the creation of partnerships with the industry. This may include the setting-up of a structure within each cluster able to address coordination, market failures and bureaucracy bottlenecks and able to identify economic opportunities; improved access to a series of inputs (finance, labour, markets, technology know-how, etc.) thanks to actions by the government; a proper governance structure for GITA able to connect businesses and create partnerships with industry and improved industry access to capital, access to skilled labour, technical knowhow, availability of local and international technology partners. The exact wording and benchmarks of the indicators are subject to results of specific baseline studies and negotiations with the competent authorities.

The chosen performance targets and indicators to be used for disbursements will apply for the duration of the programme. However, in duly justified circumstances, the State Minister on European and Euro-Atlantic Integration may submit a request to the Commission for the targets and indicators to be changed. The changes agreed to the targets and indicators may be authorised by exchange of letters between the two parties.

In case of a significant deterioration of fundamental values, budget support disbursements may be formally suspended, temporarily suspended, reduced or cancelled, in accordance with the relevant provisions of the financing agreement.

*5.3.3 **Budget support details***

Both fixed and variable tranches are to be used in an approximate ratio of 20/80.

Budget support is provided as direct untargeted budget support to the national Treasury. The crediting of the Euro transfers disbursed into Georgian Lari will be undertaken at the appropriate exchange rates in line with the relevant provisions of the financing agreement.

5.4 Implementation modalities for complementary support to budget support and other support

5.4.1 Grants: call for proposals for twinning project for the implementation of part of Component 2 (direct management)

(a) Objectives of the grants, fields of intervention, priorities of the year and expected results

A twinning call for proposals modality will be used to conclude a grant for actions supporting the following priority areas, in line with the objectives, results and activities described in sections 4.1 and 4.2.

- Connected to budget support:

Under Component 2, Result 2.4 – A twinning on insurance supervision will strengthen the institutional capacity of ISSSG to implement laws and regulations related to insurance supervision in view of approximation with the EU *acquis*.

(b) Eligibility conditions

In line with Article 4(10)(b) of Regulation (EU) No 236/2014, participation in twinning calls for proposals is limited to public administrations of the EU Member States, being understood as central or regional authorities of a Member State as well as their bodies and administrative structures and private law bodies entrusted with a public service mission under their control provided they act for the account and under the responsibility of that Member State.

(c) Essential selection and award criteria

The essential selection criterion is the operational capacity of the applicant.

The essential award criteria are the technical expertise of the applicant, and the relevance, methodology and sustainability of the proposed action.

(d) Maximum rate of co-financing

The rate of co-financing for Twinning grant contracts is 100%[9].

In accordance with Articles 192 of Regulation (EU, Euratom) No 966/2012, if full funding is essential for the action to be carried out, the maximum possible rate of co-financing may be increased up to 100 %. The essentiality of full funding will be justified by the Commission's authorising officer responsible in the award decision, in respect of the principles of equal treatment and sound financial management.

(e) Indicative timing to launch the call

3rd quarter 2018.

(f) Use of lump sums/flat rates/unit costs

Twinning contracts include a system of unit costs and flat rate financing, defined in the Twinning Manual, for the reimbursement of the public sector expertise provided by the selected Member State(s) administration(s). The use of this system of unit costs and flat rate financing, which exceeds the amount of EUR 60 000 per beneficiary of a twinning contract, is authorised through Commission Decision C(2017)1122.

5.4.2 Direct award to the World Bank Group for the implementation of part of Component 2

(a) Objectives of the grants, fields of intervention, priorities of the year and expected results

<u>Connected to budget support</u>: Under Component 2 this implementation entails improving the insurance sector, namely supporting reforms aimed at introducing a mandatory MTPL insurance law and on strengthening the legal and supervision capacities of ISSSG. As a result, the insurance market will be expanded, compulsory insurance products will be put into practice and the insurance regulatory and supervision frameworks will be more robust.

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[9] As provided for in the Twinning Manual.

Not connected to budget support: Under Component 2 this implementation entails enhancing capital market development including the framework for investment funds, improving responsible financial inclusion and financial information in order to ease access to finance. As a result, the support would bring strengthened capacities of the NBG and SARAS and other key stakeholders of the financial sector, improved access to finance for business and especially SMEs, improved financial inclusion and financial education, improved knowledge and use of alternative financial products, improved protection of the consumers of financial products, improved quality and standards of corporate financial reports, and enhancement of professions in the financial area.

(b) Justification of a direct grant

Under the responsibility of the Commission's relevant authorising officer, this grant may be awarded without a call for proposals. The recourse to an award of a grant without a call for proposals is justified because in accordance with Article 195 (f) of Financial Regulation, the action has specific characteristics requiring a specific type of beneficiary for its technical competence, specialisation or administrative power.

Under the responsibility of the Commission's relevant authorising officer, the direct award to World Bank Group is foreseen. The direct award is justified because the World Bank has the necessary organisational, human and management capacities as well as a solid experience of financial sector reform in Georgia as well as in the development and implementation of innovative eco-systems. The World Bank has a well-established policy dialogue (including a DPO - Development Policy Operation) with the Georgian authorities and key national stakeholders in the financial system such as the MoESD, the MoF and newly established agencies under the MoF, the NBG, and the ISSSG.

In the financial area the World Bank is successfully implementing the EU-funded multi-country project STAREP. The EU action will complement this on-going project as well as the FIRST World Bank project. Through the on-going GENIE project strong relationships were built with GITA and other relevant stakeholders, including municipalities and academia. The EU action will add extra activities to this running project, by further supporting the growth of existing incubators, facilitating the creation of new ones in Georgian regions and by boosting real exchanges between similar models in the EU and Georgia.

The actions will be implemented under the bank-executed Trust Fund "Europe 2020".

If negotiations with the World Bank Group fail, this action may be implemented in direct management in accordance with the following modalities:

Subject	**Type**	**Indicative number of contracts**	**Indicative trimester of launch of the procedure**
Alternative to 5.4.2 - direct award to WBG	services	up to 3	3rd quarter 2019

5.4.3 Procurement (direct management)

Subject	**Type**	**Indicative number of contracts**	**Indicative trimester of launch of the procedure**

Communication and visibility	services	1	2nd trimester 2018
Evaluation and audit	services	4	3rd quarter 2018 4th quarter 2020 2nd quarter 2023

5.4.4 *Indirect management with Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH (GIZ), for the implementation of part of Component 1* (connected to Budget Support)

A part of this action may be implemented in indirect management with Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH (GIZ) in accordance with Article 58(1)(c) of Regulation (EU, Euratom) No 966/2012.

This implementation entails support in achieving major objectives of Component 1, i.e. ensuring fairer and faster litigations for businesses through streamlining judicial proceedings (Result R.1.1.1), implementation of the new company law (Result R.1.1.3), strengthening rehabilitation-oriented insolvency proceedings (Result R.1.1.4), and enhancing enforcement of judicial decisions (Result R.1.1.5). The action will accompany the achievement of the two sets of the budget support indicators set for insolvency and enforcement proceedings.

This implementation is justified because GIZ possesses high and specialized technical and managerial capacity, extensive experience in developing civil, administrative and commercial legal frameworks in Georgia and high reputation and engagement with the beneficiary institutions, gained significantly through its long term programme entitled "Legal approximation towards European standards in the South Caucasus", a part of which has been supported by the European Union under a project entitled "Support to the Development of Private and Administrative Law System in Georgia".

The entrusted entity would carry out the following budget-implementation tasks: grants, procurement and/or hiring external experts.

If negotiations with GIZ fail, that part of this action may be implemented in indirect management with UNDP (or, as the case may be, in direct management in accordance with the implementation modalities foreseen in section 5.4.11 for the procurement of services).

The implementation by this alternative entrusted entity is justified by the reasons mentioned under section 5.4.4 and because UNDP further possess sufficient experience and engagement with the authorities to implement successfully the results referred to under the present section.

5.4.5 *Indirect management with United Nations Development Programme (UNDP) for the implementation of part of Component 1* (not connected to Budget Support)

A part of this action may be implemented in indirect management with UNDP in accordance with Article 58(1)(c) of Regulation (EU, Euratom) No 966/2012.

This implementation entails support in achieving the major objectives of Component 1, i.e. ensuring fairer and faster litigations for businesses through streamlining judicial proceedings, and specifically through training of lawyers for commercial disputes and monitoring of court proceedings in business cases (Result R.1.1.1.) and enhancing the use and quality of arbitration and mediation (Result R.1.1.2.).

This implementation is justified because UNDP possesses high and specialized technical and managerial capacity, extensive experience in developing the quality and availability of legal services, arbitration and mediation in Georgia and high reputation and engagement with the beneficiary institutions, gained also through the EU supported project with UNDP on access to justice implemented in 2016-2018.

The entrusted entity would carry out the following budget-implementation tasks: grants, procurement and/or hiring external experts.

If negotiations with UNDP fail, that part of this action may be implemented in indirect management with GIZ (or, as the case may be, in direct management in accordance with the implementation modalities foreseen in section 5.4.11 for the procurement of services).

The implementation by this alternative entrusted entity is justified by the reasons mentioned under section 5.4.3 and because GIZ further possess sufficient experience and engagement with the authorities to implement successfully the results referred to under the present section.

5.4.6 *Indirect management with the World Bank Group for the implementation of part of Component 3*

A part of this action may be implemented in indirect management with the World Bank Group in accordance with Article 58(1)(c) of Regulation (EU, Euratom) No 966/2012.

The actions related to Component 3 under the hybrid Trust Fund "EC-World Bank Partnership on Europe and Central Asia" (EEPP). The World Bank will implement actions to accompany the budget support operation.

Under Component 3 this implementation entails enhancing the use of innovation and technology transfers for gradually supporting business incubation and increasing investment readiness of start-ups. The expected results are strengthened capacities of GITA, enhanced access to innovation and technologies for start-ups, stronger relationships between EU and Georgian business incubators, further acceleration in the dissemination and use of innovation in regions, stronger links with the private sector, more efficient use of matching/collaborative grants for start-ups.

The entrusted entity would carry out the following budget-implementation tasks: grants, procurement and/or hiring external experts.

If negotiations with the World Bank fail:

- that part of this action related to Component 3 may be implemented in direct management in accordance with the implementation modalities identified in section 5.4.11 through (i) a direct grant to GITA as the Legal Entity of Public Law mandated with innovation policy; (ii) combined with a call for proposal.

5.4.7 *Indirect management with Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH (GIZ) for the implementation of part of the Component 3* (connected to Budget Support)

A part of this action may be implemented in indirect management with Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH (GIZ), in accordance with Article 58(1)(c) of Regulation (EU, Euratom) No 966/2012.

This implementation entails improving the business and economic environment; stimulating business development in selected value chains and regions; improving the competitiveness of the private sector at large (mainly R3.1 and R3.2 under Component 3).

The specific fields of intervention are SMEs and clustering development in construction materials and tourism area. This latter one will complement the support to mountain tourism to be provided under the implementation modality specified in section 5.4.8. Apparel might be another eligible cluster to be developed in connection with creative industries. Green economy, energy efficiency, environmental safeguard and gender equality are horizontal aspects that will be considered during the implementation.

The expected results are strengthened capacities and coordination efforts in SME development and clustering policy at all levels; development of regional sector associations; increased efficiency and productivity of economic sectors; business integration; improved quality and labour standards; and new jobs created.

This implementation is justified because GIZ possesses in-house resources and capabilities to perform cluster development. GIZ has the necessary organisational, human capacity and a long standing experience in the implementation of projects for the sustainable economic development in Georgia and in the Eastern Partnership region, primarily focused on private sector development. The current GIZ Programme Private Sector Development and Technical Vocational Education and Training South Caucasus (PSDTVT) builds on a track record of successful activities, such as the establishment of a Qveri Wine Cluster. In addition, the on-going EU funded project "SME Development and DCFTA" promotes enterprise development via clusters and business networks, while supporting Georgian institutions at policy level. GIZ is very familiar with the country context; closely cooperates with the authorities and efficiently interacts with the Delegation of the EU to Georgia.

Key interlocutors of this implementation would be the MoESD and other line ministries involved in economic and sector policy development and implementation.

The entrusted entity would carry out the following budget-implementation tasks: grants, procurement and hiring of external experts.

If negotiations with GIZ fail, that part of the action may be implemented (i) in indirect management with UNDP (or, as the case may be, in direct management in accordance with the implementation modalities foreseen in section 5.4.11 for the procurement of services); (ii) combined with a call for proposal grants in accordance with the implementation modalities identified in section 5.4.11.

The implementation by this alternative entrusted entity is justified by the reasons mentioned under section 5.4.9 and because UNDP further possesses sufficient experience and engagement with the authorities to implement successfully the results referred to under the present section.

5.4.8 Indirect management with the Austrian Development Agency (ADA) for the implementation of part of the Component 3 (connected to Budget Support)

A part of this action may be implemented in indirect management with the Austrian Development Agency (ADA) in accordance with Article 58(1)(c) of Regulation (EU, Euratom) No 966/2012.

This implementation entails improving the business and economic environment; stimulating economic development in selected value chains and regions; improving the competitiveness of the private sector in agriculture and tourism (mainly R3.1 and R3.2 under Component 3). The specific fields of intervention are clustering development in organic/bio agri-food processing, in combination with tourism (mountain and agro-tourism). Green economy, climate change considerations, environmental safeguard and gender equality are cross-cutting issues that will be considered during the implementation.

The expected results are strengthened capacities and coordination efforts in the clustering policy at all levels; clustering development in the selected clusters, including social integration for the poor and contribution to income generation.

This implementation is justified because ADA has experience in agriculture and regional development. It has well-established relationships with key national and regional stakeholders such as the MoESD, the Ministry of Agriculture (MoA), municipalities and the National Tourism Administration. Also, Austrian expertise supported the development of the Regional Development Strategy and Action Plans in six regions of Georgia for the period 2014-2021 and the preparation of the Strategy for the development of High Mountain Areas of Georgia. Supporting a sustainable tourism sector, combined with organic farming in selected Georgian regions would be an asset given this background and ADA's existing portfolio.

The MoESD, the MoA and other line ministries involved in agriculture and tourism economic would be the key interlocutors of this implementation.

The entrusted entities would carry out the following budget-implementation tasks: grants, procurement and hiring of external experts.

If negotiations with ADA fail, that part of the action may be implemented (i) in indirect management by GIZ and/or with UNDP (or, as the case may be, in direct management in accordance with the implementation modalities foreseen in section 5.4.11 for the procurement of services); (ii) combined with a call for proposal in accordance with the implementation modalities identified in section 5.4.11.

The implementation by these alternative entrusted entities is justified by the reasons mentioned under section 5.4.7 and/or 5.4.9 and because GIZ and UNDP further possess sufficient experience and engagement with the authorities to implement successfully the results referred to under the present section.

5.4.9 Indirect management with United Nations Development Programme (UNDP) for the implementation of part of Component 3 (connected to Budget Support)

A part of this action may be implemented in indirect management with United Nations Development Programme (UNDP) in accordance with Article 58(1)(c) of Regulation (EU, Euratom) No 966/2012.

This implementation entails supporting the private sector development through cluster mapping, capacity building of key institutions, cluster policy formulation, business support through selected value chains and business scaling-up, technology and innovation-related aspects (mainly R3.1, R3.2 and part of R3.3 of Component 3).

The priority fields of intervention are clustering development in packaging and seeds/seedlings. The action will contribute to facilitate access to markets, advance in productivity and diversity of Georgian farming, as well as to support quality infrastructure in packaging (labelling, green packaging, supply and recycling chain) and develop an appropriate certification scheme which is currently lacking in seeds. Seeds was identified as one of the bottlenecks for the development of Georgian agriculture and seeds certification is one of the priorities of the Strategy for Agriculture Development for 2015-2020.

This implementation is justified because UNDP possesses the resources and capabilities to deliver the expected results in a systemic manner. UNDP has a significant experience in supporting private sector development and employment in Georgia for over a decade. This has included work on policy development and technical assistance, business support and support to cooperatives and women in business. UNDP has been implementing the first phase of the EU-funded ENPARD project in Ajara, where experience in encouraging the idea of cooperation was gained. UNDP is currently working with the Ministry of Agriculture on the implementation of the Rural Development Policy. Well-established relations exist with key institutional interlocutors. The MoESD, the MoA and other key institutions involved in economic and sector policy development and implementation will be the direct beneficiaries of the project.

UNDP will carry out the action together with United Nations Industrial Development Organisation (UNIDO), Food and Agriculture Organisation (FAO) and International Organisation for Migration (IOM):

- UNIDO, a specialised agency of the United Nations will primarily focus on the development of selected value chains.
- FAO has extensive competence in Georgia in agriculture and rural development, and its technical knowledge is particularly relevant for the development of the cluster and business acceleration on seeds.
- IOM will foster the link between migration and economic, social and cultural development, promoting diaspora engagement through relevant institutions support to facilitate investments and networking.

This partnership among UN agencies will ensure an integrated approach based on UNDP competences in Georgia tied with the technical expertise of UNIDO and FAO, and of IOM experience on diaspora inclusion.

The entrusted entity(ies) entity would carry out the following budget-implementation tasks: grants, procurement and hiring of external experts. It is envisaged to conclude a co-delegation agreement.

If negotiations with UNDP fail, that part of this action may be implemented (i) in indirect management by GIZ and/or ADA for respective actions (or as the case may be in direct management in accordance with the implementation modalities foreseen in section 5.4.11 for the procurement of services); (ii) combined with a call for proposal in accordance with the implementation modalities identified in section 5.4.1.11.

The implementation by these alternative entrusted entities is justified by the reasons mentioned under section 5.4.7 and 5.4.8 and because GIZ and ADA further possess sufficient experience and engagement with the authorities to implement successfully the results referred to under the present section.

5.4.10 Indirect management with the European Bank for Reconstruction and Development (EBRD) for the implementation of part of Component 2 (<u>not connected to Budget Support</u>)

A part of this action may be implemented in indirect management with the European Bank for Reconstruction and Development (EBRD) in accordance with Article 58(1)(c) of Regulation (EU, Euratom) No 966/2012.

This implementation entails increasing knowledge of capital market participants under Component 2.

This implementation is justified because the entrusted entity has the required capacities and expertise to implement part of the action. The EBRD is a reliable partner with a long standing experience in Georgia and the Eastern Partnership region, helping the EaP countries in the transition process towards market-oriented economies and promoting private and entrepreneurial initiatives.

The choice of EBRD for implementing part of this action is further justified by EBRD's proven experience in supporting Georgia's financial sector, backed also by the MoU signed in October 2016 with the Ministry of Finance and the National Bank of Georgia. The EBRD is well placed to deploy its expertise in the specific areas of preparing participants of capital markets to take advantage of the reforms of the financial sector. Access to finance, SME financing and trade facilitation programmes are the main pillars of EBRD's mandate in Georgia.

The EBRD is currently implementing several EU-funded projects in Georgia aimed at facilitating access to finance and SME financing, including trade financing, through a combination of policy dialogue, technical assistance and investments, and in co-operation with local partner banks. The EBRD is also leading the Investors Council, a unique platform for high level policy dialogue, where also financial sector issues are covered. In the implementation of the action EBRD would liaise with the Ministry of Economy and other relevant stakeholders in the financial sector environment.

The entrusted entity would carry out the following budget-implementation tasks: grants, procurement and/or hiring external experts.

If negotiations with EBRD fail, that part of this action may be implemented in direct management in accordance with the modalities foreseen in section 5.4.11 for the procurement of services.

5.4.11 Changes from indirect to direct management mode due to exceptional circumstances

The change of management mode from indirect to direct management, whether partially or entirely is not considered a substantial change.

The indirect management can be replaced by the direct management in the following cases: failure of negotiations with the entrusted entity(ies) followed by failure of negotiations with the alternative entrusted entity(ies).

5.4.11.1 Procurement (direct management)

Subject	**Type**	**Indicative number of contracts**	**Indicative trimester of launch of the procedure**
Alternative to 5.4.4 - indirect management with GIZ 5.4.5 - indirect management with UNDP 5.4.7 – (part of) indirect management with GIZ	services	Up to 10	In the course of 2019 and 2020

5.4.8 – (part of) indirect management with ADA 5.4.9 – (part of) indirect management with UNDP 5.4.10 - indirect management with EBRD			

5.4.11.2 Grants: calls for proposals (direct management)

The calls for proposals modality may be used as an alternative to:

- part of the activities to be implemented by the World Bank Group as provided for in section 5.4.6
- part of the activities to be implemented by GIZ, ADA, UNDP and EBRD as provided for in sections 5.4.7, 5.4.8, 5.4.9 and 5.4.10 respectively

(a) Objectives of the grants, fields of intervention, priorities of the year and expected results

- Objectives: improved socio-economic development in Georgia and its regions.
- Fields of intervention: SME development, cluster support in selected economic sectors, innovation policy.
- Expected results and eligible actions: strengthened capacities of policy makers in business and clusters development; business integration; enhanced use of innovation and technology transfers for gradually supporting business incubation/acceleration.

(b) Eligibility conditions

The essential eligibility criteria for applicants include, among others, to be established in a Member State of the European Union or in Georgia.

Subject to information to be published in the call for proposals, the indicative amount of the EU contribution per grant is EUR 2 000 000 to 4 000 000, and the grants may be awarded to entities acting alone or in partnership. The indicative duration of the grant is up to 48 months.

(c) Essential selection and award criteria

The essential selection criteria are the financial and operational capacity of the applicant.

The essential award criteria are relevance of the proposed action to the objectives of the call; design, effectiveness, feasibility, sustainability and cost-effectiveness of the action.

(d) Maximum rate of co-financing

The maximum possible rate of co-financing for grants under this call is 95%.

In accordance with Article 192 of Regulation (EU, Euratom) No 966/2012, if full funding is essential for the action to be carried out, the maximum possible rate of co-financing may be increased up to 100 %. The essentiality of full funding will be justified by the Commission's authorising officer responsible in the award decision, in respect of the principles of equal treatment and sound financial management.

(e) Indicative timing to launch the call

4th trimester of 2018.

5.4.11.3 Grants: direct award (direct management)

(a) Objectives of the grant, fields of intervention, priorities of the year and expected results

The direct award modality may be used as an alternative to part of the activities to be implemented by GIZ, ADA, UNDP and EBRD as provided for in sections 5.4.7, 5.4.8, 5.4.9 and 5.4.10 respectively.

(b) Justification of a direct grant

Under the responsibility of the Commission's authorising officer responsible, the grant may be awarded without a call for proposals to the Georgian Innovation and Technology Agency (GITA), Georgian legal entity of public law.

Under the responsibility of the Commission's authorising officer responsible, the recourse to an award of a grant without a call for proposals is justified because in accordance with Article 190 (1) (f) of Commission Delegated Regulation (EU) No. 1268/2012, the action has specific characteristics requiring a specific type of beneficiary for its technical competence, specialisation or administrative power. GITA was established in 2014 by the Georgian government to support and coordinate the innovative ecosystem. GITA elaborated inter alia the draft law on innovation adopted in June 2016. Since its set-up GITA also gained specialised experience through several grants and projects for technology innovation, including for the launched establishment of tech parks, incubators, accelerators, innovation laboratories and pilot university-based fabrication laboratories (FabLab), but also in relation to broadband internet connectivity. GITA is also planned to partner with the Georgian National Academy of Sciences to establish a bio-technology centre that will help Georgia realise its market potential in innovative applications of indigenous bacteria, enzymes and phages. GITA is also member of the Enterprise Europe Network (EEN).

(c) Essential selection and award criteria

The essential selection criteria are the financial and operational capacity of the applicant.

The essential award criteria are relevance of the proposed action to the objectives of the call; design, effectiveness, feasibility, sustainability and cost-effectiveness of the action.

(d) Maximum rate of co-financing

The maximum possible rate of co-financing for grants under this call is 95%.

In accordance with Article 192 of Regulation (EU, Euratom) No 966/2012, if full funding is essential for the action to be carried out, the maximum possible rate of co-financing may be increased up to 100 %. The essentiality of full funding will be justified by the Commission's authorising officer responsible in the award decision, in respect of the principles of equal treatment and sound financial management.

(e) Indicative timing to launch the conclusion of the direct grant

During the course of 2019.

5.5 Scope of geographical eligibility for procurement and grants

The geographical eligibility in terms of place of establishment for participating in procurement and grant award procedures and in terms of origin of supplies purchased as established in the basic act and set out in the relevant contractual documents shall apply.

The Commission's Authorising Officer responsible may extend the geographical eligibility in accordance with Article 9(2)(b) of Regulation (EU) No 236/2014 on the basis of urgency or of unavailability of products and services in the markets of the countries concerned, or in other duly substantiated cases where the eligibility rules would make the realisation of this action impossible or exceedingly difficult.

5.6 Indicative budget

	EU contribution (in EUR)	**Indicative third party contribution (in EUR)**
Budget Support - Sector Reform Contract	**21 250 000**	
5.4.1 - Grants: call for proposals for a twinning grant	1 200 000	
5.4.2 Direct award to the World Bank Group for the implementation of part of Component 2	4 500 000	
5.4.3 - Procurement (direct management)	0	
5.4.4 - Indirect management with GIZ for the implementation of part of Component 1	1 300 000	
5.4.5 - Indirect management with UNDP for the implementation of part of Component 1	1 050 000	
5.4.6 – Indirect management with the World Bank Group for the implementation of part of Component 3	2 700 000	
5.4.7 - Indirect management with GIZ for the implementation of part of Component 3	5 300 000	
5.4.8 Indirect management with ADA for the implementation of part of Component 3	3 000 000	3 800 000
5.4.9 - Indirect management with UNDP for the implementation of part of Component 3	5 000 000	
5.4.10 – Indirect management with EBRD for the implementation of part of Component 2	1 850 000	
5.9 – Evaluation 5.10 - Audit	300 000	N.A.
5.11– Communication and visibility	200 000	N.A.
Totals	**47 650 000**	3 800 000

5.7 Organisational set-up and responsibilities

This action will be managed by the European Commission through the EU Delegation to Georgia. Effective leadership and ownership of the government over the programme are key to efficiency, efficacy and sustainability of the results. In this sense, all initiatives will be conducted with the support and engagement of the authorities, the civil society and the private sector and ensuring that Georgian strategies and policies will be well-coordinated.

The programme will be governed by a steering committee, which will oversee and guide the overall direction and policy of the programme. It will assess progress in the implementation of the action and decide if any modifications are needed. It shall meet indicatively twice a year and can be convened whenever the project implementation requires strategic decisions. Separate sessions may be organised for different components. The project steering committee shall be chaired by the Ministry of Economy and Sustainable Development or the Ministry of Justice, as the case may be, and made up indicatively of representatives of the following entities:

- Ministry of Economy and Sustainable Development (MoESD)

- Ministry of Finance (MoF)

- Ministry of Agriculture (MoA)

- Ministry of Justice (MoJ)

- National Bank of Georgia (NBG)

- Insurance State Supervision Service of Georgia (ISSSG)

- Service for Accounting, reporting and Auditing Supervision (SARAS)

- Enterprise Georgia (Produce in Georgia)

- Georgian Innovation and Technology Agency (GITA)

- EU Delegation

Indicatively other agencies may participate such as the Enforcement Bureau, the Data Exchange Agency, the National Tourism Administration (NTA) and the Georgian Statistics Office (Geostat).

The steering committee will invite further members of any of the stakeholders whenever deemed appropriate.

5.8 Performance monitoring and reporting

The day-to-day technical and financial monitoring of the implementation of this action will be a continuous process and part of the implementing partner's responsibilities. To this aim, the implementing partner shall establish a permanent internal, technical and financial monitoring system for the action and elaborate regular progress reports (not less than annual) and final reports. Every report shall provide an accurate account of implementation of the action, difficulties encountered, changes introduced, as well as the degree of achievement of its results (outputs and direct outcomes) as measured by corresponding indicators, using as reference the list of result indicators (for budget support). The report shall be laid out in such a way as to allow monitoring of the means envisaged and employed and of the budget details for the action. The final report, narrative and financial, will cover the entire period of the action implementation.

The Commission may undertake additional project monitoring visits both through its own staff and through independent consultants recruited directly by the Commission for independent monitoring reviews (or recruited by the responsible agent contracted by the Commission for implementing such reviews).

5.9 Evaluation

Having regard to the nature of the action, a mid-term, final and/or ex-post evaluation may be carried out for this action or its components via independent consultants contracted by the Commission.

A mid-term evaluation would be carried out for problem solving, learning purposes, in particular with respect to the gathering of information, review of the indicative log-frame and assessing the project's implementation progress towards the objectives.

A final or ex-post evaluation may be carried out for accountability and learning purposes at various levels (including for policy revision), taking into account in particular the impact and sustainability of the programme.

The Commission shall inform the implementing partner at least 15 days in advance of the dates foreseen for the evaluation missions. The implementing partner shall collaborate efficiently and effectively with the evaluation experts, and inter alia provide them with all necessary information and documentation, as well as access to the project premises and activities.

The evaluation reports shall be shared with the partner country and other key stakeholders. The implementing partner and the Commission shall analyse the conclusions and recommendations of the evaluations and, where appropriate, in agreement with the partner country, jointly decide on the follow-up actions to be taken and any adjustments necessary, including, if indicated, the reorientation of the project.

Where relevant, the provisions of the Financial and Administrative Framework Agreement concluded between the European Union and the selected international organisations shall apply.

Indicatively, two contracts for evaluation services shall be concluded under a framework contract during the second year (mid-term evaluation – 4th quarter of 2020) and the fifth year (final evaluation – 2nd quarter of 2023) of the implementation of the action. Additionally one contract for budget support external review missions shall be concluded under a framework contract during the implementation of the Programme (3rd quarter of 2018).

5.10 Audit

Without prejudice to the obligations applicable to contracts concluded for the implementation of this action, the Commission may, on the basis of a risk assessment, contract independent audits or expenditure verification assignments for one or several contracts or agreements.

Where relevant, the provisions of the Financial and Administrative Framework Agreement concluded between the European Union and the selected international organisations shall apply.

Indicatively, one contract for audit services shall be concluded under a framework contract during the fifth year of implementation of the Programme (2nd quarter of 2023).

5.11 Communication and visibility

Communication and visibility of the EU is a legal obligation for all external actions funded by the EU.

This action shall contain communication and visibility measures which shall be based on a specific Communication and Visibility Plan of the Action, to be elaborated at the start of implementation and supported with the budget indicated in section 5.4.2 above.

In terms of legal obligations on communication and visibility, the measures shall be implemented by the Commission, the partner country, contractors, grant beneficiaries and/or entrusted entities. Appropriate contractual obligations shall be included in, respectively, the financing agreement, procurement and grant contracts, and delegation agreements.

The Communication and Visibility Manual for European Union External Action shall be used to establish the Communication and Visibility Plan of the Action and the appropriate contractual obligations shall be included in the financing agreements or delegation agreements.

With regards to the Neighbourhood East, all EU-supported actions shall be aimed at increasing the awareness level of the target audiences on the connections, the outcome, and the final practical benefits for citizens of EU assistance provided in the framework of this action. Visibility actions should also promote transparency and accountability on the use of funds.

Outreaching/awareness raising activities will play a crucial part in the implementation of the action, in the case of budget support the national government shall ensure that the visibility of the EU contribution is given appropriate media coverage. The implementation of the communication activities shall be the responsibility of the implementing organisations, and shall be funded from the amounts allocated to the Action.

All necessary measures will be taken to publicise the fact that the action has received funding from the EU in line with the Communication and Visibility Manual for EU External Actions. Additional Visibility Guidelines developed by the Commission (European Neighbourhood Policy and Enlargement Negotiations) will be strictly adhered to.

Where relevant, the provisions of the Financial and Administrative Framework Agreement concluded between the European Union and the selected international organisations shall apply.

It is the responsibility of the implementing organisation to keep the EU Delegations and, where relevant, DG NEAR, fully informed of the planning and implementation of the appropriate milestones specific visibility and communication activities.

The implementing organisation shall report on its visibility and communication actions, as well as the results of the overall action to the relevant monitoring committees.

This action will be communicated externally as part of a wider context of EU support to the country, and where relevant to the Eastern Partnership region in order to enhance the effectiveness of communication activities and to reduce fragmentation in the area of EU communication.

The implementing organisation shall coordinate all communication activities with EU Delegations as well as regional communication initiatives funded by the European Commission to the extent possible. All communication strategies developed as part of this action shall ensure they are in line with the priorities and objectives of regional communication initiatives supported by the European Commission and in line with the relevant EU Delegation's communication strategy under the "EU4Georgia" umbrella initiative.

ANNEX:

Results	Budget Support	GIZ	UNDP	WB	EBRD	UNDP+ UNIDO +FAO+ IOM	ADA	twinnings
Component 1: Fairer and faster litigations in commercial matters								
R 1.1: Faster and faire litigations in commercial disputes								
R.1.1.1. Streamlined judicial proceedings		v	v					
R.1.1.2. Increased use of mediation and arbitration			v					
R.1.1.3. New company law put well into practice		v						
R.1.1.4. Streamlined and rehabilitation-oriented insolvency proceedings	v	v						
R.1.1.5. More efficient enforcement of judicial decisions	v	v						
Component 2: Modernised financial infrastructure								
R 2.1: Capital market development								
R.2.1.1 Strengthened NBG in approximating and enforcing EU legislation on capital markets with increasing knowledge of capital market participants					v			
R.2.1.2 Improved capital market infrastructure				v				
R.2.1.3 Improved legal framework for selective capital market instruments				v				

R.2.1.4 Improved legal framework for investment funds and mutual collective schemes				v				
R 2.2: Responsible financial inclusion and alternative financing								
R.2.2.1 Improved collateralisation framework				v				
R.2.2.2 Improved legal framework and regulation of private credit bureau and microfinance institutions				v				
R.2.2.3 Enhanced consumer protection and financial literacy				v				
R 2.3: Better financial information								
R.2.3.1 Improved Accounting and Auditing Quality Control				v				
R.2.3.2 Enhanced accounting framework for SMEs				v				
R.2.3.3 Strengthened capacity of business service providers				v				
R 2.4: Enhanced insurance system								
R.2.4.1 A functional insurance supervision system is in place	v			v				V (with ISSSG)
R.2.4.2 Insurance market is expanded through compulsory insurance products	v			v				v

Component 3: Greater business sophistication								
R 3.1: Strengthened policy framework to facilitate the development of SME, clusters and incubators								
R.3.1.1 The institutional framework for business integration is developed and tailored for target regions and sectors	v	v				v	v	
R.3.1.2 Economic opportunities are identified in pilot regions and are elaborated in consultation with local authorities and the private sector	v	v				v	v	
R.3.1.3 Business network with Europe is accelerated (performance of Enterprise Europe Network Georgia, led by Enterprise Georgia and GITA consortium)		v				v	v	
Result 3.2: Development and functioning of the clustering approach in at least 5 pilot sectors in Georgian regions (such as construction materials, packaging, apparel, creative industry, tourism, organic farming, seeds/seedlings)								
R.3.2.1 Diversified and increased number of services delivered by incubators to businesses, start-ups and social enterprises	v	v						
R.3.2.2 Cluster governance and management structure(s) are leading to better private-public coordination	v	v				v	v	
R.3.2.3 Synergies among economic actors, including BSOs, in the cluster are intensified	v	v				v	v	
R.3.2.4 EU standards are promoted in the cluster	v	v				v	v	
CONSTRUCTION PRODUCTS		v						
PACKAGING						v		

AGRI-TOURISM and MOUTAIN TOURISM							v	
TOURISM (other than AGRI-TOURISM and MOUNTAIN TOURISM)		v						
ORGANIC/BIO AGRICULTURE							v	
SEEDS/SEEDLINGS						v		
APPAREL + FASHION (TBD)		v						
R 3.3: Development and functioning of business accelerators/incubator, serving target regions and sectors								
R.3.3.1 Diversified and increased number of services delivered by incubators to businesses, start-ups and social enterprises	v			v		v		
R.3.3.2 Increased synergies among business incubator(s), private sector and academia/ research centres are created	v	v		v		v		
R.3.3.3 Higher number of businesses participating to the EU programme Horizon 2020				v				
R 3.4: Improved delivery and quality of public services to businesses								
R.3.4.1 The digitalisation of public services in Tbilisi and Georgian regions is prepared		v			v			

6 APPENDIX - INDICATIVE LIST OF RESULT INDICATORS

The inputs, the expected direct and induced outputs and all the indicators, targets and baselines included in the list of result indicators are indicative and may be updated during the implementation of the action without an amendment to the financing decision. The table with the indicative list of result indicators will evolve during the lifetime of the action: new columns will be added for intermediary targets (milestones), when it is relevant and for reporting purpose on the achievement of results as measured by indicators.

	Intervention logic	Indicators	Baselines (incl. reference year)	Targets (incl. reference year)	Sources and means of verification
Overall objective: Impact	**Promotion of inclusive and sustainable growth**	Rate of economic growth Unemployment rate Wages Trade	Baseline 2016 (estimated): 2.7% Baseline 2016: 11.8% Baseline Q4 2016 average monthly remuneration of employed persons in enterprises: 1 130 GEL Baseline 2016: 2 112 890 415 GEL	*Targets to be determined through policy dialogue*	GEOSTAT, GEOSTAT Business Statistics, NBG, WB, IMF reports,

Specific objective(s): Outcome(s)	**1. Trust of public (incl. business people) in courts**	Increased level of trust of public (incl. business people) in courts	In 2017, 18% people trust, and another 45% people rather trust the courts country-wide (EU-funded survey with UNDP). 36% persons think that situation at courts improved (and 2% strongly improved) between 2012-2017.	In 2022, 25% people trust and another 50% rather trust the courts. 45% people think that the situation at courts improved between 2017-2022.	Surveys of public opinion and perception
	2. Increased confidence and trust in the financial sector	More effective operation and use of financial services Increased savings into the economy Increased credit to the private sector	Global Competitiveness Index (8th pillar on **Financial market development**). Baseline: 58/138 (2016). Gross national savings in % of GDP. Baseline 2013: 18.9% Credit to private sector/GDP. Baseline 2015: 48%.	In 2022 to reach 52/138. In 2022 at least 22% of savings In 2022 60%.	WEF Global Competitiveness Report, Financial System Stability Assessment (savings indicators), IMF and NBG reports EBRD Transition Report, NBG reports
	3. Business environment meeting market demands	Adjustment of economic policies in favour of competitiveness and business reforms	WEF Global Competitiveness Indicator. Baseline: 59/138 (2016) Improvement in at least 6 sub-indicators of the Ease of Doing Business indicator. Baseline 2016: 1. Starting a business 8 2. Construction permits 8 3. Getting electricity 39 4. Registering property 3 5. Getting credit 7 6. Protection minority investors 7 7. Paying taxes 22 8. Trading across border 54 9. Enforcement contracts 16 10. Resolving insolvency 106	In 2022 to reach 54/138.	WB Ease of Doing Business, WEF Global Competitiveness Report, WEF publications, MoESD reports, etc.

Induced outputs	<u>**COMPONENT 1**</u> **Faster and fairer litigations in commercial matters**	Decreased average total duration of court proceedings (concluded by issuance of a final/enforceable decision) in disputes involving businesses/entrepreneurs with a total value of more than EUR 10 000 (in equivalent amount in GEL determined in the final decision), as possibly cleared by a 5% margin respectively in extreme cases in both directions (extremely short/extremely lengthy proceedings). Decreased average duration and increased recovery rate/rehabilitation in insolvency cases Decreased average duration of enforcement of judicial decisions in disputes involving businesses/entrepreneurs with a value of more than EUR 5 000 (in equivalent amount in GEL determined in the final decision), as possibly cleared by a 5% margin respectively in extreme cases in both directions (extremely short/extremely lengthy proceedings). Increased use of mediation Increased use of arbitration	*TBD based on judiciary statistics* *TBD based on upcoming baseline study commissioned by EU* *TBD based on ongoing baseline study commissioned by EU* <100 in-court mediations between 2014 – 2016 On average 3 000 applications submitted for court endorsement in 2015-2016 in mostly micro-credit disputes; <10 business-to-business arbitrations until 2016	*TBD based on judiciary statistics* *TBD based on upcoming baseline study commissioned by EU* *TBD based on ongoing baseline study commissioned by EU* 400 in-court mediations between 2017 – 2021 20 business-to-business or other than microcredit arbitrations between 2017- 2021	Analytical studies commissioned by EU
Direct outputs	Streamlined judicial proceedings Increased use of mediation, arbitration and business ombudsman	Revised procedural legislation, regulations and practice, expert advice provided to specialisation of judges or chambers, capacities of lawyers and judges enhanced. Increased awareness and confidence in alternative dispute resolution	Situation described in the current institutional, project and other reports	Situation described in the institutional, project and other reports in 2018-2022	Reports, minutes and other statistics and information

	New company law put well into practice Strengthened and rehabilitation-oriented insolvency proceedings More efficient enforcement of judicial decisions	mechanisms, implementation of the new mediation law ensured. The new company law and all related legislation adopted, awareness and knowledge raised. Expert advice provided to the new insolvency law, including possibly establishment and operationalisation of a chamber of private administrators, enhanced skills of professionals and business operators. Legislation and practice improved, capacities of public and private bailiffs improved, Expert advice provided to revise the legislation			
Induced outputs	**<u>COMPONENT 2</u>** **Modernised financial infrastructure**	Increased financial services meeting business needs Increased affordability of financial services Eased access to loans	Global Competitiveness Index (Sub-indicator 8.01 ***Financial services meeting business needs***). Baseline: 79/138 (2016). Global Competitiveness Index (Sub-indicator 8.01 ***Affordability of financial services***). Baseline: 82/138 (2016). Global Competitiveness Index (Sub-indicator 8.04 ***Ease of access to loans***). Baseline: 52/138 (2016).	At least 75 in 2022. At least 79 in 2022. At least 48 in 2022.	WEF Global Competitiveness Report, EBRD reports, banks reports
Direct outputs	**Capital market development**	Lowered transaction costs Increased portfolio of government securities/GDP Share of non-resident investors in the portfolio of government securities	*TBD* Baseline 2016: 5.1% Baseline 2016: 3%	*TBD* In 2022: 9% In 2022: 15%	*TBD*

	Responsible financial inclusion and alternative financing	Increased financial literacy Increased value of movable collaterals used as credit guarantee by commercial banks Diversification of financial instruments	Number of NPLs. Baseline: 3.7% in 2016. *TBD* *TBD*	*In 2022: TBD* *TBD* *TBD*	
	Better financial information	Improved quality of financial statements Increased number of loans to SMEs due to improved quality	*TBD* *TBD*	*TBD* *TBD*	
	Enhanced insurance system	Increased number of insured domestic vehicles Increased turnover of insurance companies	*TBD* *TBD*	> 35% of domestic vehicles is insured by the end of 2022 *TBD*	
Induced outputs	<u>**Component 3**</u> **Greater business sophistication**	**Business sophistication** has increased.	Baseline 2016: Local supplier quantity: 132 Local supplier quality: 116 State of cluster development: 122 Nature of competitive advantage: 60 Value chain breadth: 75 Control of international distribution: 86 Production process sophistication: 95 Extent of marketing: 77 Willingness to delegate authority: 117	By 2022 at least 6 out of the 9 sub-indicators of the Global Competitiveness Index 11th pillar on business sophistication have increased.	WEF Global Competitiveness Report, WEF publications, Business surveys
		R&D and innovation has increased	Baseline 2016: Capacity for innovation: 105 Quality of scientific research institution: 118, Company spending on R&D: 123	By 2022 at least 4 out of the 7 sub-indicators of the Global Competitiveness Index 12th pillar on	

			University-industry collaboration in R&D: 119 Government procurement of advanced technology products: 84 Availability of scientists and engineers: 115 PCT patent applications: 59	R&D and innovation have increased	
		Increased number of businesses making use of services provided by Business House (on-line and/or on-site)	*TBD*	*TBD*	

Direct Outputs	**Strengthened policy framework to facilitate the development of SME, clusters and incubators**	Institutional framework: Increased quality of (i) government services and regulations, (ii) tax administration procedures, (iii) assistance with the implementation of EU standards	*TBD*	*TBD*	Business surveys
	Development and functioning of the clustering approach in at least 5 pilot sectors in Georgian regions (such as construction materials, packaging, apparel, creative industry, tourism, organic farming, seeds/seedlings)	Increased productivity (% turnover per employee) in agriculture Increased productivity (% turnover per employee) in industry (including manufacturing and constructions) Increased productivity (% turnover per employee) in services	GEOSTAT data on turnover by sector and number of employees *(baseline TBD)*	*TBD*	GEOSTAT
		Increased cluster performance	Cluster performance as measured by the Business Enabling Environment (BEE) index – to be introduced through the budget support *(baseline TBD)*	*TBD*	Business surveys, Reports from the Chamber of Commerce and other business associations
		Increased number of companies connected into a cluster	*TBD*	*TBD*	
		Spill-over effects in the economy	*TBD*	*TBD*	
	Development and functioning of pilot (EU-labelled) business accelerators/incubator, serving target regions and sectors	Increased number of services and products brought by innovative Georgian start-ups to the market	*TBD*	*TBD*	
		Facilitation of introduction of new technologies (technology transfers)	*TBD*	*TBD*	
	Improved delivery and quality of public services to businesses	|Improved services of Enterprise Georgia	*TBD*	*TBD*	

Annex 1: List of Projects

List of EU-funded projects under the **bilateral envelope**

EU Programme	*EUR million*	*Duration*	*Complementarity with this programme*
Budget support under the "Support to EU-Georgia DCFTA and SMEs"	25	2015-2020	Targets the development of SMEs and business organisations, supports economic integration, trade and enterprise reforms and institutions. Includes CSOs and business organisations in the monitoring of enterprise and trade policies.
SME Development and DCFTA-GEORGIA (implemented by GIZ)	5	Nov 2015/Nov 2019	Assists the Georgian government in the implementation process of the DCFTA, facilitating Georgia's integration into the EU market.
DCFTA Adaptation Programme (DAP) Support for SME competitiveness in Georgia (implemented by EBRD)	4.5	Dec 2015/Dec 2019	Aims at improving the competitiveness of Georgian SMEs, enabling them to respond to the challenge brought by the DCFTA.
Support to Competition Agency (implemented by B&S Europe)	2	Jan 2016/Jan 2018	Support competition law enforcement, cooperation with sector regulators and competition culture.
Employment and VET (EVET) Sector Reform Contract	27	2013-2018	Ongoing support to employment reform process.
Justice Reform	30	2015-2018	Ongoing support to the justice system.
Public Administration Reform (PAR) Phase I and II	30	2015-2018	Five pilot Ministries (MoESD, MoES, MoLHSA (Ministry of Labour, Health and Social Affairs), MoSYA (Ministry of Sports and Youth Affairs), and MoRDI (Ministry of Regional Development and Infrastructure)) will benefit in terms of improved strategic planning and policy development capacity
Regional Development Phase II	30	2015-2018	Support to planning and management of public funds for the regions; including rural development measures for the benefit of agriculture and agribusiness.
ENP for Agriculture and Rural Development (ENPARD) Phase II and III	79	2016-2020	Promotes inclusive and sustainable growth, creating employment and livelihoods for the poor and excluded. Special measures target vulnerable people in remote regions and empowerment of rural women; pilot action in Abkhazia.
Skills Development and Matching for Labour Market Needs	48.85	2018-2020	Support to human capital development and skills matching, VET and employability.
Justice Budget Support Programme	4.5	2015-2017	3 consecutive indicators related to land registration
EU+UNDP project component on access to justice	1.5	2016-2018	Free Legal Aid, Legal Services, Arbitration, and Mediation.
EU + GIZ project on private and administrative law reform	2	2015-2017	Civil code, civil procedural code, administrative code, insolvency law, law on enforcement of judicial decisions, land registration, and international judicial cooperation.

List of EU-funded **multi-country EU4Business** programmes that will be complementary to this action includes:

Partner	***Project and EU contribution***	***Duration until***
	EU 4 Business SME policies/business climate	
World Bank	***STAREP - Strengthening Auditing and Reporting in the Countries of the Eastern Partnership*** Supports the framework for corporate financial reporting, support to qualified accountants and auditors to implement international standards such as IFRS and International Standards on Auditing (ISA). EU contribution: EUR 1 million	June 2018
OECD	***"Supporting firm competitiveness and business environment reforms in the Eastern Partnership: a EU4Business initiative"*** It will assist the government in preparing and operationalising the SME Strategy Action Plan 2018-2020, strengthen the policy making process by introducing a public-private SME strategy stakeholder process and strengthen the institutional capacity of the government (MoESD, EDA) to monitor the implementation of the SME Development Strategy 2016-2020. EU contribution: EUR 4 million	2020
	EU 4 Business SMEs (skills and capacity building)	
International Trade Center (ITC)	***Improving export competitiveness*** It helps SMEs from EaP countries integrate into domestic and global value chains and access new markets with a focus on the European Union. EU contribution: EUR 6 million	2020
EBRD	***Implementing EBRD Small Business Support (SBS) Programme EGP and BAS phase II*** Continuation of the Small Business Support activities in the EaP region. It assists SMEs in improving competitiveness, attract external financing by improving financial literacy, etc. EU contribution: EUR 8 million	Dec 2018
	EU 4 Business SMEs access to finance	
EBRD/KfW	***SME Finance Facility I*** It offers a wide range of financial services and products to SMEs and financial intermediaries throughout the region EU contribution: EUR 10.2 million	Dec 2019
EIB	***SME Finance Facility I - EIB window*** Emphasis is given to stimulating local currency lending, particularly for micro, small and medium-sized enterprises EU contribution: EUR 5.1 million	Dec 2020
EBRD	***Women in Business*** Access to finance for women-led SMEs and business development know-how. EU contribution: EUR 5.035 million	Dec 2022
KfW	***Neighbourhood Window of the European Fund for South East Europe (EFSE)*** Aims to foster economic development in Southeast Europe & Caucasus region through sustainable provision of additional development finance, notably to micro businesses and private households, via qualified local financial institutions. EU contribution: EUR 5.1 million	Dec 2019

KfW	***Neighbourhood Window of the European Fund for South East Europe (EFSE*** Programme focuses on lending through micro-finance institutions particularly in local currency (with a combination of L-Shares and C-Shares). EU contribution: EUR 10 million	2018 – 2038
EBRD	***Framework for Capacity Building to support Financial Intermediaries in AZ and GE*** Improving efficiency, effectiveness and transparency of the financial sector, resulting in the provision of better access to financing for enterprises. EU contribution: EUR 3.03 million	Dec 2016
EBRD NIF TF	***Financial Sector Institution Building and Crisis Response*** Three financial institutions (EIB, EBRD and KfW) will pursue the following objectives through the regional SME Finance Facility: rebuild financial intermediaries' confidence to extend financing to SMEs, including micro-enterprises, following the financial crisis; enhance financial intermediaries' capacity to assess and monitor risks and manage SME financing; deepen SME credit markets; etc. EU contribution: EUR 12 million	Dec 2018
	EU 4 Business DCFTA Facilities	
EBRD	***DCFTA SME Direct Finance Facility EBRD*** Intended to blend EU and EBRD funds to provide financing and technical assistance to the SME sector to improve conditions for SMEs lending. EU contribution: EUR 10.22 million	Feb 2026
EIB	***EIB DCFTA Programme*** Provides support to the private sector, SMEs in particular, so that they can cope with the implied requirements and seize the new opportunities from the DCFTA. EU contribution: EUR 62 million	2026
EBRD	***EBRD DCFTA programme*** Programme supports DCFTA-related priority improvements in SMEs operating in Georgia, Moldova and Ukraine	April 2026
EIB/EBRD/KfW	***SME Finance Facility*** Even if multi-country, it is mostly targeting Ukraine. Aims to foster local currency lending to SMEs, particularly for micro, small and medium-sized enterprises that are not earning (enough) foreign currency and could not afford the associated high FX risk. EU contribution: EUR 15 million	2027
	EU 4 Business BSOs	
EuroChambres	***East Invest 1*** It facilitates the internationalisation process for SMEs networking through BSOs participation and support. It i's a trade facilitation instrument. EU contribution: EUR 7 million	Aug 2017
EuroChambres	***East Invest 2*** Continuation of East Invest 2. EU contribution: EUR 6.5 million	Sept 2017
EBRD and United Kingdom	Capacity building (EBRD) and Institutionalisation (UK GGF through Georgian Investors Council) of specialised Commercial Chambers	As of mid-2017

Other **non-EU funded** projects

GIZ	***Private Sector Development in the South Caucasus*** (funded by the Ministry of Economy of Germany and implemented by GIZ). Beneficiaries: GE/AZ/AR. This project (budget EUR 11 million) supports the development of competitive enterprises and value chains with export potential, helping businesses to achieve broad-based inclusive growth.	2013-2020 (programme extension is under discussion)
GIZ/BMZ	***Legal Approximation towards European Standards in the South Caucasus.*** Budget: EUR 7 million, Components: 1) legal approximation of selected laws, 2) fair trial, law enforcement and legal security, 3) legal education, 4) legal awareness raising.	2015-2017 (likely to be extended)
USAID	***Governing for Growth (G4G)*** (funded by USAID and implemented by Deloitte Consulting). This project has a budget of USD 19.3 million). It contributes to enhance governance in selected business areas: tax and customs administration, trade facilitation, land registration.	2015-2019
USAI	***Restoring Efficiency to Agriculture Production (REAP) Activity in Georgia.*** It aims at increasing employment and income in rural areas, by providing in-kind grants and technical assistance to agriculture-based SMEs to support improved agricultural productivity, marketing and processing. It facilitates the entry of new agribusinesses and expands the operation of existing SMEs.	2013-2018
USAID	***Promoting Rule of Law in Georgia (PROLOG)*** Total budget: EUR 15 million, however mostly focused on criminal justice, human rights and legal aid. Components: 1) human rights and due process; 2) management of justice institutions, 3) legal education, and 4) access to justice.	2015-2020
WB	***The World Bank Private Sector Competitiveness Development Policy Operation (DPO, World Bank)*** program (USD 60 million loans to the government) which aims to increase the private sector competitiveness through a second generation business environment reforms, financial sector deepening and diversification, and increasing firms' capacity to innovate (innovative ecosystems) and to export. In the area of financial inclusion, the World Bank is supporting the Georgian government on pension reform, deposit insurance scheme, capital market, insurance market, oversight of accounting & auditing.	
World Bank	***Actions on Inclusive growth through better public services, job creation and competitiveness within WB-Georgia Country Partnership Strategy*** Georgia National Innovation Ecosystem (GENIE) Project, USD 42 million – project includes a component supporting education for knowledge economy and innovation hubs (fablab incubators)	2014-2017 2016-2021
World Bank	***Agricultural Programme – Component on registration of land titles***	2017-2018